



# Bilateral Investment Treaties and Investor State Disputes

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March 16, 2016

## Abstract

Bilateral Investment treaties have been a source of political controversy in recent years because of the alarming increase in the investor state dispute settlement cases. Against this backdrop, the paper analyses the issues with diffused reciprocity imbibed in BITs leading to the unequal distribution of rights and obligations between developed and developing countries. The hypotheses developed within this analytical framework that a) BITS increases the risk of litigation and b) BITs negatively impacts on the net benefits of countries, are tested empirically using multivariate regression models using country pooled and panel data. Our conclusions are that the investors initiate higher number of cases against countries with BITs. Moreover, the net benefits accruing to countries are seen to be substantially lower for countries with BITs. Our findings support the growing view that a re-look at the traditional BITs model is warranted with a focus to evolve a new generation foreign investment policy framework that together with promoting foreign investment will also enable regulation of investment in keeping with host country public policy.

**Keywords:** Bilateral investment treaties, Investor-State Disputes, ICSID

**JEL codes:** K33, F20, F5

## 1 Introduction

The proliferation of bilateral investment treaties (BITs) from around 500 in 1980 to 2923 in 2014 is well documented and attributed to the competition among developing countries for attracting FDI (UNCTAD 2015). This is led by the belief that FDI promotes economic growth not just by narrowing the domestic saving-investment gap but by providing access to the latest technology and acting as a conduit for undertaking exports from the developing countries. In the absence of a multilateral investment framework, the BIT is seen as an instrument

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by the developing countries to signal itself as a safe investment destination. It is therefore not surprising that quantitative studies thus far have concentrated on analysing the impact of BITs in promoting FDI to developing countries. The conclusions of these studies however are not unanimous (UNCTAD 2009, Sauvant and Sachs 2009). Recent studies indicate that rather than impacting on the quantum of FDI, BITs merely determines the direction of inflow indicating that MNCs route their investments through countries like the Netherlands which is considered to have the strictest clauses favoring investors (Os & Knottnerus, 2011).

After the explosive expansion of BITs in the 90s, recent times have seen a reduction in the number of new annual BITs (UNCTAD 2012). With rising number, prominence and success of BIT claims, there is an increasing realization that traditional BITs put undue risk on the host nations without obligating the investors to follow the measures necessary for ensuring the development requirements of the host state (Friedman and Verhoosel 2003). Known investor state dispute settlement cases have increased dramatically in the last 15 years to reach 608 cases in 2014 from a level of around 50 cases in 2000 (UNCTAD 2015). The gravity of the situation is conveyed by the huge amount of claims made by the investor litigants that put host states in serious fiscal strain<sup>1</sup>

It is therefore not surprising that in recent years BITs have been a source of political controversy. At least 45 countries and four regional integration organizations are currently revising or have recently revised their model agreement to include including provisions on pre-establishment commitments and sustainable development-oriented clauses (UNCTAD 2015). South Africa has terminated its BITs with the Netherlands, Switzerland and Germany in 2014. Further, it has given notice of termination of its treaties with Belgium & Luxembourg and Spain Indonesia has followed suit recently and terminated its BITs with the Netherlands.

Literature on the arbitration impact of BITs is mostly qualitative dealing with either anecdotal cases or legal analysis of treaties (Os & Knottnerus, 2011) Markert (2011) emphasise the need to balance investors' rights with the host state interest in BITs. Studies on the arbitration impact have highlighted the inconsistencies and contradictory awards by tribunals leading to a crisis of legitimacy of treaty based awards (Sornarajah 2008). Other studies have pointed out that the lack of transparency, high costs of the proceeding and concerns regarding the qualification of arbitrators further add to the deficiencies in the system (UNCTAD WIR 2012).

Quantitative literature on the subject is scarce. While Franck (2009) has empirically analyzed the outcomes of investment treaty arbitration within the context of developed-developing countries paradigm to ascertain possible discrimination against the latter, the objective of her analysis is to ascertain the legitimacy of ICSID awards. Her conclusions are that developing countries were not unfairly treated by the current arbitration system and hence concludes an

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<sup>1</sup>For eg; the combined claims against Pakistan in the SGS, salineri and hubco arbitrations exceeded the national reserves of the country (Sornarajah 2008).

absence of the need to overhaul the system. However, Gallagher and Shrestha (2011) point out there are serious issues with the methodology of the paper in that the dataset used is inadequate apart from being small and using just 49 cases. The analysis by Franck (2009) is also further limited by the fact that it is not able to control for various important variables in its bivariate treatment of the issue.

It is well documented that an overwhelming majority of investor state disputes (ISDS) is initiated by investors from developed countries (North) against developing countries (South) (UNCTAD 2015). This is despite the fact that global inward FDI stock of developed countries outweighs that of developing countries. The poor judicial processes and other idiosyncratic characteristics of the developing countries however may explain this anomaly. It is therefore necessary to undertake a multivariate analysis to establish the role of BITs by controlling for other factors that may contribute to the differences in the number of cases against developed and developing countries.

The objective of the study is two-fold: firstly, develop an analytical framework within which hypotheses regarding the ISDS patterns are evolved; secondly, empirically test in a multivariate regression framework these hypotheses using cross-country data.

