REDESIGN AS REFORM: A CRITIQUE OF THE DESIGN OF BILATERAL INVESTMENT TREATIES

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ABSTRACT

This Article engages with the heated debates about the reform of the legal regime of international investment. The primary goal of most reform proposals is to improve the regime's dispute settlement mechanism. This Article draws attention to the redesign of bilateral investment treaties—the principal legal instrument in international investment law—as an alternative reform agenda. It describes the main extra-legal theories put forward in the investment law literature to explain the design of these treaties. The Article argues that none of the cited theories fully justify the current design, but rather warrant modifications thereof which go far beyond the reform of dispute settlement. The Article outlines these modifications as possible options for reform and provides a roadmap for further research on the redesign of bilateral investment treaties.

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I. INTRODUCTION

Whether it is suffering from "growing pains"[1] or a "teenager crisis"[2] or is merely on the path to "responsible adulthood,"[3] the "young" international investment regime is going through a tumultuous period.[4] The regime, as it has been known for the past two decades, has reached a definitive turning point. Despite the bilateral character of its main legal instrument, bilateral investment treaties (BITs), the international investment regime has provided foreign investors with legal protection that is largely uniform.[5] For better or for worse, this uniformity is slowly

1. *See* Angel Gurría, *The Growing Pains of Investment Treaties*, OECD INSIGHTS, (Oct. 13, 2014), http://oecdinsights.org/2014/10/13/the-growing-pains-of-investment-treaties/.

2. BRIGITTE STERN, *The Future of International Investment Law: A Balance Between the Protection of Investors and the States' Capacity to Regulate*, *in* THE EVOLVING INT'L INV. REGIME 174, 175 (Jose E. Alvarez & Karl P. Sauvant eds., 2011).

3. Silvia Constain, *ISDS Growing Pains and Responsible Adulthood*, 11 TRANSNAT'L DISP. MGMT., no. 1, Jan. 2014.

4. *See infra* notes 20–29 and accompanying text for a definition of the 'international investment regime.'

5. Patrick Juillard, for example, notes that "[t]he same clauses always appear in the same order; definition, admission of investment, standards of protection, expropriation and compensation, and then a dispute settlement procedure. These seem to form the basic core of each and every model. Further, these clauses seem to rely upon the same basic notions: fair and equitable treatment . . . This would appear to warrant the conclusion that there is not much dissimilarity between basic provisions from one model to another and, as a consequence, from one BIT to another." Patrick Juillard, *Variation in the Substantive Provisions and Interpretation of International Investment Agreements*, *in* APPEALS MECHANISMS IN INTERNATIONAL INVESTMENT DISPUTES 81, 91 (Karl P. Sauvant ed., 2008); *see generally* Jeswald W. Salacuse, *The Emerging Global Regime for Investment*, 51 HARV. INT'L L.J. 427 (2010) (arguing that, notwithstanding potential discrepancies, BITs form a "global regime for investment"); *see also* Stephen W. Schill, *Multilateralizing Investment Treaties through Most-Favored-Nation Clauses*, 27 BERKELEY J. INT'L L. 496 (2009).

disintegrating at a time when the globalist ethos of the 1990s is unmistakably subsiding.

Recently, the regime was hit hard by an unprecedented upheaval against investment arbitration.[6] This current backlash might be the most disruptive since the developing world's agitation against foreign direct investment (FDI) in the 1960s and 1970s which gave birth to the New International Economic Order (NIEO).[7] Unlike the NIEO, however, present-day fervor against the investment regime and globalization in general has found a new home in developed countries.[8]

In Europe, the widespread alarm engendered by the draft investment chapter in the Transatlantic Trade and Investment Partnership (TTIP) evinced growing distrust of the investment regime among the general public. The European Commission's public consultation on investor-state dispute settlement (ISDS), which concluded on July 13, 2014, received 149,399 replies—the largest number of submissions by stakeholders in the history of the EU The vast majority of responses unequivocally rejected the inclusion of ISDS, the hallmark of the contemporary investment regime, as it currently stands in the agreement.[9]

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6. Ruchir Sharma, *When Borders Close*, N.Y. TIMES, (Nov. 12, 2016), https://www.nytimes.com/2016/11/13/opinion/sunday/when-borders-close.html; *see also* MICHAEL WAIBEL ET AL., THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY (2010).

7. U.N. CENTRE ON TRANSNATIONAL CORPORATIONS, TRANSNATIONAL CORPORATIONS IN WORLD DEVELOPMENT: THIRD SURVEY 56–57 (1983). *See also generally* MAHBUB AL HAQ, OVERSEAS DEV. COUNCIL, THE THIRD WORLD AND THE INTERNATIONAL ECONOMIC ORDER, (1976); *see generally* MOHAMMED BEDJAOUI, TOWARDS A NEW INTERNATIONAL ECONOMIC ORDER (1979). On the history of the NIEO and its failure to help developing countries avoid liability for the expropriation of foreign businesses during the 1960s and 1970s, especially in the extractive sector, see JERZY MAKARCZYK, PRINCIPLES OF A NEW INTERNATIONAL ECONOMIC ORDER: A STUDY OF INTERNATIONAL LAW IN THE MAKING (1988). For a critical view of the NIEO, see Thomas Wälde, *A Requiem for the "New International Economic Order" — The Rise and Fall of Paradigms in International Economic Law and a Post-mortem with Timeless Significance*, *in* LIBER AMICORUM: PROFESSOR IGNAZ SEIDL-HOHENVELDERN IN HONOUR OF HIS 80TH BIRTHDAY 771 (Gerhard Hafner et al. eds., 1998).

8. *Contrasting Views of Foreign Investment*, PEW RESEARCH CENTER 4, 11 (Sept. 16, 2014), http://www.pewglobal.org/2014/09/16/faith-and-skepticism-about-trade-foreign-investment/trade-04/.

9. EUROPEAN COMMISSION, ONLINE PUBLIC CONSULTATION ON INVESTMENT PROTECTION AND INVESTOR-TO-STATE DISPUTE SETTLEMENT (ISDS) IN THE TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP AGREEMENT (TTIP) 132 (Jan. 13, 2015), http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153044.pdf [hereinafter EUROPEAN COMMISSION]; *see also* Greens EFA, *Investor-state dispute settlement (ISDS) in EU law and International Law*, YOUTUBE (Mar. 16, 2015), https://www.youtube.com/watch?v=OkqUYFoRG8U; European Commission, *Draft text on Investment Protection and Investment Court System, in the Transatlantic Trade and Investment Partnership (TTIP)* (Sept. 16, 2015) (proposing substantial modifications of conventional ISDS in the draft TTIP agreement).

Across the Atlantic, the investment chapter of the Trans-Pacific Partnership (TPP) was received with harsh criticism in the United States by academics, civil society organizations, and politicians at both ends of the political spectrum.[10] Among other things, the lack of popular appetite for "more" globalization paved the way for the rise of populism in American politics,[11] culminating in the U.S. withdrawal from the TPP after seven years of laborious negotiations.[12]

The frustration with the investment regime is also mounting up in the developing world, although for reasons quite different from those of developed countries. To begin with, some of the largest developing countries were never fully integrated into the investment regime. For instance, Brazil—one of the most favored destinations for FDI globally—has never ratified a single BIT despite having signed a number of these treaties in the past.[13] Additionally, major countries in the Global South, such as Brazil, India, and South Africa, and the Global North, such as Russia, have never fully acceded to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID), which establishes the principal institutional mechanism for settling investment disputes internationally.[14]

10. *See, e.g.*, Jonathan Weisman, *Trans-Pacific Partnership Seen as Door for Foreign Suits Against U.S.*, N.Y. TIMES (Mar. 25, 2015), https://www.nytimes.com/2015/03/26/business/trans-pacific-partnership-seen-as-door-for-foreign-suits-against-us.html?; Elizabeth Warren, *The Trans-Pacific Partnership Clause Everyone Should Oppose*, WASH. POST (Feb. 25, 2015), https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html; Judith Resnik, Cruz Reynoso, Honorable H. Lee Sarokin, Joseph E. Stiglitz & Laurence H. Tribe, *Letter to Congressional Leaders*, WASH. POST, (Apr. 30, 2015), https://www.washingtonpost.com/r/2010-2019/WashingtonPost/2015/04/30/Editorial-Opinion/Graphics/oppose_ISDS_Letter.pdf; *Over 1,500 Organizations Urge Opposition to the TPP*, CITIZENS TRADE CAMPAIGN (Jan. 7, 2016), https://www.citizenstrade.org/ctc/wp-content/uploads/2016/01/TPPOppositionLetter_010716.pdf.

11. Dani Rodrik, *The Politics of Anger*, PROJECT SYNDICATE (Mar. 9, 2016), https://www.project-syndicate.org/commentary/the-politics-of-anger-by-dani-rodrik-2016-03.

12. Nicky Woolf, Justin McCurry, & Benjamin Hass, *Trump to Withdraw from Trans-Pacific Partnership on First Day in Office*, GUARDIAN (Nov. 22, 2016), https://www.theguardian.com/us-news/2016/nov/21/donald-trump-100-days-plans-video-trans-pacific-partnership-withdraw.

13. Leany Barreiro Lemos & Daniela Campello, *The Non-Ratification of Bilateral Investment Treaties in Brazil: A Story of Conflict in a Land of Cooperation*, 22 REV. OF INT'L POL. ECON. 1055, 1056 (2015). In 2018, Brazil was the sixth most favored destination for FDI globally. U.N. CONF. ON TRADE AND DEV. [UNCTAD], WORLD INVESTMENT REPORT 4 (2019).

14. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID Convention]. For a full list of the State Parties to the ICSID Conventions, see DATABASE OF ICSID MEMBER STATES, INTERNATIONAL CENTER FOR SETTLEMENT OF INVESTMENT DISPUTES, https://icsid.worldbank.org/en/Pages/about/Database-of-Member-States.aspx.

Having been "bitten" by BITs, several developing countries began to curtail the role international investment agreements play in the regulation of FDI in their territories. The past decade saw the denunciation of the ICSID Convention on various grounds by some Latin American countries—namely, Ecuador, Venezuela, and Bolivia.[15] Moreover, a number of leading developing countries declared that they will let their BITs lapse without renewing them, including India, Indonesia, and South Africa.[16]

At this juncture, the reform of the investment regime tops the agenda of various stakeholders in both developed and developing countries. A wide range of reforms are currently being offered by academics, local and international NGOs, governments, and international organizations. These proposals vary widely in scope—from a mere revision of national investment policy to the creation of a new global framework for dispute settlement. They also differ in their character, with the vast majority being institutional, mainly concerned with addressing the shortcomings of the ISDS system. Few proposals, however, call for the amendment of particular provisions in BITs to achieve several regulatory objectives.

In the investment law literature, the debates about reform are shaped by the academic interests of lawyers in the field which mainly center on the settlement of disputes. The policy aspect of international investment law, especially the design of its principal legal instrument—BITs—receives little or no attention except from select lawyers. The term "design" in this Article refers to both the legal provisions a BIT would typically consist of, as well as the policy justifications for choosing these provisions to the exclusion of all other possible provisions.

From among the small minority of policy-oriented investment lawyers, some lawyers openly theorize and debate the design of BITs as a

15. Tania Voon & Andrew D. Mitchell, *Denunciation, Termination and Survival: The Interplay of Treaty Law and International Investment Law*, 31 ICSID REV. 413, 416–7 (2016).

16. On India, see Kavaljit Singh & Burghard Ilge, *India Overhauls Its Investment Treaty Regime*, FIN. TIMES BLOG (July 15, 2016), http://blogs.ft.com/beyond-brics/2016/07/15/india-overhauls-its-investment-treaty-regime/. On Indonesia, see *Indonesia to Terminate More Than 60 Bilateral Investment Treaties*, FIN. TIMES (Mar. 26, 2014), https://www.ft.com/content/3755c1b2-b4e2-11e3-af92-00144feabdc0. On South Africa, see *Shift African Investment Towards Industry, South African Minister Recommends*, UNCTAD (Sept. 23, 2012), http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=292&Sitemap_x0020_Taxonomy=UNCTAD%20.

distinct question in international investment law.[17] Others do not openly debate the issue, but rather cite specific extra-legal theories or models as justifications of BITs' design, keeping such justifications in the background as basic assumptions of their doctrinal analysis.[18] Despite these differences, both camps predominantly support, rather than critique, the design of BITs. Hence, the question of reform does not figure prominently in their scholarship. By contrast, the opponents of the investment regime offer several critiques of BITs and the ISDS system, but their critiques do not go far enough to challenge the foundations of BITs' design. In fact, some of these critiques inadvertently support the design of BITs.

Apart from this small minority of policy-oriented investment lawyers, most lawyers in the field disregard the design of BITs altogether, considering it to be a matter that should only concern other professionals. Regardless of whether they possess specific views about the design of BITs or not, these lawyers only show interest in the settlement of disputes arising out of these treaties. As a result, the reform proposals they make, while being significant with respect to ISDS, do not address the design of BITs.

This Article contributes to the ongoing debates about the reform of the current investment regime by critiquing the design of BITs and exploring options for an alternative design of investment agreements. It investigates the relationship between the design of BITs and the four extra-legal theories the policy-oriented proponents of the investment regime generally invoke in defense of this design. These are: (1) the theory of political risk, as modeled by the obsolescing bargain model and the dynamic inconsistency problem; (2) economic growth or development; (3) economic efficiency; and (4) the theory of comparative advantage.

In relation to the first two of these theories, i.e., political risk and economic growth, the Article scrutinizes the descriptive claim that these theories can explain the design of BITs. It argues that neither of these two theories fully explains the current design. The Article also refutes the normative conclusion that BITs' design should be viewed as legitimate or desirable because it is justified by the aforementioned theories. It asserts that these theories do not legitimize but rather support

17. The works that invoke economic efficiency and comparative advantage as foundations for the design of BITs provide a good example. *See infra* Section VI.

18. This approach to the question of design is best exemplified by the works which cite, as justifications of the design of BITs, either the obsolescing bargain model or the problem of dynamic inconsistency. *See infra* Section IV.

modifying the design of BITs. The Article describes these modifications as possible options for the reform of the investment regime.