The two hypotheses developed and tested are whether; a) BITs increase the risk of litigation and b) Cost outweighs the benefits of BITs. These hypotheses are tested by analysing the cases that are pending and have concluded at ICSID using multivariate regression analysis. Our conclusions are that the investors initiate a higher number of cases against countries with BITs. Moreover, the net benefit accruing to countries with BITs is lower than for countries without BITs.

The paper is divided into the following sections: Section two undertakes a review of the dispute settlement mechanisms imbibed in BITs. This is followed by hypothesis development in section three. Section four provides a preliminary statistical analysis of the ICSID cases within the North-South paradigm followed by a discussion on the methodology for multivariate econometric analysis in section five. Section six presents the results of multivariate regressions. Lastly, we conclude with section seven.

## **2 Dispute settlement mechanisms under BITs**

It is important to acknowledge that not only do the treaty practices widely vary between countries but it also differs between treaties of a single country with respect to different countries. This has implications on the legal strictness of a BIT thus impacting on the arbitrations that arise under its jurisdiction. A temporal classification into first, second, and third generation BITs also is an indication of shifting purposes, patterns, and legal strictness of BITs (Newcombe and Paradell, 2009, Jandhyala et al 2011).

Nevertheless, some of the standard components of a BIT are: definition of investor and investment, Most Favored Nation and National Treatment clause, provision for repatriation of capital and transfer of funds, guarantee against and

compensation in the event of expropriation and the dispute settlement clause relating to State-to-State and investor to State disputes (Mosoti 2005, Sequeiros 1993)

BITs usually contain two dispute resolution clauses: one between investor and host state and the other between the two signatory states. Although state vs state litigation is starting to manifest in the ICSID, it is still a far more rare phenomenon compared to Investor-state disputes (Roberts 2014). With a couple of exceptions the Investor-state disputes are initiated by the investor against the host state (Kalicki 2013). Our study is hence limited to an analysis of the Investor-state disputes registered at ICSID with investor being the litigant and the host state the defendant.

Bilateral investment treaties provide for international arbitration of investor-state disputes either at World Bank's dispute settlement body the International Center for the Settlement of Investment Disputes (ICSID), Stockholm Chamber of Commerce (SCC), International Chamber of Commerce (ICC) in Paris, or agree to an ad hoc tribunal set up in accordance with the procedural rules of the United Nations Commission on International Trade Law (UNCITRAL) (Sequeiros 1993). Unlike ICSID cases which are registered publicly, other forums of international investment arbitration like ICC, SCC do not do so. Moreover until recently under UNCITRAL arbitration the parties concerned could invoke rules under which only they are made aware of the arbitration (Peterson 2003). The new UNCITRAL rules to ensure greater transparency in treaty-based Investor-State arbitration came into effect in 2014. However it is limiting in that the rule only applies to arbitrations brought under international investment agreements (IIAs) concluded after 1 April 2014 (UNCTAD 2015).

ICSID accounts for 62% of all Investor state dispute cases followed by UNCITRAL (28%), SCC (5%) and others including ICC (5%) (IIA Monitor 2013). According to Petersen (2003) BITs cases at ICSID grew from 5 of 12 new arbitrations in 2000, to 12 of 14 in 2001, and a striking 15 of 19 in 2002. He records that there were 38 cases pending in ICSID based on alleged violations of Bilateral Investment Treaties in April 2003. The increase in BITs cases to 436 at the time of this study (December 2014) indicates a 10 fold increase in cases based on BITs in just over 10 years. This clearly points to the increased number of cases in ICSID following the proliferation of BITs.

The dispute settlement provisions differ widely under BITs and WTO. The WTO system does not provide for individual actors to initiate cases against states, whereas the primary purpose of investor-state dispute settlement procedures is to enable the private investors to bring action against a host state in an international forum. Moreover, the arbitration outcome can result in provision of compensation award under the BITs whereas under WTO the primary purpose of arbitration is to ensure compliance with the agreement with only limited provisions for temporary compensation. This has implications for developing countries who have to often face heavy fiscal burden under BITs awards of compensation. Apart from the compensation requirement, Franck (2011b) highlights the enormous costs of investment treaty arbitration at ICSID with partial costs representing more than 10% of an average award.

While some countries like Brazil and India are not signatory to ICSID and have never been members, other countries have alleged that arbitration under ICSID as unfair and withdrawn from it. This includes Bolivarian Republic of Venezuela, Ecuador and Bolivia. It is in this back drop that Franck (2011) investigated the relationship between development status and outcome of the case as well as development status and amount awarded. The primary variable of the study is the developmental status of the presiding arbitrator's country. Western bias of arbitrators from developing countries is found to be evident in the lower awards against developed countries. However no bias was found in the arbitration outcomes based on the development status of the parties at ICSID. The focus of this paper differs in that it looks at the impact of BITs on determining arbitration at ICSID and also analyses the net benefit of BITs on developing countries.

### **3 Framework of analysis**

This section is dedicated to developing the analytical framework within which we develop our hypotheses. The two pillars of our framework are the implications of the reciprocity clause within BITs and the economic theory of market failures. The former is used to explain the greater number of cases against developing countries even though they account for less than 40% of world FDI stock. The theory of market failures explain the overwhelming number of cases against host States initiated by investors as compared to cases initiated by host States against the investors as well as counterclaims by host States.

The concept of reciprocity is interpreted distinctly in various fields of study contributing to its ambiguity. Although GATT/WTO is said to be based on the twin pillars of reciprocity and non-discrimination, the principle of reciprocity is not explicitly defined in GATT/WTO articles (Ossa 2009). Bagwell and Staiger (1999) consider the principle of reciprocity came to be a GATT norm under which one country agrees to reduce its level of protection in return for a reciprocal concession from its trading partner. According to Bagwell and Staiger (1999) "At the broadest level, this principle refers to the "ideal" of mutual changes in trade policy that bring about equal changes in import volumes across trading partners" In reality though the "ideal" does not hold as one country manages to elicit more benefits from free trade leading to an imbalance in trade balance.

This necessitates a discussion on the two distinct types of reciprocity within the field of international trade, which Keohane (1986) term as specific and diffused reciprocity. He refers specific reciprocity to situations where exchange of goods of equivalent value occur in a sequence between specified partners. Whereas diffused reciprocity neither insists on equivalence or sequence of actions. While the former ensures inter-temporal trade balance between trading patterns, the latter may not.

Nevertheless, the reciprocity component has been the less controversial among the standard clauses of State agreements. This is because reciprocity is seen as a

benign clause that provides symmetrical rights and obligations to both parties of the treaty. Sequeiros (1993) in fact highlight the main accomplishment of BITs as the fact that they do not specify which contracting party is the source of the investment or which is the recipient. However Monebhurrin (2014) questions the meaning of reciprocity between unequals pointing out the vast disparity in the resources, institutional capacity and power of developed and developing countries. This is especially relevant in the context of diffused reciprocity where the notion of equivalence does not hold and where balance is not brought about by repeated actions raises the potential of exploitation of one party by the other (Keohane 1986). This is illustrated in the net rights payoff matrix of BITs between a developed and a developing country where IMP and EXP refer to import and export of capital (Table 1). The net rights payoff of BITs would approach zero for countries that are equal exporters and importers of capital (as in the case of FDI between developed countries or North-North FDI). On the other hand, BITs between a developing and a developed country would result in unequal payoffs with the capital importing developing countries burdened with net obligations as compared to developed capital exporting countries who enjoy net rights. North-South FDI reflects this pattern. Disputes arising out of North-North FDI therefore have a greater possibility of settlement through diplomatic interventions because of the equal distribution of rights and obligations between the countries as compared to North-South FDI. The threat of a developed defendant country retaliating in future with arbitration against the litigant country is real and credible. On the other hand a developing country with negative net rights vis-à-vis a developed country is less able to retaliate. Implications of this on the payoff of countries are illustrated using game trees in Fig 1 & 2. Given the uncertainty of arbitration outcomes, the possibility of a developed country (N1) benefitting through arbitration more than through settlement with another developed country (N2) is only in one out of four outcomes (Fig 1). The North-South game is not dynamic as developing countries are less likely to retaliate. Therefore the possibility of N1 receiving a bigger payoff through arbitration as compared to settlement with a developing country is higher (Fig 2).

The proposition that follows then is that the large multinationals (mostly located in developed countries) are more likely to initiate cases against developing nations as compared to developed nations even though bulk of their investment are in developed countries.

This apart, as pointed out by Dolzer and Schruer (2012), the reciprocity clause is asymmetric in the context of BITs because although it is entered upon by two States, it bestows on the investor privileges without burdening it with obligations. This is not surprising as the primary purpose of a traditional BIT is considered to be to offer protection to the investor. The rationale for this is based on the very questionable assumption that all FDI is good and hence host interest is not different from investor interest (Dolzer and Schruer 2012). This translates to unequal right between States as well because developing and developed countries are importers and exporters of capital respectively. Therefore in factuality the rights embodied in BITs are in favour of the developed countries

at the cost of the developing countries.

Keeping the above assertions aside, the equal exercise of rights by investors and by host countries would imply the following patterns of investment disputes: a) *Ceteris paribus*, the developed countries would have more disputes against them compared to developing countries as the former accounts for 63% of world inward FDI stock and, b) the number of complaints lodged by the host State and foreign investor would tend not to differ significantly. An empirical analysis of cases filed at ICSID indicates both of the above to be untrue. Using ICSID online data we estimate that almost 90% of cases filed under the jurisdiction of bilateral treaties are against developing nations although they account for only 37% of world FDI stock. The second interpretation of reciprocity is not without debate because the primary purpose of a traditional BIT is accepted to be to protect the commercial interest of the investor and for foreign investor to seek redress from the relevant host State. All but a couple of cases in ICSID are of this nature. This, compounded by the fact that most large MNCs originate from the developed countries, imply that developing countries are subject to more arbitrations against them as compared to developed countries.

According to Kalecki (2013) very few counter claims are initiated by nations against investors at ICSID because of the perception that international tribunals have limited jurisdiction to hear such claims. Although this and the contract enforcement constraints of developing countries may be used to explain the skewed distribution of cases at ICSID, the economic theory of market failures adds further understanding of the pattern. Monitoring difficulties of the State together with asymmetry of information between the State and the investor regarding the investment reduces the likelihood of the State identifying any violations by the investor that could potentially lead to a dispute. This is compounded by the principal-agent problem that incentivizes corruption of the government officials that further reduces the possibility of the State initiating a dispute even when violations by the investor is noticed by the agents of the host State. Lastly, the practical aspect of the high costs involved in international litigation can be inhibitive for smaller developing countries whose resources is very often less than that of the large multinationals. Franck (2011b) highlights that the cost of litigation is an issue of concern and even suggests using Alternative Dispute Resolution strategies because of it. Using pre-2007 dataset, she finds that even partial costs represent more than 10% of an average award and was positively related to the amount claimed by the investors.