With respect to the other two theories, i.e., economic efficiency and comparative advantage, the Article describes the different ways both models have been imported into the design debate in international investment law and the lack of a systematic critique of this importation by the opponents of the investment regime. It also proposes a roadmap for future critical research on the role of these models as theories of the design of BITs.

The Article proceeds as follows: Section II explains how reconsidering the design of BITs can be an important reform agenda at the present moment of uncertainty in international investment law. Such uncertainty can be explained not only by shifts in the classical roles both developed and developing countries used to play in investment relationships, but also by the divergent reform proposals currently advocated by the main exporters and importers of FDI. Section III analyzes the lack of interest that most lawyers in the field show to the question of design. It expounds these lawyers' overemphasis on ISDS and shows how the reform agendas they advance indirectly solidify the current design of BITs. Moving on to the justifications of BITs' design, Section IV focuses on the theory of political risk. It elaborates on the ways in which the obsolescing bargain model and the dynamic inconsistency problem may explain the design of BITs. Additionally, it explores the normative consequences of fully accepting these two models as well as the broader theory of political risk as theories of design. Section V examines the relationship between the design of BITs and the models of economic growth and elucidates what a holistic consideration of the relationship between FDI and growth would suggest from the perspective of design. Finally, Section VI provides an overview of how economic efficiency and the theory of comparative advantage are widely cited by lawyers as two important explanations of BITs' design and how these two models are received by the opponents of the investment regime. The section also proposes a roadmap for a critical inquiry into the role of these models as theories of design in international investment law. Section VII concludes.

II. The International Investment Regime: A Disintegrating Consensus?

The advocates of BITs assert that the contemporary investment regime was founded on a "grand bargain," whereby developing countries agreed to limit their sovereignty in exchange for a promise to receive larger FDI flows from developed countries.[19] While a plausible

19. *See* 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, 77 (2005).

description of the world three decades ago, the concept of grand bargain no longer holds today. This is mainly because the traditional differences between developed and developing countries with regard to the exportation and importation of FDI have collapsed to a certain degree—a fact that brought about fundamental changes in the investment policies of both groups of states. Moreover, the unanimity in the 1990s and the early 2000s over the legal protection foreign investors should receive across borders gave way to growing divergence among the main players on the international investment scene, best exemplified by the incongruous proposals they put forward to reform the investment regime.

This section begins with a brief overview of the investment regime. Next, it shows how the changing dynamics in international investment relationships contributed to the heterogeneity of states' interests and, consequently, added to the uncertainty about the future of the investment regime. Finally, the section addresses the reform proposals propounded by the leading exporters and importers of FDI and explains what the redesign of BITs can uniquely offer at the present moment of confusion in international investment law.

A. *What is the Investment Regime?*

In the parlance of international investment lawyers, the "investment regime" refers to a massive web of international investment agreements comprised mainly of BITs along with "other international investment agreements."[20] The latter category encompasses a diverse group of agreements, including those with investment chapters similar to BITs, those with narrower regulation of investment than BITs, and those meant merely to enable the state parties to cooperate and/or negotiate in the future.[21] In 2018, the investment regime consisted of 3317 agreements; 2932 of these agreements were BITs, while 385 fell in the group of "other international investment agreements."[22]

20. On the view that BITs form a "global regime for investment," see Salacuse, *supra* note 5, at 427; *see also* JOSÉ E. ALVAREZ, THE PUBLIC INTERNATIONAL LAW REGIME GOVERNING INTERNATIONAL INVESTMENT 24 (2011).

21. For a typology of "other international investment agreements," see UNCTAD, WORLD INVESTMENT REPORT 84 (2012).

22. WORLD INVESTMENT REPORT, *supra* note 13, at 99; *see generally* Zachary Elkins et al., *Competing for Capital: the Diffusion of Bilateral Investment Treaties, 1960-2000*, 60 INT'L ORG. 811 (2004); Stanimir A. Alexandrov, *The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICS1D Tribunals-Shareholders as "Investors" under Investment Treaties*, 6 J. WORLD INV. & TRADE 387 (2005).

Although bilateral in form, all BITs more or less share the same structure: they only provide legal protections for foreign investors in host states, with no regulation whatsoever of any other aspect of FDI.[23] Legal protections in BITs are either absolute or relative. The former category includes provisions whose substance is defined by merely looking at the text of BITs.[24] Some of these provisions are rules such as the prohibition of expropriation and performance requirements or the right to repatriate profits. Others are standards such as the right to a minimum standard of treatment, the right to fair and equitable treatment, and the right to full protection and security.

The other category of legal protections in BITs comprises relative protections whose substance is determined only by the comparative treatment host states grant to other investors.[25] The goal of these protections is to equalize the treatment foreign investors receive from host states, which is achieved by way of two standards. The first is national treatment, which ensures that host states accord foreign investors the same treatment they provide to national investors in like circumstances. The second is the most-favored nation, which requires host states to provide the same treatment to all foreign investors in its territory regardless of their nationality, as long as they are in like circumstances.

The foregoing protections are enforceable through ISDS. This exceptionally effective mechanism allows private investors to bring claims against host states for the latter's violations of their international obligations under international investment agreements. The most relevant convention in this regard is the ICSID Convention.[26] Most BITs establish jurisdiction for ICSID over the disputes arising out of these treaties.[27] The state parties to BITs may additionally agree to settle investment disputes through ad hoc arbitration such as the UNCITRAL Arbitration Rules or the Permanent Court of Arbitration.[28] By the end of 2018, the total number of publicly known ISDS proceedings initiated by investors amounted to 942.[29]

23. *See generally* Stephan W. Schill, *The Multilateralization of International Investment Law: Emergence of a Multilateral System of Investment Protection on Bilateral Grounds*, 2 TRADE L. & DEV. 59 (2010).

24. UNCTAD, BILATERAL INVESTMENT TREATIES 1995–2006 TRENDS IN INVESTMENT RULEMAKING 28–33 (2007).

25. *Id.* at 33–43.

26. *See supra* note 14.

27. UNCTAD, DISPUTE SETTLEMENT: INVESTOR-STATE 35–37 (2003).

28. *Id.* at 34–35.

29. WORLD INVESTMENT REPORT, *supra* note 13, at 102.

B. *The Dynamic Division of Labor in International Investment*

The 1990s saw the dramatic rise of the contemporary investment regime.[30] This notable transformation brought an end to the post-colonial saga of states' permanent sovereignty over their natural resources, as well as the standard of compensation payable to aliens for the expropriation or nationalization of their property under customary international law.[31] The failure of the NIEO compelled developing countries to voluntarily limit their sovereign powers and to prioritize the attraction of FDI mostly originating in developed countries.[32] Under the new regime, expropriation, nationalization, and discrimination against foreign investors ceased to be legitimate policy tools developing host states could utilize.[33]

The new investment regime emerged against the backdrop of a specific division of labor between developed and developing countries, with developed countries being the exporters of FDI and developing countries being its importers. Such division of labor, however, did not last for too long. Some of the postwar developing countries, after undergoing intense industrialization in the 1960s and 1970s, became developed capital-exporting countries in the following decades.[34] Others preserved their classification as developing countries while simultaneously turning into leading capital exporters.[35] Developed

30. UNCTAD, TRENDS IN INTERNATIONAL INVESTMENT AGREEMENTS: OVERVIEW 44 (1999).

31. DONALD R. SHEA, THE CALVO CLAUSE: A PROBLEM OF INTER-AMERICAN AND INTERNATIONAL LAW AND DIPLOMACY 17–20 (1955); *see also* Denise Manning-Cabrol, *The Imminent Death of the Calvo Clause and the Re birth of the Calvo Principle: Equality of Foreign and National Investors*, 26 L. & POL'Y INT'L BUS. 1169 (1995). *But cf.* Wenhua Shan, *Is Calvo Dead?* 55 AM. J. COMP. L. 123 (2007) (affirming the possible resurgence of the Calvo doctrine in Latin America despite having already fallen into disuse).

32. *See* Manuel Jr. Pastor, *Latin America, The Debt Crisis, and the International Monetary Fund*, 16 LATIN AM. PERSP. 79 (1989).

33. *See* Michael S. Minor, *The Demise of Expropriation as an Instrument of LDC Policy 1980-1992*, 25 J. INT'L BUS. STUD. 177 (1994).

34. A notable example is South Korea, which became a member of the OECD in 1996. *See generally* ALICE H. AMSDEN, ASIA'S NEXT GIANT: SOUTH KOREA AND LATE INDUSTRIALIZATION (1989).

35. In 2018, China was the world's second largest recipient and exporter of FDI. WORLD INVESTMENT REPORT, *supra* note 13, at 3–7. In addition, in 2014, "developing Asia" became the leading capital-exporting region in the world and the source of almost one third of total world FDI. UNCTAD, WORLD INVESTMENT REPORT 5 (2015). Similarly, in 2007, Malaysia became a net capital exporter. *See* Philip J. Kitchen & Syed Z. Ahmad, *Outward investments by developing country firms: the case of emerging Malaysian corporations*, 2 INT'L J. BUS. & MGMT. 122 (2007). *See generally* Jie Wang, *Investor-State Arbitration: Where Does China Stand?* 32 SUFFOLK TRANSNAT'L L. REV. 493 (2009); Tham S. Yean, *Outward foreign direct investment from Malaysia: an exploratory study*, 26 J. CURRENT SOUTHEAST ASIAN AFF. 44 (2005).

countries were no exception in terms of playing the dual role of capital exporters and importers. The United States, for instance, was both the largest exporter and importer of FDI in the world in 2017.[36] As a result, the classical distinctions in international investment between capital exporters and importers, developed and developing countries, or the center and the periphery, have become somewhat outdated.[37]

In addition to these structural transformations, the dynamism of the roles states play under international investment law can also be attributed to the bilateral character of BITs. Because these treaties create mutual obligations for their state parties, states are equally exposed, at least theoretically, to the risk of appearing as respondents in ISDS. It is therefore not necessarily favorable for states, even if they are net capital exporters, to adopt excessively protective BITs since they can be held liable under the same strict standards applicable to their treaty partners.[38] Stated differently, the drafters of BITs always face a tradeoff between providing national investors with heightened protection abroad and enjoying more regulatory flexibility at home.[39]

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36. UNCTAD, WORLD INVESTMENT REPORT 3–6 (2018).

37. The genealogy of the center/periphery distinction goes back to the dependency theory and the world systems analysis. *See* RAUL PREBISCH, THE ECONOMIC DEVELOPMENT OF LATIN AMERICA AND ITS PRINCIPAL PROBLEMS (1950); Giovanni Arrighi, THE LONG TWENTIETH CENTURY (1994); IMMANUEL WALLERSTEIN, THE ESSENTIAL WALLERSTEIN 56 (2000).

38. For instance, the earlier U.S. BITs were among the most protective of foreign investors abroad. During the 1980s, it was merely a theoretical possibility that the strict standards of U.S. BITs would be invoked against the U.S. government by investors from U.S. treaty partners. José E. Alvarez, for instance, notes that "[t]he regulatory burdens of this treaty [referring to U.S. BITs] fell almost entirely on our (LDC) BIT partners. It was the Grenadas and Bangladeshes of the world that had to reform their laws and practices to be sure that they could satisfy the U.S. BIT's treatment standards. The United States did not need to worry very much about adapting its laws or practices . . . because, given the one-way flow of capital between the relevant parties, it was extremely unlikely that investors from any of those countries would emerge in any significant numbers with a presence in the United States, much less be in a position to file a complaint against the United States for breach of the BIT." José E. Alvarez, *The Evolving BIT*, 7 TRANSNAT'L DISP. MGMT., no. 1, Apr. 2010, at 3. Several factors motivated the U.S. to revise its earlier Model BITs by way of limiting their disciplines and carving out more sovereign exceptions. These factors include the U.S. experience as a defendant under NAFTA, the numerous ICSID decisions rendered against Argentina in relation to the claims arising from its 1998-2002 crisis to which the US-Argentina BIT was applicable, and the persistent advocacy of NGOs to include environmental and human rights norms in BITs. *See, e.g.*, Kenneth J. Vandevelde, *A Comparison of the 2004 and 1994 U.S. Model BITs: Rebalancing Investor and Host Country Interests*, 2009 Y.B. INT'L INV. L. & POL'Y 283 (Karl P. Sauvant ed., 2008).

39. In contrast to the U.S., China curtailed the disciplines of the earlier BITs it signed while being a net capital-importing country. In the 1990s, however, it began to expand outwardly as a capital exporter. As a result, China adopted more rigorous BITs in order to guarantee a higher level of legal protection for its national investors abroad. On the development of Chinese BITs,

The fluidity of states' positions under the investment regime, however, does not mean that we cannot categorize states according to the roles they usually play in investment relationships into two relatively stable and distinct groups. The first encompasses "home states" which are the states that typically promote BITs as a legal framework for the governance of FDI; the states which develop national BIT programs; the states whose nationals usually appear in ISDS as claimants; the states which are generally in favor of FDI liberalization; and the states which are mostly high- or middle-income. The second group includes "host states" which are the states that are largely on the receiving end of BIT promotion campaigns; the states which sign BITs upon the initiation of capital-exporting counterparts; the states which frequently appear as respondents in ISDS; the states which more or less seek a larger domestic policy space; and the states which are mostly middle- or low-income.[40]

A third source of dynamism under the investment regime is the current attempts to make BITs the default regulatory framework of FDI among developed countries.[41] The investment chapter in TTIP

see Stephan W. Schill, *Tearing down the Great Wall: The New Generation Investment Treaties of the People's Republic of China*, 15 CARDOZO J. INT'L & COMP. L. 73 (2007); THE ECONOMIC INTELLIGENCE UNIT, EVALUATING A POTENTIAL US-CHINA BILATERAL INVESTMENT TREATY (2010); Tong Qi, *How Exactly Does China Consent to Investor-State Arbitration: On the First ICSID Case against China*, 5 CONTEMP. ASIA ARB. J. 265 (2012); Duncan Freeman, *China's Outward Investment Institutions, Constraints, and Challenges*, 45 J. WORLD BUS. 1 (2010).