The above arguments indicate that BITs provide asymmetric rights in favour of developed countries and obligations weighed against the developing countries. This implies that the concept of reciprocity imbibed in a BIT is limited as, although the agreement is entered between two countries (who may be unequal), it is exercised by two parties (State and foreign investor) who are very different from one another in terms of their functions, objectives and resources.

The hypotheses we test in the subsequent sections of this paper are:

1. Countries with BITs stand a higher risk of litigation against them
2. Net benefit to countries with BITs is less as compared to countries without



BITs

## 4 Methodology

While it is important to acknowledge that the nature of each case differs and it is important to analyse the merits of each qualitatively to comprehend the core economic as well as sustainable development issues involved, this study is an endeavor for quantitative analysis of investor initiated cases against host states arbitrated in ICSID under a BIT jurisdiction

We first undertake a preliminary analysis of ICSID cases to understand the profiles of litigants and defendants. Although clear indications emerge no conclusions regarding the determinants can be derived from such bivariate analysis. We therefore follow up with the use of cross-country multivariate regression analysis to understand the role of BITs in determining the arbitration patterns in ICSID and in the net benefits derived by countries. We discuss these two models in separate sections below.

### 4.1 Determinants of Number of Cases

The determinants of the number of cases is modelled using pooled cross-country data across 5 litigant countries (US, UK, Italy, Netherlands, and Spain) who have 30 or more cases filed by their investors against other countries. These 5 litigant countries account for almost 50% of total cases filed at ICSID. Based on the analytical framework developed in Section 3 we test the hypothesis that developed countries and countries that have signed BITs have greater probability of litigation. The number of cases that existed prior to the signing of the BIT and the FDI share of the defendant country are included as control variables. In addition dummies are included to control for litigant fixed effects. The dependent variable being count data of rare events, we use Poisson regression as our base model for estimating Eq1.

$$C_{il} = \partial_1 + \partial_2 Dev_i + \partial_3 BIT_{il} + \partial_4 PreC_{il} + \partial_5 FDIsh_{il} + e_1 \quad (1)$$

Where,  $C_{il}$  denotes the number of cases filed by investor country  $j$  against host country  $I$  post-signing of a bilateral investment treaty.  $PreC_{il}$  denotes the number of cases filed by investor country  $j$  against host country  $I$  prior to signing of a bilateral investment treaty.  $Dev_i$  is a dummy variable taking the value 1 and 0 for developing and developed countries respectively to account for the development status of host country  $i$ .  $BIT_{il}$  is a dummy variable taking value 1 if a bilateral investment treaty exists between host country  $i$  and litigant country  $l$ .  $FDIsh_{il}$  is the share of country  $i$  in the global outward FDI stock of litigant country  $l$ .

The relationship between FDI share of a country and the number of cases arbitrated against it is fraught with endogeneity issues arising out of reverse causality. While greater amount of FDI received increases the risk of disputes between the investor and host state, the direction of causality between FDI share

and number of cases can run in the opposite direction as well with FDI flows being determined by the number of cases. Investors are likely to consider it too risky to invest in countries that are seen to be involved in litigation. Including the lagged dependent variable as an explanatory variable in the base poisson model takes care of this issue to some extent, nevertheless we undertake instrument variable two-stage least squares, instrument variable poisson regression estimation using Generalized Method of Moments (GMM) as well as panel data fixed effects estimation. The instrument variables for the endogenous variable FDI share which are not expected to be correlated to the dependent variable are identified based on the empirical study by Kerner (2009). The three instruments are trade openness ( $Open_i$ ), the number of cases registered at ICSID prior to BITs ( $PreCi$ ) and the institutional quality of the host country ( $DTFi$ ).

## 4.2 Determinants of Net Benefits

Heteroscedasticity-and-autocorrelation-consistent OLS regression estimates are used as the base model to test the second hypothesis that the net benefit of countries with BITs is less than to countries without BITs. The dependent variable, as the difference in the share of FDI to share of cases of host country captures the net benefit of BITs to the host countries. The dependent variable in Eq 2 is a continuous variable allowing the use of OLS regression in its estimation

$$NB_{il} = \alpha_0 + \alpha_1 Dev_i + \alpha_2 BIT_{il} + \alpha_3 Open_i + e_2 \quad (2)$$

Where  $NB_{il}$  is the net benefits accruing to host defendant country  $i$  because of its BIT with investor country  $l$ . Net Benefit of each host country vis-à-vis the investor country is estimated as the difference between its share of FDI and share of cases as follows:

$$NB_{il} = \frac{\sum FDI_{il}}{\sum FDI_I} - \frac{\sum C_{il}}{C_i} \quad (3)$$

A positive value of NB indicates that the country  $i$  benefits overall from the BIT as its share of FDI is higher than its share of cases. On the contrary negative net benefits indicates that risks associated with BITs outweigh the benefits from it. The target variable included is  $BIT_{il}$  taking value 1 if a bilateral investment treaty exists between host country  $i$  and investor country  $l$  and 0 otherwise. The development status of the country is included using the  $Dev_i$  variable. Trade openness of the host economy is included as a control variable as more open economies are likely to attract more FDI and is expected to have a positive relationship to the dependent variable (Kerner 2009).

Further, 2SLS instrument variable regression as well as GMM estimations are run to account for possible reverse causality between BIT variable and the dependent variable. This will account for the possibility that BITs is likely to exist between countries that have strong investment relationship. The instruments used to proxy for the BITs variable are DTF, cases before BITS was signed (PreC) and Corruption levels of the invested country (Corr)

The sources of data and variable definitions are discussed in Appendix1.

### **4.3 Study limitations**

This quantitative study using cross-country regressions does not allow taking into account the merits of each case. The BITs are taken as homogenous whereas a difference in the legal strictness between BITs is acknowledged. The net benefit, estimated as the difference in the FDI share and case share of each country is based on the assumption that the FDI is homogenous and benefits accruing do not vary. In other words the quality of FDI is treated as homogenous. The interpretation of net benefits is therefore more appropriate as a relative measure that enables comparison across countries rather than as an absolute quantitative measure of net benefits to a country. The biggest constraint that the empirical analysis faces is the inability to include an interactive dummy to capture the impact of BITs on developing countries due to collinearity issues. This is because although all developing countries have not signed BITs, all countries that have signed BITs with the 5 top litigators are developing countries.

## **5 Preliminary analysis**

This section is divided into two subsection with the first analyzing the patterns of Investor State Litigation at ICSID and the second analyzing the net benefits from BITs.

### **5.1 Investor State Litigation at ICSID**

Tables 2 & 3 below summarise the distribution of ICSID cases in a North-South paradigm.

Over 86% of cases have developing countries as defendants. The number of countries involved in these cases are also overwhelmingly developing countries. This shows that it is not just a few developing countries that account for bulk of the cases. The cases per country stands at 4.2 for developing countries whereas it is lower at 3 for developed countries.

The picture is reversed when it comes to the profile of litigants. The number of cases initiated by developed countries outnumber those filed by developing countries. Investors from developed nations account for almost 88% of ICSID cases with investors from the developing countries accounting for only 12% of cases. Developed countries figure as litigants more than developing countries, and the number of cases per country indicate that a few developed countries account for bulk of the cases initiated. While the 29 developed countries accounted for 382 cases as litigants, 21 developing countries accounted for 54 cases indicating a much higher case per country for the developed countries. This however can be argued as not surprising given that majority investors hail from developed countries.

We may conclude that while a handful of developed countries account for bulk of the cases initiated at ICISD, the defendants are spread across the developing countries.

Table 3 brings out further details on the dynamics of developed and developing countries at ICSID. Over 85% and 93% of cases initiated by developed and developing country investors are against developing states. It is clear that both developed as well as developing country litigants initiate overwhelmingly more cases against developing host states as compared to developed countries. While the large share of South-South FDI as compared to South-North FDI may explain the latter, the same does not hold for FDI from North. North-North FDI continues to dominate North-South FDI and thus cannot explain the litigation pattern of developed countries.

Moving on to country –specific analysis, US investors is seen to have initiated the largest number of cases in ICSID (Table 4). US is followed at a distance by Netherlands, Italy, Spain and UK. The only developing country figuring among top 10 litigants is Turkey. Not surprisingly, the opposite pattern is observed when it comes to defendant patterns. Developing nations predominate as the defendants at ICSID with highest number of cases registered against Argentina, followed by Venezuela and Egypt. The only developed country figuring in the top ten defendant list is Hungary with 13 cases.

A litigant country-wise distribution of cases between developed and developing countries indicate that an overwhelming number of cases of all major litigant countries are concentrated on developing countries (Table 5). All the 32 cases filed by litigants under the Spanish BIT jurisdiction relate to developing countries. Canada with 83% had the lowest share of cases against developing vis-avis developed countries. The cases are however not uniformly distributed across countries. Therefore it is important to look at the countries that are being litigated against irrespective of the number of cases against them. The high proportion of the number of developing countries indicate that it is not just a few countries being targeted for litigation. Dutch, UK and Canadian investors appear to be the only ones willing to take on the developed countries to any extent. 72.7% of countries that Dutch investors are litigating against are developing countries while the rest 27.3% are developed countries.

Drawing conclusion regarding the litigation patterns without taking into account the patterns of global FDI stock can be misleading. The number of cases initiated by investors of a country is likely to be positively correlated with the FDI outward stock of the country. Therefore it is not surprising that US investors have the largest number of cases initiated by them as US outward FDI stock accounts for almost 25% of global FDI stock. However the impact of a BIT can be construed to be negative if a investor country share of cases is over and above its share of the outward FDI stock of the investor country.

Italy, Spain and Netherlands retain their top positions with not just large number of cases initiated by their investors but with disproportionately large share of cases given their share in global outward FDI stock (Table 6). US and UK investors are not seen to be aggressive at all in initiating litigation with lower than proportionate number of cases leveled by them.

## 5.2 Net Benefits

In order to quantify the net benefits accruing from BITs to host nations, it is necessary to take in to account the FDI it attracts together with the risk of litigation it entails. Therefore an analysis of the difference in the shares of global FDI stock and shares in the total cases at ICSID of host nations are undertaken next (Table 7).

It is evident from table above that statistically significant difference exists in the net benefits of developed and developing countries. Almost 93 % of developed countries accrue positive net benefits while only 42% of developing countries are able to do so. A regional analysis reveals that differences in net benefits from BITs among developing countries is not statistically significant (Table 8). It is however evident that negative net benefits outweigh positive net benefits in all regions except Asia where both are in balance. Latin America seems to fare the worst with 75% of countries having negative net benefits.