40. Most BITs are based on model treaties designed by capital-exporting states to which only minor modifications may be added following negotiations with capital-importing BIT partners. *See* Todd Allee & Clint Peinhardt, *Revisiting "Rational Design": Preferences, Power, and the Design of Bilateral Investment Treaties*, Paper presented at the Workshop on the Politics of Preferential Trade Agreements, Princeton, NJ, (Apr. 2010). Alvarez's description of the U.S. BIT partners, at least during the early years of the U.S. BIT program, is very telling: "BIT partners turn to the U.S. BIT with the equivalent of an IMF gun pointed at their heads . . . For many, a BIT relationship is hardly a voluntary, uncoerced transaction. They feel that they must enter into the arrangement, or that they would be foolish not to, since they have already made the internal adjustments required for BIT participation in order to comply with demands made by, for example, the IMF." José E. Alvarez, *The Development and Expansion of Bilateral Investment Treaties*, 86 AM. SOC'Y INT'L L. PROC. 532, 550 (1992); *see also* Wolfgang Alschner & Dmitriy Skougarevskiy, *Mapping the Universe of International Investment Agreements*, 19 J. INT'L ECON. L. 561 (2016).

41. Todd Tucker, *The TPP Has a Provision Many Will Love to Hate: ISDS. What Is It, and Why Does It Matter?*, WASH. POST: MONKEY CAGE (Oct. 6, 2015), https://www.washingtonpost.com/news/monkey-cage/wp/2015/10/06/the-tpp-has-a-provision-many-will-love-to-hate-isds-what-is-it-and-why-does-it-matter/?noredirect=on&utm_term=.cbc58a81c602 (insisting that "the old argument that ISDS is only necessary because of poor nations' weak court systems must be officially retired" and adding that "indeed, ISDS would have to be seen as a core part of economic governance at the center of the world's most important trading relationships").

provides an instructive example in this respect.[42] Traditionally, the parties to BITs were developed countries, on the one hand, and developing countries, on the other hand. As such, developed countries rarely appeared as respondents in ISDS. Should these recent initiatives come to fruition, developed countries will run a higher risk of appearing as respondents in ISDS and of being "bitten" by BITs.

C. *Divergent Reforms*

The shifting roles of countries under international investment law, coupled with the checkered experience of many of them attracting larger flows of FDI and appearing as respondents in ISDS, made the reform of the investment regime a pressing priority. But the fact that many countries share this goal does not mean that they agree about what the regime should become. In fact, the striking disagreement among countries in this regard shows that the standardized legal protection the investment regime sought and largely managed to secure for investors across borders in the past is coming to an end.

First and foremost, the United States does not seem supportive of any far-reaching reform of the investment regime. The U.S. BIT policy has largely been stable since 2004. Major changes were brought about by the 2004 Model BIT, especially in relation to the previous Model of 1994. The 2004 Model limited the protections accorded to foreign investors, reinforced the regulatory capacity of host states in several respects, increased the openness of ISDS, and provided for host states' obligations to respect labor rights and protect the environment.[43] The 2012 Model included minor revisions to the 2004 Model, expanding the regulatory powers of host states in the financial sector and adding more refined clauses for labor and environmental protection which nonetheless remain unenforceable through ISDS, i.e., they can be enforced only through state-state dispute settlement.[44] But apart from these modest changes, the United States is in favor of the continuation of its BIT policy as it currently stands, provided that the hortatory

42. Shayerah Ilias Akhtar & Vivian C. Jones, *Transatlantic Trade and Investment Partnership (TTIP) Negotiations*, *in* CONG. RES. SERV. 2014, at 28–31 (Cong. Res. Serv. No. R43158, 2014).

43. Lise Johnson, *The 2012 US Model BIT and What the Changes (or Lack Thereof) Suggest About Future Investment Treaties*, 8 POL. RISK INSURANCE NEWS., no. 2, (Robert Wray PLLC, Washington, D.C.), Nov. 2012, at 2, http://www.robertwraypllc.com/wp-content/uploads/2012/11/RWPLLC-POLITICAL-RISK-INSURANCE-NEWSLETTER-VOLUME-VIII-ISSUE-2-2.pdf; Stephen M. Schwebel, *The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law*, 3 TRANSNAT'L DISP. MGMT., no. 2, Apr. 2006, at 3–7.

44. Johnson, *supra* note 43, at 5, 8.

requirement that "investors in the United States are not accorded greater substantive rights than domestic investors" is respected.[45]

In the EU, the negotiation of investment agreements has become the exclusive competence of the European Commission (EC) upon the entry into force of the EU Lisbon Treaty on December 1, 2009.[46] Substantively, the EU and the United States agree about the main standards of investment protection. However, the former qualifies its support of these standards by the requirement that they "should be consistent with the other policies of the Union and its Member States."[47] This requirement drives a wedge between the EU and the United States with regard to ISDS. As the recent EU-Canada Free Trade Agreement shows, the EU investment agreements currently provide for the settlement of investment disputes by a permanent tribunal or court.[48] The EC insists that these forums are more sensitive to the EU law than ad hoc investment tribunals. Broadly speaking, the EC's vision for the reform of the investment regime prioritizes the establishment of a multilateral investment court which would replace the currently decentralized ISDS system.[49]

By contrast, several leading developing countries have either drafted new model investment agreements or enacted domestic legislations which considerably depart from BITs. For instance, India adopted a new Model BIT in 2015 which includes significant modifications to the

45. U.S. TRADE REP., EXEC. OFFICE OF THE PRESIDENT, SUMMARY OF OBJECTIVES FOR THE NAFTA RENEGOTIATION, 8 (2017), https://ustr.gov/sites/default/files/files/Press/Releases/Nov%20Objectives%20Update.pdf.

46. Consolidated Version of the Treaty on the Functioning of the European Union, May 9, 2008, 2008 O.J. (C115). Article 3.2 provides that "[t]he Union shall also have exclusive competence for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence, or in so far as its conclusion may affect common rules or alter their scope."

47. EUROPEAN COMMISSION, COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE EUROPEAN PARLIAMENT, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS: TOWARDS A COMPREHENSIVE EUROPEAN INTERNATIONAL INVESTMENT POLICY 9 (July 7, 2010), https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0343:FIN:EN:PDF.

48. European Commission, *Investment Provisions in the EU-Canada Free Trade Agreement (CETA)*, 4 (Feb. 1, 2016), http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf.

49. European Commission, *Factsheet*, (July 10, 2017), http://trade.ec.europa.eu/doclib/docs/2017/july/tradoc_155744.pdf. In 2015, the European Commission advocated the establishment of an investment court during the negotiations with the U.S. over the TTIP. European Commission, *TTIP Textual Proposal on Investment Protection and Investment Court System*, (Nov. 12, 2015), http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf. The proposal followed the overwhelming rejection of adding conventional ISDS provisions to the TTIP in the public consultation held by the European Commission in 2014. *See* EUROPEAN COMMISSION, *supra* note 9.

protections found in conventional BITs.[50] One of the most important changes brought about by the new Model is the complete elimination of the most-favored-nation standard.[51] Additionally, while preserving ISDS in principle, the new Model raises the procedural requirements investors must meet in order to be able to initiate a claim against the host state.[52]

In the same vein, after relying for so long on its domestic law as the sole legal framework governing FDI inflows, Brazil has recently developed a new model investment agreement known as the Cooperation and Facilitation Investment Agreement (CFIA). The new model agreement deviates from BITs in various respects, the most notable being that it leaves out ISDS completely while establishing two novel mediation procedures: the Joint Committees and the Ombudsmen (or Focal Points).[53] As of 2015, Brazil has signed CFIAs with Angola, Chile, Colombia, Malawi, Mexico, and Mozambique and initiated negotiations of similar agreements with Algeria, India, Morocco, Nigeria, Peru, South Africa, and Tunisia.[54]

Unlike Brazil and India, South Africa implemented its reform agenda through domestic law. In 2015, the South African Parliament adopted the Promotion and Protection of Investment Bill, which overturned some of the most salient innovations of the current investment regime. The new Bill does not accord foreign investors fair and equitable treatment or the most-favored-nation treatment and excludes ISDS altogether.[55] It also envisions that recourse to international arbitration shall be had only to settle potential disputes between home and host states, provided that the two states consent to such arbitration.[56] Additionally, unlike most BITs, the new Bill does not provide for full

50. Grant Hanessian & Kabir Duggal, *The Final 2015 Indian Model BIT: Is This the Change the World Wishes to See?* 32.1 ICSID REV.—FOREIGN INV. L.J. 216, 216 (2017).

51. *Id.* at 220.

52. *Id.* at 221–24. On the ways in which many host states are increasingly limiting foreign investors' access to arbitration in the new generation of BITs, see Leon E. Trakman & David Musayelyan, *The Repudiation of Investor–State Arbitration and Subsequent Treaty Practice: The Resurgence of Qualified Investor–State Arbitration*, 31 ICSID REV.—FOREIGN INV. L.J. 194 (2016).

53. Vivian Gabriel, *The New Brazilian Cooperation and Facilitation Investment Agreement: An Analysis of the Conflict Resolution Mechanism in Light of the Theory of the Shadow of the Law*, 34 CONFLICT RESOL. Q. 141, 147–48 (2016).

54. *Id.* at 145.

55. *See* Protection of Investment Act 22 of 2015 (S. Afr.). https://www.gov.za/sites/default/files/gcis_document/201512/39514act22of2015protectionofinvestmentact.pdf. Accordingly, unless otherwise agreed upon, foreign investors in South Africa may only bring their claims against the South African government before domestic courts.

56. *Id.* art. 12.

market value as the standard of compensation for the expropriation of foreign investments.[57]

The preceding reforms vindicate the earlier assertion of this Article that the global consensus on the governance of FDI of the 1990s is breaking apart. While some of the main players in the field, such as the United States, the EU, and China, remain committed to that consensus, more and more influential countries are breaking away. Upon a closer look, it turns out that even the former countries are not in full agreement about the future of the investment regime.

Against this backdrop, the present critique of the theoretical foundations of the design of BITs aims to safeguard globalism in international investment law at a moment when discordant nationalist solutions are on the rise. It is an initial, necessary step towards reimaging international investment agreements. A new design of investment agreements that takes into account the recent dramatic shifts in global investment flows and the evolving interests of states may facilitate a new consensus in the field. It will also provide a serious alternative to the two options states currently have under the current system: the acceptance of the limited reforms offered by the loyalists to the "old" global consensus; or, the defection from the investment regime altogether.

Until a new consensus emerges, however, the old consensus will likely remain the dominant model for regulating FDI across borders, even if in a restrained form. Thus, it remains indispensable for any project aiming to reimagine international investment law to engage with this consensus, specifically the arguments made to explain and justify the design of its main legal instrument—BITs.

III. The Mainstream View and the Uncontested Design of BITs

This section reviews the ways in which the majority of investment lawyers take the design of BITs for granted, focusing instead on BITs' operationalization through ISDS and thereby ruling out the possibility of reform by way of redesign. The section begins by shedding light on mainstream scholarship in international investment law. It then looks at the main reform proposals offered in this strand of scholarship. Finally, it explains how the general disinterest in design among investment lawyers limits the range of imaginable reforms. The section critiques the mainstream view according to which BITs can simply be operationalized without recourse to a coherent theory of design. It

57. S. Afr. Const., 1996, art. 9 (providing that the property of investors shall be protected in accordance with Section 25 of the South African Constitution which establishes the standard of "just and equitable compensation").

asserts that, even for those lawyers exclusively interested in ISDS, a theory for the design of BITs remains indispensable.

A. *The Contours of Mainstream Scholarship*

Perhaps the most distinctive character of investment law scholarship is its overriding commitment to legal positivism. In legal theory, positivism refers to a particular understanding of law as a social fact or, more specifically, as the command of the sovereign which is backed by material sanction.[58] Law is viewed from this vantage point as a bundle of edicts that are perfectly separable from their extra-legal origin, be it religious, moral, philosophical, or economic, and whose violation entails a specific penalty. Positivist lawyers believe that their sole professional task is to enforce the law regardless of their approval or disapproval of its origins or content. Thinking about law beyond pure enforcement thus ceases to be the task of lawyers and becomes the exclusive competence of legislators.

In international investment law, most lawyers take the design of BITs for granted while assuming that some justification of this design can be found in economics or political science—two areas which do not implicate lawyers. As bargains between two sovereigns, BITs are thought capable of creating whatever rights and obligations the parties deem fit. What solely matters from these lawyers' perspective is that sovereigns abide by their agreements, as long as they were duly adopted, pursuant to the famous international legal principle *pacta sunt servanda*. Most investment lawyers accordingly limit their role to settling the disputes which arise under BITs, understood as nothing but the extrapolation of the will of the parties embodied in those treaties. Such complete avoidance of the question of design is clearly seen in a mushrooming number of treatises and academic articles whose primary, if not only, preoccupation is the interpretation of the provisions of BITs.[59]

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58. *See* JOHN AUSTIN, THE PROVINCE OF JURISPRUDENCE DETERMINED 157 (W.E. Rumble ed., 1995); JEREMY BENTHAM, OF LAWS IN GENERAL (H.L.A. Hart ed., 1970) (1782); HANS KELSEN, PURE THEORY OF LAW (M. Knight. ed., 1967); H.L.A Hart, *Positivism and the Separation of Law and Morals*, 71.4 HARV. L. REV. 593 (1958).

59. The following is a representative sample of how scholars approach different topics in international investment law from a positivist perspective: THOMAS POLLAN, LEGAL FRAMEWORK FOR THE ADMISSION OF FDI (2006); YVES DERAINS AND RICHARD H. KREINDLER, EVALUATION OF DAMAGES IN INTERNATIONAL ARBITRATION (2006); Andrea K. Bjorklund, *National Treatment*, *in* STANDARDS OF INVESTMENT PROTECTION 29 (August Reinisch ed., 2008); Anthony C. Sinclair, *The Substance of Nationality Requirements in Investment Treaty Arbitration*, 20 ICSID REV. 357 (2005); Julian Davis Mortenson, *The Meaning of "Investment": ICSID's Travaux and the Domain of International Investment Law*, 51 HARV. INT'L L.J. 257 (2010); Stephen Vasciannie, *The Fair and*

Occasionally, however, mainstream scholars address the design of BITs as part of their discussion of the history of international investment law. The consideration of design in this context is nevertheless limited to a brief standardized introduction about the genesis of BITs.[60] Authors point out how BITs emerged against a background of indeterminacy about the customary international legal standards applicable to the expropriation of the property of aliens. They note that this legal uncertainty was exacerbated by the UN General Assembly resolutions which established the NIEO.[61] In a celebratory mode, they commend BITs for having rendered international investment law concrete and determinate before quickly transitioning to the analysis of doctrine.

The construction of a "mainstream" as a distinct, coherent scholarly strand in investment law scholarship is by no means straightforward. This is because the same legal arguments can be made in both positivist and non-positivist modes. What decisively distinguishes the positivist mainstream, however, is the excessive preoccupation with dispute settlement and the general avoidance of policy questions except those which are necessary for the interpretation and enforcement of investment agreements. For example, the critique of the doctrinal variations among BITs—which will be discussed later in detail—is positivist if it is

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Equitable Standard in International Investment Law and Practice, 70 BYIL 99, 104 (1999); Christoph Schreuer, *Full Protection and Security*, 1 J. INT'L DISP. SETTLEMENT 353 (2010); Ruth Teitelbaum, *Who's Afraid of Maffezini-Recent Developments in the Interpretation of Most Favored Nation Clauses*, 22 J. INT'L ARB. 225 (2005); L.Y. Fortier & S.L. Drymer, *Indirect Expropriation in the Law of International Investment: I Know When I See It, or Caveat Investor*, 19 ICSID REV. FOREIGN INV. L.J. 293 (2004); Jarrod Wong, *Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide between Developing and Developed Countries in Foreign Investment Disputes*, 14 GEO. MASON L. REV. 135 (2006).

60. For example, standard textbooks in the field discuss in passing the mid-twentieth century controversy over whether the Hull doctrine or the Calvo doctrine represented the customary international legal standard applicable to the expropriation of aliens. They also highlight how this debate has largely come to an end under modern BITs, which adopted the Hull doctrine on a conventional basis. *See, e.g.*, RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 1–12 (2012); KRISTA N. SCHEFER, INTERNATIONAL INVESTMENT LAW TEXT, CASES AND MATERIALS 3–10 (2013). Some textbooks completely skip the history of the investment regime. *See, e.g.*, CAMPBELL MCLACHLAN ET AL., INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (2007).

61. The cornerstone of the NIEO was the Declaration on the Establishment of a New International Economic Order and the Programme of Action adopted by a divisive vote at the U.N. General Assembly in May 1974. In the same year, the General Assembly adopted the Charter of Economic Rights and Duties of States. *See* G.A. Res. 3201 (S-VI), Declaration on the Establishment of a New International Economic Order (May 1, 1974); G.A. Res. 3202 (S-VI), Programme of Action on the Establishment of a New International Economic Order (May 1, 1974); G.A. Res. 3281 (XXIX), Charter of Economic Rights and Duties of States (Dec. 12, 1974).

only concerned with jurisprudential coherence in the case law. By contrast, the same critique is considered non-positivist if it is also motivated by considerations beyond dispute settlement, such as the potential negative impact of these variations on the global allocation of FDI.[62] In both cases, the critiques are substantively identical, but they differ considerably in their rationales, the debates they engender, and possibly the programs they advocate for. Only a non-positivist perspective of international investment law would make questioning the design of BITs possible. It should also be borne in mind that the same authors may alternate between the two styles of argumentation instead of committing to only one approach across the board.

Two different explanations can be given for the prevalence of positivism in investment law scholarship: one is offered by comparative law and the other is derived from political economy. The first explanation pertains to the background of many prominent scholars and practitioners in the field. Unlike other branches of international law, the main textbooks on international investment law, as well as a fairly large number of academic articles, are produced in continental Europe. In addition, European lawyers play a major role in the settlement of international investment disputes. The statistics of ICSID show that European arbitrators enjoy the lion's share of arbitral appointments in the cases administered by ICSID, with French lawyers topping the list.[63] Within continental Europe, the objectivity of legal scholarship and the isolation of law from the influence of other social sciences remain the dominant mode of legal thought up to this day.[64]

An alternative explanation is that the positivist approach allows lawyers in the field to signal their expertise while preserving an impartial

62. *See, e.g.*, Serge Brunner & David Folly, *The Way to a Multilateral Investment Agreement* (Swiss Nat'l Ctr. of Competence in Research, Working Paper No. 2007/24, 2007), https://pdfs.semanticscholar.org/a67a/c7bb19d0a54d965d99883404d6d80d29397e.pdf. Other examples can be given for how non-positivist scholarship in the field differs from the positivist mainstream. On inconsistency in investment arbitration case law, see Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005). On the decentralization of ISDS and the possible competition between domestic and international forums, see Andrea K. Bjorklund, *Private Rights and Public International Law: Why Competition Among International Economic Law Tribunals Is Not Working*, 59 HASTINGS L.J. 241 (2007). On the competing paradigms in international investment law, see Susan D. Franck, *The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future?* 12 U.C. DAVIS J. INT'L L. & POL'Y 47, 69–79 (2005).

63. *See* ICSID, 1 ICSID CASELOAD – STATISTICS 22 (2018).

64. Duncan Kennedy, *The Disenchantment of Logically Formal Legal Rationality, or Max Weber's Sociology in the Genealogy of the Contemporary Mode of Western Legal Thought*, 55 HASTINGS L.J. 1031, 1070 (2004).

professional standing indispensable for participation in such a highly selective area of practice. The case law establishes that the expression of academic opinions on the investment regime does not per se disqualify arbitrators in any specific case.[65] Nevertheless, the consensual nature of arbitral appointments inevitably imposes a chilling effect on the views expressed by the lawyers aspiring to serve as arbitrators.[66] Labeling any practitioner as "biased" either jeopardizes her prospects of future appointment or, at least, limits her involvement in disputes settlement to specific roles, i.e., the claimants' or the respondents' side. By avoiding policy questions altogether, and by limiting legal scholarship to the interpretation of doctrine, mainstream lawyers create a space where they can showcase their skills, and even express normative views about the investment regime, in an apolitical fashion. In doing so, they are able to preserve the neutrality of the profession which all investment lawyers have high stakes in.

B. *The Positivist Agenda(s) of Reform*

Notwithstanding the dominance of positivism in investment law scholarship, mainstream lawyers offer the most influential proposals in the legal debates about reform. They call for a wide range of doctrinal and institutional changes in the investment regime which aim to reinforce jurisprudential coherence in the case law and remedy what the critics of ISDS point out as sources of institutional illegitimacy. Apart from addressing these specific shortcomings, mainstream scholarship keeps the core structure of the investment regime intact.[67] As a result, reform by redesign remains an unimaginable option.

65. *See* Urbaser S.A. & Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic, ICSID Case No. ARB/07/26, Decision on Claimant's Proposal to Disqualify Professor Campbell McLachlan, Arbitrator ¶ 20–59 (Aug. 12, 2010); *see also* Michael Hwang & Kevin Lim, *Issue Conflict in ICSID Arbitrations*, 8 TRANSNAT'L DISP. MGMT., no. 5, Dec. 2011, at 20–23.

66. Stephan W. Schill, *W(h)ither Fragmentation? On the Literature and Sociology of International Investment Law*, 22 EUR. J. INT'L L. 875, 892 (2011).

67. For an archetypal example, see Luis González García, *Making Impossible Investor-State Reform Possible*, 11 TRANSNAT'L DISP. MGMT., no. 1, Jan. 2014. The author reviews five different reform proposals put forward by UNCTAD and dismisses each one of them. He appeals to the fact that such reforms would entail a revision of BITs' design (which to him seems both impractical and of little added value) in order to justify his conclusions. He instead offers several institutional changes to the ISDS system, all of which keep the design of BITs unaltered. These include changing the way arbitrators are selected, setting clearer ethical guidelines for arbitrators, and creating a new international body for the harmonization of international investment law.

Doctrinally, as was noted earlier, the investment regime is mainly comprised of BITs which provide foreign investors with more or less standardized legal protections.[68] Nevertheless, the fact that BITs are negotiated and signed on a bilateral basis results, at times, in substantive variations among these treaties. For mainstream scholars, the massive number of BITs and the possible doctrinal differences among them are one of the main obstacles to developing coherent case law in the field.[69] This leads some to argue that, despite the explosion in the number of BITs signed over the past two decades, BITs have failed to create clear and coherent customary international legal rules on the protection of foreign investors that can bind host states on a non-conventional basis.[70]

Another doctrinal challenge facing the investment regime is highlighted by outsiders to the field. Many scholars raise concerns about the possibility that international investment law might grow more isolated from other subfields of international law as a manifestation of the increasing compartmentalization of international law.[71] A related critique emphasizes the potential tensions between the duties BITs impose on host states for the benefit of foreign investors and the obligations these states owe to their own citizens under human rights treaties.[72] Likewise, authors note a possible conflict between the protection

68. *See* Salacuse *supra* note 5, at 427–28.

69. *See* IOANA TUDOR, THE FAIR AND EQUITABLE TREATMENT STANDARD IN THE INTERNATIONAL LAW OF FOREIGN INVESTMENT 19–52 (2008); Catherine Yannaca-Small, *Fair and Equitable Treatment Standard in International Investment Law* 2 (OECD Working Papers on International Investment, 2004/03, 2004), https://www.oecd.org/daf/inv/investment-policy/WP-2004_3.pdf. Both authors highlight the different formulations of the fair and equitable treatment standard in BITs. *See also* Anna Joubin-Bret, *The Growing Diversity and Inconsistency in the IIA System*, *in* APPEALS MECHANISMS IN INTERNATIONAL INVESTMENT DISPUTES 137, 137–38 (Karl P. Sauvant ed., 2008); Juillard, *supra* note 5, at 81–82.

70. For example, Kishoiyian argues that the doctrinal differences among BITs make it more plausible to conclude that BITs represent lex specialis rather than the new customary international law of the protection of FDI in host states. *See* Bernard Kishoiyian, *The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law*, 14 NW. J. INT'L L. & BUS. 327 (1993); *see also* Patrick Dumberry, *Are BITs Representing the "New" Customary International Law?* 28 PENN. ST. INT'L L. REV. 675 (2010). *But see* José E. Alvarez, *A BIT on Custom*, 42 N.Y.U. J. INT'L L. & POL'Y 17, 44 (2009).

71. *See, e.g.*, Campbell McLachlan, *Investment Treaties and General International Law*, 57 INT'L & COMP. L.Q. 361 (2008); INTERNATIONAL INVESTMENT LAW AND GENERAL INTERNATIONAL LAW—FROM CLINICAL ISOLATION TO SYSTEMIC INTEGRATION? (Rainer Hofmann & Christian J. Tams eds., 2011).

72. *See, e.g.*, Annika Wythes, *Investor-State Arbitrations: Can the "Fair and Equitable Treatment" Clause Consider International Human Rights Obligations?* 23 LEIDEN J. INT'L L. 241 (2010). On the intersection of investment law and human rights, see generally LUKE ERIC PETERSON, HUMAN

of foreign investors under BITs and host states' obligations to protect the environment.[73]

The mainstream response to the compartmentalization critique is to advocate the interpretation of BITs in a way that achieves more harmony between international investment law and the other branches of international law—a principle known as "systematic integration" in international law.[74] In recent years, scholars have discussed different interpretative strategies to make investment arbitration more receptive to human rights norms.[75] Likewise, proposals are made to include non-justiciable provisions in BITs calling on state parties to refrain from lowering their environmental and labor standards as a means to attract FDI.[76] Apart from these solutions, redesigning BITs, for instance by adding enforceable provisions on human rights, environmental protection, or labor rights, remains a peripheral proposition in mainstream scholarship.[77]

The settlement of investment disputes is the area which attracts most interest in the mainstream debates about reform. Scholars discuss at length the deficiencies in the current ISDS system. They focus first and foremost on the jurisprudential divides among investment tribunals. These schisms, which impact all the legal protections provided by BITs, are manifested in the notoriously inconsistent decisions rendered by

RIGHTS AND BILATERAL INVESTMENT TREATIES: MAPPING THE ROLE OF HUMAN RIGHTS LAW WITHIN INVESTOR-STATE ARBITRATION. RIGHTS AND DEMOCRACY (2009); PIERRE-MARIE DUPUY ET AL., HUMAN RIGHTS IN INTERNATIONAL INVESTMENT LAW AND ARBITRATION (Pierre-Marie Dupuy et al. eds., 2009); LUKE ERIC PETERSON & KEVIN R. GRAY, INT'L INST. FOR SUSTAINABLE DEV., INTERNATIONAL HUMAN RIGHTS IN BILATERAL INVESTMENT TREATIES AND IN INVESTMENT TREATY ARBITRATION (International Institute for Sustainable Development, 2003) https://iisd.org/pdf/2003/investment_int_human_rights_bits.pdf.

73. *See, e.g.*, Joseph A. Strazzeri, *A Lucas Analysis of Regulatory Expropriations under NAFTA Chapter Eleven*, 14 GEO. INT'L ENVTL. L. REV. 837 (2002); J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465 (1999); SAVERIO DI BENEDETTO, INTERNATIONAL INVESTMENT LAW AND THE ENVIRONMENT (2013).

74. *See generally* Campbell McLachlan, *The Principle of Systemic Integration and Article 31(3)(C) of the Vienna Convention*, 54 INT'L & COMP. L. Q. 279 (2005).

75. Bruno Simma, *Foreign Investment Arbitration: A Place for Human Rights?*, 60 INT'L COMP. L. Q. 573, 581–92 (2011); Wythes, *supra* note 72, at 241–56; Valentina Sara Vadi, *Reconciling Public Health and Investor Rights: The Case of Tobacco*, *in* HUMAN RIGHTS IN INTERNATIONAL INVESTMENT LAW AND ARBITRATION 485–86 (Pierre-Marie Dupuy et al. eds., 2009); *see also* Ursula Kriebaum, *Privatizing Human Rights: The Interface between International Investment Protection and Human Rights*, 3 TRANSNAT'L DISP. MGMT., no. 5, Dec. 2006.

76. Mary E. Footer, *Bits and Pieces: Social and Environmental Protection in the Regulation of Foreign Investment*, 18 MICH. ST. U.C.L. J. INT'L L. 33, 42–46 (2009).