The net benefits from BITs are seen to favour the developed countries as their share of global inward FDI outweigh their share of cases as defendants. Brazil is the only developing country to figure in the top 20 beneficiaries of BITs. The net benefits of developing countries are seen to be negative. An analysis of net benefits in Table 9 does not drastically change the conclusion drawn from Table 4 earlier. The countries with most number of cases initiated against them are also seen to be the countries against whom disproportionately large number of cases are leveled against. Argentina, Venezuela and Egypt top both the lists and Hungary continues to be the only developed country in top 10 of both lists.

## 6 Multivariate Analysis: Results

### 6.1 Poisson Regression results:

This section presents the regression results of Eq 1 estimated using various models with pooled and panel data. It is evident from Table 10 that the coefficient of the BIT dummy variable is positive and significant across all the estimated models. This indicates that the average number of cases filed against host states are higher for countries with BITs as compared to countries without BITs. The dummy variable for developing countries are significant in the OLS and Poisson estimations, however it ceases to be significant in instrument variable estimations. An interactive dummy of developing countries with BITs could not be retained in the regressions because of perfect collinearity. After controlling for endogeneity the *fdishare* variable is not significant in any of our estimations of Eq 1. This indicates that countries with larger share of FDI stock do not face more number of cases. The panel data regression that controls for country fixed effects validate the findings from the instrument variable poisson GMM estimation .

## 6.2 OLS Regression results:

This section presents the cross-country regression estimation results of Eq 2. enabling us to ascertain whether the net benefits are different for countries with and without BITs (Table 11). The negative and significant coefficient of the BIT variable across all estimations emphasise that costs of BITs is substantial. The coefficient of the DEVG dummy is negative and significant for OLS estimation but cease to be significant for 2SLS and GMM estimations.

Both the hypotheses developed in section 3 are validated by our findings. Countries with BITs have higher cases initiated against them and that there are substantial costs associated with signing of BITs.

## 7 CONCLUSION

This paper analysed the issues with diffused reciprocity imbibed in BITs leading to the unequal distribution of rights and obligations between countries. The hypotheses developed within this analytical framework that a) BITs increases the risk of litigation for countries and b) The costs associated with BITs outweigh the benefits from BITs were tested empirically. Our conclusions are that the investors initiate higher number of cases against countries with BITs. Moreover, the net benefit accruing to countries with BITs is substantially lower than for countries without BITs.

Our analysis confirms the need among developing nations to be wary of the risks associated with traditional BITs with investment protection being the primary if not sole concern of it. It is clear from our analysis that the call for a new generation foreign investment policy framework that together with promoting foreign investment will also enable regulation of investment in keeping with host country public policy is well founded. It is therefore imperative to include the social and developmental interests of the host developing countries while negotiating BITs. UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD) is a step forward in this direction (UNCTAD 2012). A new generation of BITs needs to evolve in keeping with IPFSD that is based on synergies between investment policy and development strategies of host country as well as responsible investor behavior.

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## 8 APPENDIX 1 Variable definition and Data sources:

### References

- [1] Case: ICSID investor state dispute cases are screened to identify the nationality of the investor litigant. In cases where this information is unavailable, the country of the litigant was identified by the litigant investor's country of origin.
- [2] PreC: The number of cases registered at ICSID prior to BITs being signed between the investor and host countries.
- [3] Dev: The countries are classified based on their development status according to the World Bank classification
- [4] Fdshare: The variable is estimated as the share of the host country in the total outward FDI stock of the specific investor country using UNCTAD bilateral FDI database.
- [5] BITs: UNCTAD database on international investment agreements provide details on BITs between various countries.
- [6] LNGDP: is the natural logarithm of the Gross Domestic Product estimated using World Development Indicators data.
- [7] Open: Trade Openness is estimated as the ratio of total trade to GDP using World Bank World Development Indicators data.
- [8] Corr: The Corruption Perception Index published by Transparency International is used as a proxy for corruption levels.
- [9] DTF:  $DTF_1$  captures the levels of efficiency of the judicial system of country  $i$  with 0 representing the lowest performance and 100 the best Contract Enforcement distance to frontier index (DTF) is used as a proxy for the judicial quality of a country. This variable assesses the efficiency of the judicial system by following the evolution of a commercial sale dispute over the quality of goods and tracking the time, cost and number of procedures involved from the moment the plaintiff files the lawsuit until payment is received. The distance to frontier measure shows the distance of each economy to the "frontier," which represents the best performance observed on each of the indicators across all economies in the World Bank *Doing Business* sample since 2005.

**Table 1: Net Rights Payoff Matrix**

Developing countries		Developed Countries		
		EXP>IMP	EXP=IMP	EXP<IMP
	EXP>IMP			(Positive, Negative)
	EXP=IMP		(Zero, Zero)	
	EXP<IMP	(Negative, Positive)		

**Table 2: Profiles of Defendants & Litigants**

	Defendant		Litigant	
	Developed	Developing	Developed	Developing
No. of cases	60 (13.8%)	376(86.2%)	382(87.6%)	54(12.4%)
No. of countries	20(18.4%)	89(81.6%)	29(58%)	21(42%)
Cases per country	3.0	4.2	13.2	2.6