77. *See, e.g.*, Yira Segrera Ayala, *Restoring the Balance in Bilateral Investment Treaties: Incorporating Human Rights Clauses*, 32 REVISTA DE DER. 139 (2009), http://www.redalyc.org/pdf/851/85112936007.pdf.

investment tribunals in similar cases.[78] Some scholars even go as far as to characterize the lack of coherence in the investment arbitration case law as a "legitimacy crisis" in the field.[79]

The analysis of the root causes of jurisprudential incoherence in investment arbitration takes mainstream lawyers in different directions. For some, the doctrinal variations among BITs are the primary cause of incongruity in the case law.[80] For others, the decentralization of the ISDS system is the culprit.[81] Lawyers who subscribe to this latter view explain the lack of a unified interpretation of BITs by appealing to the absence of an institution, similar to the WTO Dispute Settlement Body, which would monopolize the settlement of investment disputes globally. A third group of lawyers disagree with the previous perspective, claiming that the mere absence of a centralized system for the settlement of investment disputes is not an insurmountable problem. They argue that, although tribunals are not formally bound by the earlier decisions of other tribunals on the same questions,[82] the case law can still be coherent if a de facto doctrine of stare decisis is recognized in investment arbitration.[83] This way, they maintain, like cases would be

78. Gabriel Egli, *Don't Get Bit: Addressing ICSID's Inconsistent Application of Most-Favored-Nation Clauses to Dispute Resolution Provisions*, 34 PEPP. L. REV. 1045 (2006); August Reinisch, *Necessity in International Investment Arbitration - An Unnecessary Split of Opinions in Recent ICSID Cases? Comments on CMS v. Argentina and LG&E v. Argentina*, 3 TRANSNAT'L. DISP. MGMT., no. 5, Dec. 2006, at 5; James Crawford, *Similarity of Issues in Disputes Arising under the Same or Similarly Drafted Investment Treaties*, *in* PRECEDENT IN INTERNATIONAL ARBITRATION 97, 97–103 (Emmanuel Gaillard & Yas Banifatemi, eds., 2008); Rudolf Dolzer, *Perspectives for Investment Arbitration: Consistency as a Policy Goal?*, 9 TRANSNAT'L DISP. MGMT., no. 3, Apr. 2012; Leah D Harhay, *Investment Arbitration in 2021: A Look to Diversity and Consistency*, 18 SW. J. INT'L L. 89, 94–97 (2011).

79. Charles H. Brower, *Structure, Legitimacy, and NAFTA's Investment Chapter*, 36 VAND. J. TRANSNAT'L L. 37, 52–53, 66-68 (2003); MARIEL DIMSEY, THE RESOLUTION OF INTERNATIONAL INVESTMENT DISPUTES: CHALLENGES AND SOLUTIONS 35–100 (2008).

80. *See supra* note 70 and accompanying text.

81. Schill, *supra* note 66, at 890; David D. Caron, *Investor State Arbitration: Strategic and Tactical Perspectives on Legitimacy*, 32 SUFFOLK TRANSNAT'L L. REV. 513, 516-18 (2009); Barton Legum, *Options to Establish an Appellate Mechanism for Investment Disputes*, *in* APPEALS MECHANISM IN INTERNATIONAL INVESTMENT DISPUTES 234–36 (Karl P. Sauvant ed., 2008); *see also* Donald McRae, *The WTO Appellate Body: A Model for an ICSID Appeals Facility?*, 1 J. INT'L DISP. SETTLEMENT 371 (2010).

82. W. Mark C. Weidemaier, *Toward a Theory of Precedent in Arbitration*, 51 WM. & MARY L. REV. 1895, 1900–01 (2010); Giovanni Zarra, *Orderliness and Coherence in International Investment Law and Arbitration: An Analysis Through the Lens of State of Necessity*, 34 J. INT'L ARB. 653, 669–72 (2017); *see also* Gabrielle Kaufmann-Kohler, *Arbitral Precedent Dream, Necessity or Excuse?* 23 ARB. INT'L. 357 (2007); Valentina S. Vadi, *Towards Arbitral Path Coherence & Judicial Borrowing: Persuasive Precedent in Investment Arbitration*, 5 TRANSNAT'L DISP. MGMT., no. 3, May 2008.

83. August Reinisch, *The Proliferation of International Dispute Settlement Mechanisms: The Threat of Fragmentation vs. the Promise of a More Effective System? Some Reflections from the Perspective of Investment*

decided alike regardless of the arbitral entity which renders the decision. Finally, some authors trace inconsistency in the case law to the diverse backgrounds of arbitrators and the competing perceptions they have of the investment regime.[84] They point out that different lawyers may view the investment regime as a specialized regime within public international law, private international law, public law, or international public law.

Multiple reform proposals are put forward to achieve a higher level of consistency in the investment arbitration case law. Although the doctrinal discrepancy among BITs is one of the most common explanations of interpretative conflicts, mainstream lawyers are generally not optimistic about the prospects of sorting out these disagreements by way of concluding a new multilateral investment agreement.[85] Their disenchantment arises from the failure of the negotiations over the Multilateral Agreement on Investment in 1998 which was the first and last attempt to create a multilateral framework for the governance of FDI.[86]

As a result, most reform programs focus on the procedural aspects of ISDS. Some lawyers advocate for the introduction of an appellate mechanism to ICSID which currently limits the review of its arbitral decisions to the restrictive procedures of annulment.[87] Another major proposal is

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Arbitration, *in* INTERNATIONAL LAW BETWEEN UNIVERSALISM AND FRAGMENTATION: FESTSCHRIFT IN HONOUR OF GERHARD HAFNER 107, 122–25 (Isabelle Buffard et al., eds., 2008); Crawford, *supra* note 78, at 101–03. On the argument that a de facto doctrine of stare decisis exists in investment arbitration, see Tai-Heng Cheng, *Precedent and Control in Investment Treaty Arbitration*, 30 FORDHAM INT'L L.J. 1014 (2006); Christoph Schreuer & Matthew Weiniger, *A Doctrine of Precedent?*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 1188 (Peter Muchlinski et al. eds., 2008).

84. *See* Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 AM. J. INT'L L. 45 (2013); ERIC DE BRABANDERE, INVESTMENT TREATY ARBITRATION AS PUBLIC INTERNATIONAL LAW: PROCEDURAL ASPECTS AND IMPLICATIONS (2014).

85. For one of the very few exceptions in this regard, see Rainer Geiger, *Towards a Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 123 (1998). For an older version of the same proposal, see Michael A. Geist, *Toward a General Agreement on the Regulation of Foreign Direct Investment*, 26 L. & POL'Y INT'L BUS. 637 (1994).

86. Katia Tieleman, *The Failure of the Multilateral Agreement on Investment (MAI) and the Absence of a Global Public Policy Network*, U.N. VISION PROJECT ON GLOBAL PUBLIC POLICY NETWORKS (2000), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.627.7992&rep=rep1&type=pdf.

87. *See* Asif H. Qureshi, *An Appellate System in International Investment Arbitration?*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 1154 (Peter Muchlinski et al. eds., 2008); Christopher Smith, *The Appeal of ICSID Awards: How the AMINZ Appellate Mechanism Can Guide Reform of ICSID Procedures*, 41 GA. J. INT'L & COMP. L. 567 (2013); Gabriel Bottini, *Should Arbitrators Live On Mars? Challenge of Arbitrators in Investment Arbitration*, 32 SUFFOLK TRANSNAT'L L. REV. 341 (2009); Van Vechten Veeder, *The Necessary Safeguards of an Appellate System*, 2 TRANSNAT'L DISP. MGMT., no. 2, Apr. 2005; Christian J. Tams, *An Appealing Option? The debate about an ICSID appellate structure*, 57 ESSAYS IN TRANSNAT'L ECON. L. (2006). For a skeptical view, see Legum, *supra* note 81.

the one championed by the EC which calls for the replacement of the decentralized ISDS system with a permanent investment court.[88] The proponents of this proposal contend that the centralization of ISDS would help harmonize the case law while simultaneously overcoming other procedural limitations in the current model of ad hoc dispute settlement.[89]

Besides doctrinal and jurisprudential incoherence in international investment law, mainstream lawyers pay a great deal of attention to the various institutional deficiencies in the ISDS system. Some scholars note the unmistakable influence of investment arbitration on how legislatures, public administrators, and courts in host states exercise their regulatory powers. They argue that, notwithstanding this influence, the ISDS system is not transparent enough so as to allow the general public to effectively monitor the fairness of its procedures and outcomes.[90] Others underscore the insufficient representation of the affected communities within respondent states in the ISDS procedures.[91] A third major institutional concern is how the small number of practitioners in the field may well give rise to incidents of conflict of interest in light of the fact that many practitioners serve as lawyers in some cases and arbitrators in others.[92]

To address these institutional shortcomings, several revisions of the ISDS procedures have been suggested in mainstream scholarship. Some lawyers push for more transparency in investment arbitration by way of increasing public participation in the ISDS procedures. Accordingly, they make a case for enabling interested third parties to

88. *See* Hanessian & Duggal, *supra* note 50.

89. The proposal of a standing investment court, modeled after the WTO Dispute Settlement Body, is not new. *See, e.g.*, Michael D. Goldhaber, *Wanted: A World Investment Court*, 3 TRANSNAT'L DISP. MGMT., no. 3, July 2004.

90. *See* C. Knahr & A. Reinisch, *Transparency Versus Confidentiality in International Investment Arbitration – The Biwater Gauff Compromise*, 6 L. & PRAC. OF INT'L CTS. & TRIBUNALS 97 (2007); Barnali Choudhury, *Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit?* 41 VAND. J. TRANSNAT'L L. 775 (2008).

91. *See* Noemi Gal-Or, *The Investor and Civil Society as Twin Global Citizens: Proposing a New Interpretation in the Legitimacy Debate*, 32 SUFFOLK TRANSNAT'L L. REV. 271 (2009).

92. *See* Thomas Buergenthal, *The Proliferation of Disputes, Dispute Settlement Procedures and Respect for the Rule of Law*, 3 TRANSNAT'L DISP. MGMT., no. 5, Dec. 2006, at 6 (arguing that "[t]hese revolving-door problems – counsel selecting an arbitrator who, the next time around when the arbitrator is counsel, selects the previous counsel as arbitrator – should be avoided"). *See also* J. Levine, *Dealing with Arbitrator "Issue Conflicts" in International Arbitration*, 5 TRANSNAT'L. DISP. MGMT., no. 4, July 2008; Hwang & Lim, *supra* note 65.

submit amici curiae to investment tribunals.[93] In 2006, this proposal was put into effect by an amendment to the ICSID Arbitration Rules which made it possible, for the first time, for non-disputing parties to file submissions with arbitral tribunals upon the latter's approval.[94] The submission of amici curiae under NAFTA is also possible, although it remains subject to the tribunals' discretionary power.[95]

Additionally, to cope with the increasing involvement of investment tribunals in public law matters within host states, lawyers call for the introduction of institutional safeguards which would turn these tribunals into court-like bodies.[96] So far, the EC has been the main proponent of this proposal. Recent EU investment agreements provide for the settlement of investment disputes by tribunals which would be staffed by arbitrators drawn from a permanent roster rather than appointed on an ad hoc basis.[97] The EC also seeks to circumscribe potential conflicts of interest in investment arbitration through its proposal to replace the fragmented ISDS system with a multilateral investment court. It maintains that the establishment of a cadre of permanent investment arbitrators would shield them from the pressure the parties can currently apply to ISDS forums given the consensual and ad hoc character of arbitral appointments.[98]

93. *See* Christina Knahr, *Transparency, Third Party Participation and Access to Documents in International Investment Arbitration*, 23 ARB. INT'L 327 (2007); Andrew Newcombe & Axelle Lemaire, *Should Amici Curiae Participate in Investment Treaty Arbitrations?* 5 VINDOBONA J. INT'L L. & ARB. 22 (2001). Some arguments for amici curiae are based on balancing. *See* Eugenia Levine, *Amicus Curiae in International Investment Arbitration: The Implications of an Increase in Third-Party Participation*, 29 BERKELEY J. INT'L L. 200 (2011).

94. Aurélia Antonietti, *The 2006 Amendments to the ICSID Rules and Regulations and the Additional Facility Rules*, 21 ICSID REV.—FOREIGN INV. L.J. 427, 429-43 (2006).

95. Statement of the Free Trade Commission on Non-Disputing Party Participation (Oct. 7, 2003), https://2009-2017.state.gov/documents/organization/38791.pdf.

96. GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW 175–84 (2007); Barnali Choudhury, *Democratic Implications Arising from the Intersection of Investment Arbitration and Human Rights Special Issue: International Law and Democratic Considerations*, 46 ALTA. L. REV. 983, 1005–07 (2009).

97. The recent Canada-EU free trade agreement, CETA, established a Permanent Investment Tribunal to settle the investment disputes arising out of this agreement. *European Union Report on Investment provisions in the EU-Canada*, EU Comprehensive Economic and Trade Agreement *(CETA)*, art. 8.27 (2006), http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf.

98. European Commission, *Recommendation for a Council Decision Authorising the Opening of Negotiations for a Convention Establishing a Multilateral Court for the Settlement of Investment Disputes* 493 (Sept. 13, 2017), https://eur-lex.europa.eu/resource.html?uri=cellar:df96826b-985e-11e7-b92d-01aa75ed71a1.0001.02/DOC_1&format=PDF.

C. *The Problematic Avoidance of the Question of Design*

As we saw, many important doctrinal, jurisprudential, and institutional critiques are made in mainstream scholarship, and a wide range of reforms are put forward to address them. The common denominator among these critiques and reforms, however, is that they do not question the design of BITs at all.

Leaving its reform-related implications aside for a moment, the positivist approach to international investment law is problematic on its own terms. This is mainly because it is untenable to operationalize BITs by only relying on their text without taking into consideration the broader policy goals that underlie their design. Like any other legal regime, international investment law requires lawyers to fill in doctrinal gaps, resolve conflicts, and overcome a great deal of ambiguity.[99] In fact, this role is substantial in international investment law given the nascence of this legal regime and the brevity of the provisions of international investment agreements.

Pursuant to the customary rules of treaty interpretation, codified by the Vienna Convention on the Law of Treaties (VCLT), BITs should be interpreted in accordance with the ordinary meaning of their terms in their context and in the light of their object and purpose.[100] While the context of BITs plays a minimal role in practice, the case law shows that investment tribunals interpret BITs mainly by having recourse to their object and purpose.[101] Similar to the context of BITs, the supplementary means of interpretation, provided for by Article 32 of the VCLT, offers very limited guidance to tribunals due to the absence of *travaux preparatoires* for almost all BITs.[102]

The definition of the object and purpose of BITs, however, makes it necessary to develop a theory of the design of these treaties, i.e., a

99. This is what Hart calls the "penumbra of doubt." H.L.A. HART, THE CONCEPT OF LAW 123 (1961). For a phenomenological perspective of legal indeterminacy, see DUNCAN KENNEDY, A CRITIQUE OF ADJUDICATION: FIN DE SIÈCLE 170 (1997).

100. Vienna Convention on the Law of Treaties, art. 31, May 23, 1969, 1155 U.N.T.S. 331.

101. Fair and equitable treatment provides a perfect example of the prominent role of BITs' object and purpose in treaty interpretation. *See, e.g.*, LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic, ICSID Case No. ARB/02/1, Decision on Liability, ¶ 125 (Oct. 3, 2006); Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, Award, ¶ 290 (Feb. 6, 2007); Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3, Award, ¶ 259 (May 22, 2007); Sempra Energy International v. Argentine Republic, ICSID Case No. ARB/02/16, Award, ¶ 300 (Sept. 28, 2007).

102. Wintershall Aktiengesellschaft v. Argentine Republic, ICSID Case No. ARB/04/14, Award, ¶ 85 (Dec. 8, 2008) (citing expert testimony from Christopher Schreuer).

theory which rationalizes the government measures that BITs discipline versus those they permit. Of course, it might be argued that the object and purpose of BITs is to merely protect foreign investors in host states. Nevertheless, a quick review of the preambles to many Model BITs belies this view. These preambles show that BITs proclaim a number of policy objectives besides the protection of foreign investors such as the reinforcement of economic cooperation between the parties,[103] the promotion of economic development,[104] and the maximization of the effective utilization of economic resources.[105] Given the multiplicity of these goals, neither investment lawyers nor arbitral tribunals are in agreement about what constitutes the object and purpose of BITs.[106] In fact, the case law suggests that investment tribunals do not prioritize the protection of investors across the board as they occasionally curtail this protection for the sake of other considerations such as the harmonization of international investment law.[107]

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103. China Model BIT 2003, preamble; Germany Model BIT 2008, preamble; France Model BIT 2006, preamble; U.S. Model BIT preamble, 2012, *available at* https://2009-2017.state.gov/documents/organization/188371.pdf; Canada Model BIT preamble, Aug. 25, 2014, *available at* https://www.italaw.com/sites/default/files/files/italaw8236.pdf.

104. U.S. Model BIT 2012, *supra* note 103; France Model BIT 2006, preamble; *Canada Model BIT 2014*, *supra* note 103. Some BITs use the term "prosperity" instead of "development": India Model BIT preamble, 2003, *available at* https://www.italaw.com/sites/default/files/archive/ita1026.pdf (last visited Jan. 21, 2020); Germany Model BIT preamble, 2008; China Model BIT preamble, 2003.

105. U.S. Model BIT 2012, *supra* note 103.

106. The protection of investors is posited by some scholars and investment tribunals as the object and purpose of BITs. *See, e.g.*, José Alvarez & Kathryn Khamsi, *The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, 2009 Y.B. INT'L INV. L. & POL'Y 379, 470–71 (Karl P. Sauvant ed., 2008); *see also* SGS Société Générale de Surveillance S.A. v. Republic of the Phil., ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, ¶ 116 (Jan. 29, 2004). Other scholars and tribunals give more prominence to the development of the state parties. *See* STERN, *supra* note 2, at 189–91; *see also* Noble Ventures, Inc. v. Romania, ICSID Case No. ARB/01/11, Award, ¶ 52 (12 Oct. 2005); Saluka Inv. B.V. v. Czech Republic, UNCITRAL, Partial Award, ¶ 300 (Mar. 17, 2006). In the same vein, several investment tribunals consider the economic development of the state parties the object and purpose of the ICSID Convention: Saba Fakes v. Republic of Turk., ICSID Case No. ARB/07/20, Award, ¶ 111 (July 14, 2010); Joseph C. Lemire v. Ukraine, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, ¶¶ 272–73 (Jan. 14, 2010).

107. For example, the majority of ICSID tribunals determine the scope of their subject-matter jurisdiction in a way that qualifies the freedom of states to choose whatever definition of investment they deem fit in their respective BITs. Specifically, tribunals give effect to the BIT definition, which is usually more protective of investors, but only within the boundaries of what objectively constitutes an "investment" under article 25 of the ICSID Convention. *See, e.g.*, Fedax N.V. and Republic of Venez., ICSID Case No. ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction, ¶ 43 (July 11, 1997); Ceskoslovenska obchodní banka, a.s. v. Slovak Republic,

Accordingly, even if mainstream scholars try to commit entirely to a positivist agenda, a conversation must still be had about the design of BITs as an integral part of the "application" of international investment law.[108] Avoiding the design debate altogether spares these scholars the need to pronounce the assumptions that guide their interpretative work; thereby mystifying the choices they make in this regard.[109] Moreover, the sidelining of the design debate leaves the ever-expanding investment arbitration case law unrationalized due to the absence of theories along the lines of which the case law can be explained and developed.[110]

When it comes to reform, mainstream scholarship renders any conversation about the reimagination of the investment regime impossible. The uncritical acceptance of the design of BITs contributes to the normalization of the current regime as natural and necessary at the core, although open to doctrinal and institutional tweaking at the margins.[111] Beyond these modest revisions, the redesign of the system is viewed as a debate lawyers cannot be part of and thus should be left to economists and political scientists in the same way that the regime's initial design is understood to be the monopoly of these other professionals.

ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction, ¶ 68 (May 24, 1999); Patrick Mitchell v. Democratic Republic of Congo, ICSID Case No. ARB/99/7, Decision on the Application for Annulment of the Award, ¶ 31 (Nov. 1, 2006); Phoenix Action, Ltd v. Czech Republic, ICSID Case No. ARB/06/5, Award, ¶ 96 (Apr. 15, 2009); Saba Fakes, ICSID Case No. ARB/07/20, ¶¶ 107–114; GEA Grp. Aktiengesellschaft v. Ukraine, ICSID Case No. ARB/08/16, Award, ¶¶ 137–43, 151–64 (Mar. 31, 2011); Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka, ICSID Case No. ARB/09/2, Award, ¶¶ 293–97 (Oct. 31, 2012).

108. In legal theory, different methods have been proposed to address gaps, conflicts, and ambiguities in legal systems. One of the most prominent solutions, which also bears the greatest resemblance to the interpretation of treaties in light of their object and purpose, is the one proposed by Dworkin. He asserts that in hard cases, i.e., in cases where more than one fitting interpretation exists, judges must first develop an overall theory of the legal system they are operationalizing, and must second deduce answers from this theory in a way that would be coherent with, or would fit, the overall legislative scheme of the legal system in question. Ronald Dworkin, *Hard Cases*, 88 HARV. L. REV. 1057, 1058–60 (1975).

109. Modern institutional economists are cognizant of the choices lawyers make while "enforcing" the law. They assert that the perspective of the enforcers of legal regimes, even those based on freedom of contract and property rights, is relevant to how resources are allocated. DOUGLASS NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 58 (1990).

110. For more on "unrationalized fields," see Duncan Kennedy, *Freedom and Constraint in Adjudication: A Critical Phenomenology*, 36 J. LEGAL EDUC. 518, 540 (1992).

111. *See, e.g.*, Baiju S. Vasani & Anastasiya Ugale, *Travaux Préparatoires and the Legitimacy of Investor-State Arbitration*, 11 TRANSNAT'L DISP. MGMT., no. 1, Jan. 2014. The authors maintain that "[t]he investor-State arbitration system, still in its relative infancy, is not without fault. But neither is it flawed to the extent that callers for its wholesale abolition need be given disproportionate prominence. As a community of users, participants, and observers of the system, we should be seeking to debate and propose structural tweaks with a scalpel, not with a sledgehammer."

Contrary to the mainstream scholarship's indifference towards design, a minority of investment lawyers do not take BITs' design for granted, but rather explain and justify it by recourse to various extra-legal theories. This style of argumentation has mainly been employed to support rather than critique the design of BITs. The remainder of this Article presents the four main theories invoked in the literature for that purpose. It critiques the descriptive claim that these theories can explain the current design of BITs and explores the implications of fully committing to these theories as theories of design of international investment agreements.

IV. THE THEORY OF POLITICAL RISK (OBSOLESCING BARGAINS AND DYNAMIC INCONSISTENCY)

The theory of political risk comprises two models known as the obsolescing bargain model and the dynamic inconsistency problem which were developed by business economists and political scientists. Both models illustrate the risks inherent in FDI as an international economic activity which, by definition, is conducted in the territory of a foreign country. This section elaborates on these models and highlights their relevance to the debate about BITs' design. It explains the reasons why the two models only provide a limited explanation of the current design of BITs. It also explores the normative consequences of fully adopting the two models as well as the theory of political risk as theories of design, specifically the changes this would entail for the design of BITs.

A. *Defining the Models*

The risks foreign investors are commonly exposed to in the territory of host states were extensively studied in both business economics and political science. Interest in the topic was born out of upheavals in the 1970s in numerous developing countries, such as Cuba, Chile, Iran, and Nicaragua, which eventually led to the nationalization of many foreign-owned enterprises, especially in the extractive sector. The concept of political risk was developed to refer to the sovereign-related threats a multinational corporation (MNC) is exposed to while conducting its economic activity in the territory of a foreign country.[112] The literature from this period traces political risk to one of two reasons. The first is

112. *See* THEODORE H. MORAN, TRANSNATIONAL CORPORATIONS AND THE POLITICS OF DEPENDENCE: COPPER IN CHILE (1974); *see also* Stephen J. Kobrin, *Political Risk: A Review and Reconsideration*, 10 J. INT'L BUS. STUD. 67 (1979); CHARLES LIPSON, STANDING GUARD: PROTECTING CAPITAL IN THE NINETEENTH AND TWENTIETH CENTURIES (1985).

political instability in host states which indirectly affects the profitability of the foreign investment. The second is the deliberate regulatory interference with the foreign enterprise which directly undermines its value.[113]

The obsolescing bargain model, first formulated by Raymond Vernon in 1971, presents one illustration of political risk.[114] The model draws attention to a typical change in the power relations between MNCs, or foreign investors in general, and host states. Once MNCs establish their investments in host states, they become highly vulnerable to later unfavorable changes in host states' policies because it is not always feasible for an MNC to divest and remove its fixed assets out of a host state. The "sunk" cost of MNCs thus undermines their bargaining power vis-à-vis host states since the latter can always hold their fixed assets "hostage."[115]

Historically, hostile relationships between host states and MNCs, as depicted by the obsolescing bargain model, did not last long. The debt crisis of the 1970s and the collapse of the NIEO forced developing countries to be more open to and even to compete for FDI. As a result, the obsolescing bargain model lost significant traction. Some scholars argue that investor-state relationships have now become more cooperative because of major ideological shifts in developing countries as well as the high reputational costs associated with the nationalization or expropriation of foreign investments.[116] Other authors note that it is increasingly becoming the case that MNCs are politically influential in host states due to the benefits they bring to the host economy.[117] Recent empirical studies corroborate this view by demonstrating the

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113. For an excellent review of the literature on political risk, see Jo Jakobsen, *Does Democracy Moderate the Obsolescing Bargain Mechanism? – An Empirical Analysis, 1983–2001*, 15 TRANSNAT'L CORP. 65, 69–79 (2006).

114. RAYMOND VERNON, SOVEREIGNTY AT BAY: THE TRANSNATIONAL MULTINATIONAL SPREAD OF U.S. ENTERPRISES 47 (1971); *see also* C.F. BERGSTEN ET AL., AMERICAN MULTINATIONALS AND AMERICAN INTERESTS (1978). *See generally* Raymond Vernon, *The Obsolescing Bargain: A Key Factor in Political Risk*, *in* 5 THE INT'L ESSAYS FOR BUSINESS DECISION MAKERS (Mark B. Winchester ed., 1980).

115. Stephen J. Kobrin, *Testing the Bargaining Hypothesis in the Manufacturing Sector in Developing Countries*, 41 INT'L ORG. 609, 611 (1987).

116. Jason W. Yackee, *Do We Really Need BITs? Toward a Return to Contract in International Investment Law*, 3 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 121, 125–26 (2008); *see also* Lorraine Eden et al., *From the Obsolescing Bargain to the Political Bargaining Model*, *in* INTERNATIONAL BUSINESS AND GOVERNMENT RELATIONS IN THE 21ST CENTURY 251 (Robert Grosse ed., 2005); Minor, *supra* note 33.

117. *See* John H. Dunning, *Governments and Multinational Enterprises: From Confrontation to Cooperation? in* MULTINATIONALS IN THE GLOBAL POLITICAL ECONOMY 59 (Lorraine Eden & Evan

multiplicity of ways through which MNCs influence the policymaking processes in host states such that they would sometimes be more advantaged than national firms.[118]

The dynamic inconsistency model, also known as the time inconsistency problem, provides another way of theorizing the political risk inherent in FDI. It bears much resemblance to the obsolescing bargain model since it is also concerned with the worsening of foreign investors' bargaining power after their establishment in host states.[119] The model describes a specific situation in which a host state would need to tie down its own hands with an external commitment mechanism. Absent this restraint, the host state would no longer be able to adhere to the commitments it undertook in the past for the benefit of foreign investors once it ceases to consider these commitments optimal.[120]

Both models influence lawyers interested in the design of BITs. Some lawyers adopt the obsolescing bargain model as an explanation of BITs' design without questioning the model's continuing validity in light of the dramatic shifts in the 1980s and 1990s in investor-state relationships.[121] Others find in the model of dynamic inconsistency a sufficient rationale for the ISDS system. They argue that ISDS provides an external commitment mechanism that preserves host states' promises against the post-establishment mistreatment of foreign investors. The absence of this mechanism, they maintain, would give rise to a "market failure" whenever foreign investors underinvest as a result of their increased exposure to the risk of nationalization or expropriation in

Potter eds., 1993); Yadong Luo, *Toward a Cooperative View of MNC-Host Government Relations: Building Blocks and Performance Implications*, 32 J. INT'L BUS. STUD. 401 (2001).