Source: Author calculation from analysis of ICSID cases

**Table 3: Litigants and Defendants Matrix**

Defendant	Litigant			
		Developed	Developing	Total
	Developed	56 (14.7%)	4 (7.4%)	60 (13.8%)
	Developing	326 (85.3%)	50 (92.6%)	376 (86.2%)
Total	382 (87.6%)	54 (12.4%)	436 (100%)	

Source: Author calculation from analysis of ICSID cases

**Table 4: Top 20 litigant and defendant countries at ICSID**

Litigant	North=1 South=0	No. of Cases	Defendant	No. of Cases	North=1 South=0
US	1	103	Argentina	52	0
Netherlands	1	34	Venezuela	41	0
Italy	1	32	Egypt	23	0
Spain	1	32	Mexico	18	0
UK	1	30	Ecuador	17	0
France	1	27	Congo	15	0
Germany	1	22	Hungary	13	1
Canada	1	18	Peru	12	0
Switzerland	1	13	Ukraine	11	0
Turkey	0	12	Kazakhstan	10	0
Belgium - luxemburg	1	15	Costa Rica	9	0

Greece	1	10	Georgia	9	0
Austria	1	6	Romania	9	1
Sweden	1	5	Pakistan	8	0
Australia	1	4	Spain	8	1
Chile	0	4	Turkey	8	0
Cyprus	1	4	Uzbekistan	7	0
Kuwait	0	4	Albania	6	0
Norway	1	4	Estonia	6	1
China	0	3	Indonesia	6	0

Source: Author calculation from analysis of ICSID cases

**Table 5: Case Profile of Investor state disputes at ICSID**

Litigant country	Cases		Defendant countries		Cases per country	
	Total No.	% against developing	Total No.	% against developing	Developing	Developed
US	103	93.2	40	90	2.7	1.8
UK	30	83.3	17	76.5	1.9	1.3
Italy	32	93.8	20	90.0	1.7	1.0
Germany	22	95.5	16	93.8	1.4	1.0
Canada	18	83.3	11	81.8	1.7	1.5
Spain	32	100.0	12	100.0	2.7	0.0
France	27	88.9	16	93.8	1.6	3.0
Netherlands	34	85.3	22	72.7	1.8	0.8

Source: Author calculation from analysis of ICSID cases

**Table 6: Top litigant countries at ICSID: A re-look**

	Outward FDI stock share%	FDI share rank	Case share %	Case share rank	Difference in FDI & case share
Italy	2,24	12	7,41	4	-5,2
Spain	2,73	11	7,41	3	-4,7
Netherlands	4,69	6	7,87	2	-3,2
Turkey	0,09	27	2,78	10	-2,7
Greece	0,17	25	2,31	11	-2,1
Belgium-Luxemburg	0,60	23	2,31	12	-1,7
Canada	3,00	10	4,17	8	-1,2
Kuwait	0,10	26	0,93	18	-0,8
Chile	0,26	24	0,93	19	-0,7
Austria	0,76	22	1,39	13	-0,6
Norway	0,81	21	0,93	17	-0,1
China	1,22	18	0,69	20	0,5
Denmark	1,01	20	0,46	22	0,6
Sweden	1,73	14	1,16	15	0,6
US	24,63	1	23,84	1	0,8
Russian Federation	1,44	16	0,46	21	1,0
Australia	1,92	13	0,93	16	1,0

Switzerland	4,20	7	3,01	9	1,2
Ireland	1,21	19	0	27	1,2
British Virgin Islands	1,43	17	0	26	1,4
Singapore	1,58	15	0	25	1,6
France	8,16	3	6,25	6	1,9
UK	8,95	2	6,94	5	2,0
Germany	7,16	4	5,09	7	2,1

Source: Author calculation

**Table 7: Net Benefits of BITs: developed vs developing host countries**

countries	% countries with -ve Net Benefits	% countries with +ve Net Benefits	Total no. of countries
Developed	7.4	92.6	27
Developing	56.7	43.2	111
Total	47.1	52.9	138
Pearson chi2(1) =	21.2272	Pr = 0.000	

Source: Author calculation

**Table 8: Net Benefits of BITs : Regional differences among developing countries**

Region	% countries with -ve Net Benefits	% countries with +ve Net Benefits	Total no. of countries
Europe	66.7	33.3	21
Africa	58.3	41.7	36
Asia	50.0	50.0	32
Latin America	75.0	25.0	16
Total	60.0	40.0	105
Pearson chi2(4) =	3.2639	Pr = 0.353	

Source: Author calculation

**Table 9: Net Benefits of BITs**

Top 20 Winners		Top 20 Losers	
country	Net Benefits	country	Net Benefits
United States	19.65	Argentina	-10.26
United Kingdom	6.41	Venezuela	-8.18
France	5.65	Egypt	-4.44
Hong Kong	5.58	Ecuador	-3.44
Belgium	3.63	Congo Republic	-3.04
Netherlands	3.50	Peru	-2.28
Germany	3.34	Hungary	-2.21
Singapore	2.67	Mexico	-2.06
Australia	2.46	Ukraine	-2.05
Switzerland	2.44	Georgia	-1.83
China	2.37	Costa Rica	-1.80
Brazil	2.30	Kazakhstan	-1.69
Canada	2.18	Romania	-1.56
Russia	1.85	Pakistan	-1.55
Italy	1.61	Uzbekistan	-1.43
Sweden	1.60	Albania	-1.22
Ireland	1.47	Estonia	-1.16
Spain	1.46	Turkey	-1.03
Japan	0.91	Haiti	-1.02
Denmark	0.83	Algeria	-0.95