118. Rodolphe Desbordes & Julien Vauday, *The Political Influence of Foreign Firms in Developing Countries*, 19 ECON. & POL. 421, 429 (2007); *see also* Yasheng Huang, *Are Foreign Firms Privileged by their Host Governments? Evidence from the 2000 World Business Environment Survey* (4538-05 MIT Sloan Working Paper, March 2005), http://dx.doi.org/10.2139/ssrn.721221; Jeffrey T. Macher et al., *The Influence of Firms on Governments*, 11 B.E. J. ECON. ANALYSIS & POL'Y 1 (2011).

119. Behavioral economists have recognized the dynamic inconsistency problem to be a manifestation of the anomalies in individuals' discount rates of future utilities. For an early formulation of the problem, see Edmund S. Phelps & Robert A. Pollak, *On Second-Best National Saving and Game-Equilibrium Growth*, 35 REV. ECON. STUD. 185 (1968). Earlier accounts of intertemporal choices assumed that individuals discount different future utilities throughout their lifetimes at the same rate. *See* Paul A. Samuelson, *A Note on Measurement of Utility*, 4 Rev. Econ. Stud. 155, 156 (1937).

120. ALLAN DRAZEN, POLITICAL ECONOMY IN MACROECONOMICS 110 (2002); OLIVIER J. BLANCHARD & STANLEY FISCHER, LECTURES ON MACROECONOMICS 592 (1989).

121. Salacuse, *supra* note 5, at 451; Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 661 (1997).

host states.[122] Underinvestment in turn renders the allocation of FDI "inefficient" as total investment in the global economy would be "suboptimal."[123] Accordingly, the proponents of this view conclude that the design of BITs, with its provision for ISDS, overcomes the problem of dynamic inconsistency and helps avoid the "distortion" of the allocation of FDI across borders.

B. *The Models as Theories of Design*

The possibility that a foreign investor's bargain with a host state becomes obsolescent post-establishment, or that a host state becomes unable to keep its commitments to a foreign investor over time, denotes the need to provide foreign investors with *some* legal protection in host states. On that basis, both the obsolescing bargain model and the dynamic inconsistency problem can explain the design of BITs. Yet this explanation, as will be argued shortly, is partial at best. Beyond these two models, the broader theory of political risk offers a more persuasive, although not completely satisfying, explanation.

The reference made in the literature to the obsolescing bargain model as a theory of design is broad. Scholars who invoke it merely highlight the need to protect foreign investors after establishment without delving into the details of whether the protections provided by BITs do or do not fit the model.[124] By contrast, the model of dynamic inconsistency is cited in a more specific way. As we saw, the main line of argument that utilizes this model associates the absence of credible commitments against post-establishment mistreatment with "inefficiently" low levels of investment across borders.[125] In view of this, the legal protections in BITs, as well as the enforceability of these protections through ISDS, are said to provide the credible commitments needed to achieve an efficient allocation of FDI across borders.[126]

The first problematic aspect in the credible commitments argument as a theory of design relates to the counterfactual against which the claimed distortive effect of the absence of BITs and ISDS is assessed. The undersupply of FDI in the global economy that may result from

122. Anne van Aaken, *Perils of Success? The Case of International Investment Protection*, 9 EUR. BUS. ORG. L. REV. 1, 1–7 (2008); Tom Ginsburg, *International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*, 25 INT'L REV. L. & ECON. 107, 113 (2006); Guzman, *supra* note 121, at 658.

123. Guzman, *supra* note 121, at 673.

124. *E.g.*, Salacuse, *supra* note 5, at 451.

125. Guzman, *supra* note 121, at 658–66.

126. *Id.* at 681.

foreign investors' fear of nationalization or expropriation is considered a "distortion." This presupposes that foreign investors, by default, hold legal entitlements to freely invest in any country. Stated differently, the credible commitments argument assumes that the free flow of FDI across borders is the baseline, and that departure from it should be viewed as "inefficient."

Taking the free flow of FDI across borders as a baseline stands in stark contrast to the reality of the global economy, which is still comprised of national markets regulated by territorially sovereign states. Absent an international commitment to the contrary, host states owe no legal obligation whatsoever to admit FDI originating in other states into their territories. Hence, the premise of the credible commitments argument lacks justification inasmuch as it departs from this reality. By contrast, accepting the immobility of capital as a baseline means that the lack of credible commitments leads to an allocation of FDI that is not necessarily inefficient, but merely reflects the default legal entitlements of foreign investors and host states in a world divided by national borders.

Moreover, arguing that BITs provide foreign investors with credible commitments that eventually "yield an efficient allocation of capital" does not offer a theory of the design of these treaties, but rather a hypothesis about its consequences.[127] In principle, it is unanimously accepted that governments should intervene in markets in specific situations to improve the allocation of resources.[128] The claim that BITs are capable of achieving an "efficient" allocation of FDI in the global economy does not preclude the corrective regulatory role host states continue to play under these treaties. What is left unanswered, though, is whether BITs draw the "right" or the "wrong" distinction between corrective and distortive regulations. The credible commitments argument provides no answer to this question.

A third factor which undermines the credible commitments argument as an explanation of the design of BITs is empirical. While the advocates of this view maintain that BITs overcome the inhibitive effect of the lack of credible commitments on the global flows of FDI, the effect of BITs on foreign investors' choices of location is empirically ambiguous. In some cases, it is true that foreign investors establish their investments in jurisdictions where they enjoy the protection of BITs.

127. *Id.*

128. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 195–96 (6th ed. 2012). On the impossibility of having a market economy without regulation, see Duncan Kennedy, *The Role of Law in Economic Thought: Essays on the Fetishism of Commodities*, 34 AM. U.L. REV. 939, 966 (1984).

This practice, known as nationality planning or treaty shopping, is recognized by both investment tribunals and the drafters of BITs.[129]

Nevertheless, no definitive conclusion can be reached as to the extent to which signing a BIT increases the flow of FDI to state parties. Empirical evidence in this regard is at best mixed.[130] Indeed, some recent studies indicate that the existence of a BIT in force does not play a large role in the decisions of major public and private insurers to underwrite an investment.[131] Accordingly, while BITs provide foreign investors with additional, effective, and expansive legal protection in host states, the argument that these treaties lead to an "efficient" level of investment in the global economy, or that they increase the flow of FDI to the countries which sign them, remains unsubstantiated.

Based on the foregoing, the obsolescing bargain model and the model of dynamic inconsistency may be helpful as theories of the design of BITs, but only at a very basic level. They both emphasize the need for an external commitment mechanism, such as ISDS, without saying much about what the substance of host states' commitments should be.[132] Consequently, these models are incapable of explaining important legislative characteristics of international investment law such as the standardization of the provisions of BITs. Similarly, they

129. DOLZER & SCHREUER, *supra* note 60, at 52–56.

130. On the relationship between international investment agreements and FDI, see ZBIGNIEW ZIMNY & HAMED EL-KADY, U.N. Conference on Trade and Development, The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries, UNCTAD/DIAE/IA/2009/5 (Sept. 2009). Some empirical studies show a positive correlation between BITs and FDI inflows. *See, e.g.*, Eric Neumayer & Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?* 33 WORLD DEV. 1567 (2005). *But see* Jason Yackee, *Do BITs Really Work?: Revisiting the Empirical Link between Investment Treaties and Foreign Direct Investment*, *in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 379 (Karl P. Sauvant & Lisa E. Sachs eds., 2009). *See generally* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 379 (Karl P. Sauvant & Lisa E. Sachs eds., 2009).

131. *See* Lauge Skovgaard Poulsen, *The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence*, *in* YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY 2009–2010 539 (Karl P. Sauvant ed., 2010).

132. Hallward-Driemeier draws a distinction between resolving the dynamic inconsistency problem and determining the substance of BITs by arguing that "[i]t is not that formalization of relations and treaties that protect against dynamic inconsistency problems should not be encouraged, just that the terms of these agreements and the strength of the rights given to investors should be scrutinized." Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit . . . and They Could Bite* 22 (World Bank Policy Research Working Paper, No. 3121, 2003), http://documents.worldbank.org/curated/en/113541468761706209/pdf/multi0page.pdf.

cannot rationalize major trends in investment arbitration such as the inclination of the majority of investment tribunals to harmonize the treatment that BITs accord to foreign investors from different countries.[133]

Unlike the previous models, the theory of political risk provides a more plausible explanation of the design of BITs, although it is the least cited in the literature. BITs can be viewed as a means to protect foreign investors from the two categories of political risk discussed earlier: the political instability in host states which indirectly undermines the profitability of the foreign investment, and the deliberate regulatory interference by host states which destroys the value of the investment or the title thereto. The problem with the theory of political risk as a theory of design, however, is that the government measures that are disciplined by BITs are not fully aligned with these two categories of political risk.

On the one hand, some government measures proscribed by BITs do not fall into either category of political risk. Particularly, BITs prohibit host states from adopting specific measures which might be burdensome for foreign investors, such as performance requirements, or those which might discriminate against them, such as the provision of more favorable treatment to national investors. Should these measures be made public prior to the establishment of the foreign investment, it can hardly be argued that they represent unforeseeable profitability-impairing instability in the host state. Likewise, they cannot be considered a deliberate regulatory intervention destined to nullify the value of or title to the foreign investment. Instead, these measures would be mere conditions for the admission of foreign investors into the territory of host states. Notably, in the world of political risk insurance, foreign investors are required to abide by any such conditions. This is because most insurance policies make the compensation for political risk contingent on the foreign investor's compliance with host states' laws, regulations, or permit requirements.[134]

On the other hand, BITs do not protect foreign investors against all political risks. In comparison with political risk insurance, BITs are less protective in some respects, although they generally provide foreign investors with more expansive legal protections in host states.[135] For instance, political risk insurance guarantees that foreign investors

133. *See, e.g.*, *supra* note 107.

134. Mark Kantor, *Comparing Political Risk Insurance and Investment Treaty Arbitration*, *in* A REVOLUTION IN THE INTERNATIONAL RULE OF LAW: ESSAYS IN HONOR OF DON WALLACE, JR. 455, 467–68 (Borzu Sabahi et al. eds., 2014).

135. *Id.* at 462–74.

would be compensated if their investments are destroyed by physical violence in host states. Under BITs, the full protection and security standard protects foreign investors against this form of political risk. Nonetheless, the standard only imposes a due-diligence duty on host states rather than making them strictly liable to foreign investors whenever this risk materializes.[136]

By the same token, political risk insurance provides foreign investors with compensation whenever they incur losses as a result of host states' restrictions on currency exchange or transfer.[137] This entitlement to compensation is completely detached from the broader economic circumstances in host states which give rise to those restrictions. On the contrary, the risk of currency inconvertibility during crises falls completely outside the ambit of BITs. In fact, recent treaty practice limits liability for such restrictions under BITs and grants host states more powers with respect to the administration of their financial sectors.[138]

C. *Political Risk and the Redesign of BITs*

The descriptive claim that the models of obsolescing bargains and dynamic inconsistency explain the design of BITs implies that this design should be considered legitimate or favorable because it is justified by theory. On that basis, an argument can be made that redesigning BITs should be rejected. However, a serious commitment to the aforementioned models, as well as the broader theory of political risk, actually lends support to an alternative design of investment agreements which differs in important respects from that of contemporary BITs.

From a normative standpoint, the model of dynamic inconsistency is the least helpful. It only indicates the need for an external commitment mechanism which guarantees that host states honor the promises they give to foreign investors. Apart from this very general recommendation, the model offers no guidance about the substance of the commitments that host states should give to foreign investors. Therefore, it hardly

136. Jason Webb Yackee, *Political Risk and International Investment Law*, 24 DUKE J. COMP. & INT'L L. 477, 494 (2013).

137. Kantor, *supra* note 134, at 464.

138. Under Article 18.2 of the 2012 U.S. Model BIT, a host state may adopt the "measures that it considers necessary for . . . . the protection of its own essential security interests." U.S. Model BIT, *supra* note 103, art. 18.2. On the expansion of host states' powers in the administration of domestic financial sectors in the 2012 Model BIT, see *supra* note 43. *See also* Johnson, *supra* note 43; U.S. Model BIT 2012, *supra* note 103, art. 20.

provides a benchmark for what the design of investment agreements should be.

By contrast, the obsolescing bargain model is more instructive. It shows that the worsening of foreign investors' bargaining power after establishment is not identical across the board, but rather depends on how easily a foreign investment can be transferred out of the territory of a host state. In some sectors, such as extractive industries, foreign investors are more susceptible to that risk. In other sectors, like light manufacturing, the risk exists to a much lesser degree since the assets used in this type of investment remain relatively mobile even after establishment.[139]

This distinction should bring into question the sweeping definitions of investment adopted by the vast majority of BITs. Typically, BITs extend their legal protection to a wide range of assets, many of which do not meet the definitional characteristics of "sunk" costs, such as contractual rights, trademarks, portfolio investments, and sovereign bonds.[140] The reliance on these kinds of assets in FDI largely preserves the mobility of the foreign investment and thus gives foreign investors considerable leverage vis-à-vis host states. Hence, taking the obsolescing bargain model seriously as a theory of design supports the diversification of the legal protection that BITs provide to foreign investors depending on how "stuck" their assets are in the territory of host states.

In the same vein, the theory of political risk warrants the reconsideration of some of the main provisions of BITs, most of which are more favorable to foreign investors. A prime example is the prohibition of performance requirements and positive discrimination for national investors. Assuming that, before establishment, foreign investors can gain full knowledge of the requirements they have to satisfy, or the more favorable treatment national investors receive, these policies cannot be viewed as political risks but as conditions for the admission of foreign investors into the territory of host states. In principle, host states are entitled to make the admission of foreign investors conditional on whatever requirements they deem fit. Of course, this power can be limited on a conventional basis and must always be exercised in a bona fide way and through a transparent process pursuant to the international legal principle of good faith. But if implemented within these confines, these policies and their like cannot be normatively denounced based on the theory of political risk.