Source: Author calculation

**Table 10: Regression results: Dependent Variable: Number of Cases filed against countries**

	OLS	IV 2SLS@	Poisson	IV Poisson GMM@	PANEL Fixed Effects
BIT	0.225*** (0.076)	0.36** (0.15)	1.06*** (0.16)	0.95***(0.36)	0.65*** (0.09)
DEVG	0.447*** (0.13)	0.003 (0.421)	1.09*** (0.32)	0.437 (0.49)	
GDP	0.033** (0.016)	0.075* (0.041)	0.284*** (0.05)		
PreC	0.22 (0.18)		0.186*** (0.056)		
FDIsh	-0.009* (.005)	-0.133 (0.17)	-0.59*** (0.21)	-82.77 (172.2)	-0.078 (0.166)
UK D	-0.544** (0.21)	-0.63*** (0.16)	-1.5*** (0.22)	-2.20 (1.55)	
HollandD	-0.57** (0.245)	-0.65*** (0.18)	-0.137*** (0.232)	-1.03* (0.58)	
Italy D	-0.446** (0.20)	-0.534*** (0.16)	-1.073 (0.216)	-1.13** (0.50)	
Spain D	-0.35* (0.19)	-0.44** (0.18)	-0.88*** (0.25)	-0.596 (0.549)	
Constant	-0.488 (0.378)	-1.14 (0.81)	-8.9*** (1.34)	0.46 (2.14)	
Rsq	0.085	0.03			0.16
F test	3.41***				24.8***
N	570	556	570	556	322
chi2		43.74***	215.44***		
Hansen's J chi2(2)				3.41547	

Standard errors are in parenthesis.

Asterix \*\*\*, \*\*, \* indicate 1%, 5% and 10% level of significance respectively.

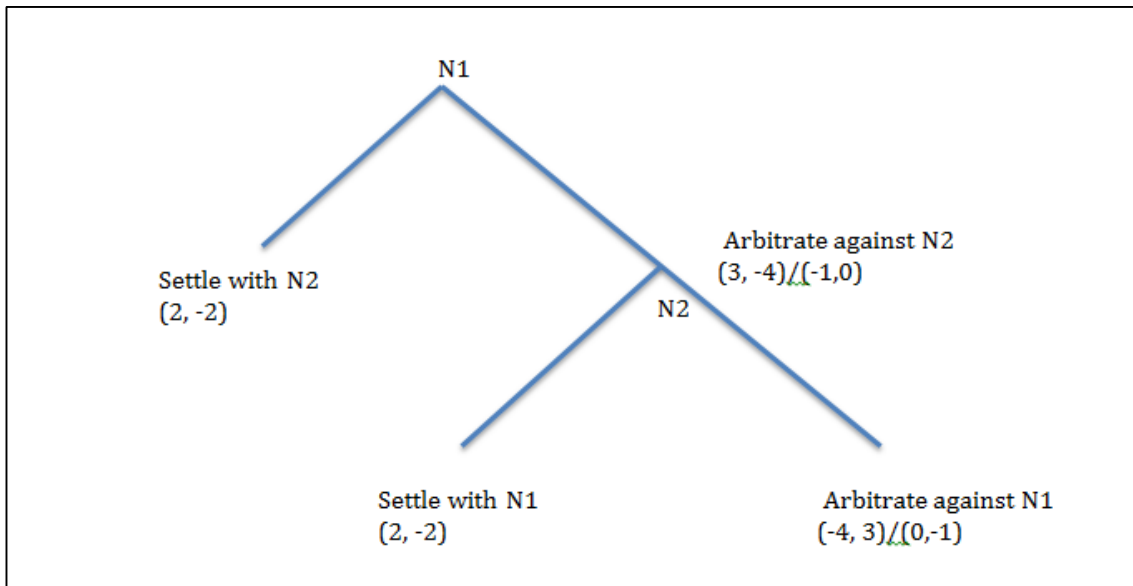
@FDIsh instruments: Open, DTF and PreC

**Table 11: Regression results: Dependent Variable: Net Benefits**

	OLS	IV 2SLS #	IV GMM #
BIT	-1.507*** (0.25)	-6.95*** (2.98)	-7.32** (3.06)
DEVG	-2.108*** (0.418)	0.587 (1.52)	0.782 (1.46)
GDP	0.148** (0.072)	0.426** (0.17)	0.446*** (0.162)
Open	0.008*** (0.002)	0.013*** (0.003)	0.013*** (0.003)
UK D	0.241 (0.37)	0.965 (0.646)	1.08 (0.66)
Netherlands D	0.122 (0.449)	1.55* (0.92)	1.63* (0.87)
Italy D	-0.118 (0.388)	0.148 (0.574)	0.135 (0.547)
Spain D	-0.053 (0.408)	-1.33 (0.87)	-1.45* (0.843)
Constant	-2.401 (1.88)	-10.06** (4.88)	-10.67* (4.44)
Rsquared	0.18	0.06	
F test	10.19***		
N	591	589	589
chi2		76.3***	60.73***
Hansen's J chi2(2)			2.46
Wu-Hausman F(1,579)		5.06**	5.66*
Sargan (score) chi2(2)		1.66	

#BIT instruments: PreC , DTF and Corr.

**Fig 1: North Vs North Dynamic Game**



**Fig 2: North Vs South Game**