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139. Yackee, *supra* note 136, at 485; Kobrin, *supra* note 115, at 613–14.

140. MUTHUCUMARASWAMY SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 8–9 (2010).

In some other respects, espousing political risk as a theory of design supports the expansion of the legal protection of foreign investors under BITs. As previously mentioned, BITs do not address some forms of political risk. The theory of political risk consequently justifies the inclusion of some regulatory areas that have been traditionally left out under the purview of these treaties, such as taxation. It also disfavors the exceptions carved out in recent BITs for certain types of regulations, such as necessity measures. A very compelling argument can be made that the unforeseeable policy changes in these areas, absent prior knowledge on the part of foreign investors, are classical manifestations of political risk.[141] Apart from these limited examples, however, the theory of political risk has little to offer in terms of rendering BITs' design more pro-investment given the fact that BITs are already highly protective of foreign investors.[142]

One final yet crucially important point is that the theory of political risk can be very helpful in the stocktaking of the policy changes in host states which might affect the value or profitability of the foreign investment. Nevertheless, the theory itself says nothing about the distribution of the costs resulting from the materialization of these risks. These costs may well be borne by any, or all, of the parties to the investment triangular relationship: the host state, the foreign investor, and the home state. The fact that the host state, the foreign investor, and even the home state derive benefits from FDI merits some form of sharing of the unforeseeable costs inherent in this international economic activity.[143] However, the current design of BITs mostly sets host states as the only party that can be held liable for these costs. This exclusive liability makes perfect sense whenever host states purposefully or recklessly inflict losses on foreign investors. But when it comes to the losses resulting from other causes of political risk, such as the poor quality of local institutions, unexpected fundamental changes in circumstances in host states, or the need to address some local market failures, a strong case can be made that they should be somehow borne by all the beneficiaries from FDI.

141. At present, the only remedy to political risk in these areas is political risk insurance which does not wipe out the cost incurred by foreign investors upon the materialization of risk. Through subrogation, the insurer merely replaces foreign investors in their claims against host states. *See* Kantor, *supra* note 134, at 461–62.

142. Notably, BITs are much more protective of foreign investors than political risk insurance. *Id.* at 464–66.

143. For more on how these parties benefit from FDI, see *infra* Section V.

V. Economic Growth

The relevance of economic growth or development to the design of BITs can be delineated in both the language of these treaties and the academic debates about the ISDS system. The preambles to many BITs establish economic growth, development, or the prosperity of the parties as a treaty objective.[144] In the literature, a connection is sometimes made between the ISDS system and economic development, especially in host states. Scholars assert that the effective enforcement of the legal protections in BITs is indispensable for maintaining constant flows of FDI across borders.[145] BITs, they argue, compensate for various institutional deficiencies in capital-importing countries which would otherwise inhibit the FDI flows that these countries receive from capital exporters.[146] In light of that, ISDS is claimed to help spur economic development in capital-importing countries.[147]

No single model exists in either economic theory or business economics to explain the importance of FDI to the growth of the three parties to investment relationships: host states, foreign investors, and home states. Instead, the theorization of the benefits each party may derive from FDI is divided into two groups of theories. The first focuses on the contribution of FDI to the growth of host states. The second explains why firms, mostly MNCs, resort to FDI as a business strategy instead of relying on exports or licensing. The latter group also informs the analysis of the gains of home states from outward FDI.

This section discusses the growth advantages of FDI not only for host states but also for foreign investors and home states, especially as they relate to the legal debate about the design of BITs. The design debate

144. *See* Model BITs, *supra* note 103.

145. Charles N. Brower & Stephen W. Schill, *Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?* 9 Chi. J. Int'l L. 471, 496–97 (2008). Brower and Schill assert that "[w]hat should, after all, not be forgotten in this debate is that both capital-importing and capital-exporting countries derive benefits from increased flows of foreign investment. Apart from the transfer of technology connected to foreign investment, the creation of employment, additional tax revenue, etc., investment treaties create a legal infrastructure for the functioning of a global market economy by protecting property rights, offering contract protection, establishing nondiscrimination as a prerequisite for competition through national and most-favored-nation treatment, and making effective dispute-settlement mechanisms. Perfect market conditions presupposed, this leads to the efficient allocation of capital, economic growth, and development, and benefits both capital-exporting and capital-importing countries through an increase in overall well-being." [footnotes omitted].

146. Stephan W. Schill, The Multilateralization of International Investment Law 5–6 (2009).

147. *Id.* at 4–5; Christoph H. Schreuer, *Do We Need Investment Arbitration?* 11 Transnat'l Disp. Mgmt., no. 1, Jan. 2014, at 3–10.

only takes the growth of host states into consideration while completely overlooking the reasons why MNCs may engage in FDI and why their home states support this business strategy. In what follows, I provide a description of these theories as a prelude to highlighting the distorted deployment of economic growth in the legal debate about design. I also explore the normative consequences of a holistic consideration of these theories for the design of BITs.

A. *The FDI-Growth Nexus in Host States*

Contrary to the notion shared by most investment lawyers that FDI is always beneficial for host states,[148] the analysis of the growth effects of FDI in host states has been a painstaking task in economics. In 1956, Robert Solow and Trevor Swan developed what came to be known as the Solow-Swan or the neoclassical growth model.[149] The model explains the growth of GDP by the accumulation of capital, the growth of the labor force, and the increase in the productivity of capital and labor resulting from technical change.[150] The last factor, also known as the Solow residual or total factor productivity, is important specifically because it explains the long-run growth of GDP that is not attributed to increases in either capital or labor, both of which are assumed to yield diminishing returns in the long run. The source of technological progress, however, is not explained by the model and thus remains exogenous.[151] With respect to FDI, the model considers it a mere additional source of capital that adds to the host state's stock of this factor of production.[152] This means that FDI has a limited, or even temporary, positive effect on growth since the benefits of capital accumulation are assumed to be diminishing in the long run.[153]

The neoclassical growth model paved the way for the endogenous growth theory introduced by Paul Romer in 1986. The theory explains the long-run growth of GDP by technological change, understood as both endogenous to the economy and capable of yielding increasing

148. *E.g.*, Salacuse, *supra* note 5, at 449.

149. *See* Robert M. Solow, *A Contribution to the Theory of Economic Growth*, 70 Q.J. ECON. 56 (1956); Trevor W. Swan, *Economic Growth and Capital Accumulation*, 32 ECON. REC. 334 (1956).

150. MARCO NEUHAUS, THE IMPACT OF FDI ON ECONOMIC GROWTH: AN ANALYSIS FOR THE TRANSITION COUNTRIES OF CENTRAL AND EASTERN EUROPE 8 (2006).

151. *Id.*

152. *See* Hans Brems, *A Growth Model of International Direct Investment*, 60 AMER. ECON. REV. 320 (1970).

153. Luiz R. de Mello, Jr., *Foreign Direct Investment in Developing Countries and Growth: A Selective Survey*, 34 J. DEV. STUD. 1, 2 (1997).

returns.[154] It considers investment in human capital and the diffusion of knowledge especially important for growth as two major components of technological change. Applied to FDI, the theory posits that MNCs not only add to the capital stock of host states but also induce knowledge spillovers in these countries by transferring technology to local firms through competition, demonstration, imitation, labor mobility, and vertical integration.[155] MNCs are also thought to contribute to local capacity building by providing the host economy with better job opportunities and more efficient management techniques.[156] In light of these benefits, Romer concluded that FDI contributes to the growth of host states mainly by bridging the "idea gap" between these countries and developed countries.[157]

Under the influence of Romer's theory, a new perspective on FDI policy came to the forefront in the 1980s as part of the Washington Consensus. Developing countries were advised to phase out their import substitution industrialization (ISI) programs, to remove the barriers hindering the free flow of FDI to their economies, and to reinforce competition domestically.[158] The ISI programs were specifically criticized for being harmful to host states' welfare because attracting FDI to a heavily protected economy, typically not large enough to make scale economies possible, was said to result in excessive profits for investors without sufficiently incentivizing them to invest due to the absence of competition.[159]

The removal of barriers to FDI was also encouraged as beneficial not only for host states, but also for creating a global system under which all investors, whether national or foreign, could compete for investment

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154. *See* Paul M. Romer, *Increasing Returns and Long-Run Growth*, 94 J. POL. ECON. 1002 (1986).

155. Paul Romer, *New Goods, Old Theory, and the Welfare Costs of Trade Restrictions*, 43 J. DEV. ECON. 5, 34 (1994); *see also* U. Walz, *Innovation, Foreign Direct Investment and Growth*, 64 ECONOMICA 63 (1997); Ilhan Ozturk, *Foreign Direct Investment-Growth Nexus, A Review of the Recent Literature*, 4 INT'L J. APPLIED ECONOMETRICS QUANTITATIVE STUD. 79, 82 (2007).

156. Magnus Blomström & Ari Kokko, *Human Capital and Inward FDI* 2–3 (CEPR Discussion Paper No. 3762, 2003).

157. Paul Romer, *Idea Gaps and Object Gaps in Economic Development*, 32 J. MONETARY ECON. 543, 548 (1993).

158. WORLD BANK, GLOBAL ECONOMIC PROSPECTS AND THE DEVELOPMENT DEVELOPING COUNTRIES 49 (2001); *see also* John Williamson, Lecture in the series "Practitioners of Development" delivered at the World Bank: The Washington Consensus as Policy Prescription for Development 8–9 (Jan. 13, 2004), https://www.piie.com/publications/papers/williamson0204.pdf.

159. These conditions were referred to as the "immiserizing growth." *See* Richard A. Brecher & Carlos F. Diaz Alejandro, *Tariffs, Foreign Capital, and Immiserizing Growth*, 7 J. INT'L ECON. 317 (1977).

opportunities in host states on an equal footing.[160] In the same vein, arguments were made that wholly-owned foreign subsidiaries, which are also free from any restrictions imposed by host states, are better able to promote growth.[161] Later on, further recommendations were given to developing countries to create FDI-friendly institutions, support the rule of law, and reinforce the protection of foreign investors by signing international investment agreements.[162]

The overall optimism in economic theory about the contribution of FDI to the growth of host states does not carry through to empirical economics. On the one hand, empirical economists do not agree about how the impact of FDI on the growth of host states should be measured. The conventional method calculates the benefits of FDI by the increase in national income that accrues if host states do not introduce barriers to FDI.[163] Romer, however, argues that, in addition to the increase in national income, the new goods FDI makes available in host states must be considered. Adopting the latter method suggests that the welfare gains from FDI are ten to twenty times the size of the gains calculated by the conventional method.[164] Nonetheless, Theodore Moran insists that it remains difficult to use econometric models to measure the positive externalities or spillover effects of FDI, especially those which result

160. WORLD BANK, WORLD DEVELOPMENT REPORT 1991: THE CHALLENGE OF DEVELOPMENT 96–98 (1991).

161. Moran argued that host states face a choice between a "liberal," or unrestricted, export-led, growth model and an inward ISI model in which FDI is restricted by barriers, such as tariffs, local content requirements, performance requirements, and joint venture requirements. *See* THEODORE H. MORAN, HARNESSING FOREIGN DIRECT INVESTMENT FOR DEVELOPMENT: POLICIES FOR DEVELOPED AND DEVELOPING COUNTRIES 6-21 (2006); *see also* Theodore H. Moran, *How Does FDI Affect Host Country Development? Using Industry Case Studies to Make Reliable Generalizations*, *in* DOES FOREIGN DIRECT INVESTMENT PROMOTE DEVELOPMENT? 281, 282–286 (Theodore H. Moran et al. eds., 2005). This binary was challenged by Lawrence who argued that the purely unrestricted, wholly-owned model Moran constructed did not actually exist, even in those countries which adopted an export-led growth model. *See* Robert Lawrence, *Comment*, *in* DOES FOREIGN DIRECT INVESTMENT PROMOTE DEVELOPMENT? 368 (Theodore H. Moran et al. eds., 2005). Numerous examples can also be given for countries which successfully combined an export-led growth model with extensive regulation of FDI. *See, e.g.*, Jaime De Melo & Sherman Robinson, *Productivity and Externalities: Models of Export-led Growth*, *in* MODELING DEVELOPING COUNTRIES' POLICIES IN GENERAL EQUILIBRIUM 43 (Jaime De Melo ed., 2015).

162. UNCTAD, THE DEVELOPMENT DIMENSION OF FDI 50 (2003); ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT [OECD], FOREIGN DIRECT INVESTMENT FOR DEVELOPMENT: MAXIMIZING BENEFITS AND MINIMIZING COSTS 24–28 (2002).

163. Romer, *supra* note 155, at 44–45.

164. *Id.* at 45.

from vertical and horizontal integration between foreign and local firms in host states.[165]

On the other hand, and more importantly, empirical studies on the relationship between FDI and growth show mixed results on the macro level.[166] On the firm level, the possibility of drawing definitive conclusions about the relationship between FDI and increased firm productivity in host states is even dimmer.[167] Absent a universal answer to the question of how FDI contributes to host states' economic growth, economists shifted their focus to the underlying causes of these divergent findings.[168] A widely held view is that the extent to which the host economy benefits from FDI depends on the former's "absorptive capacity," which refers to the ability of local firms to internalize the positive externalities created by the advanced production techniques of MNCs.[169]

The bottom line of these findings is that the mere attraction of FDI should not automatically be viewed as favorable for the growth of host states. In order for FDI to have a positive impact, host states must first attain a minimum level of institutional development and must possess the human capital necessary to assimilate the knowledge spillover from FDI. Absent these capabilities, FDI may pose no benefit or even may be detrimental to host states if it creates enclaves of high productivity that

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165. MORAN, *supra* note 161, at 32–35. Rodrik is even more skeptical. He warns against reverse causality by arguing that export-oriented firms in host states are highly productive because they face international competition, without this high productivity necessarily resulting from any spillovers from foreign investors. *See* DANI RODRIK, THE NEW GLOBAL ECONOMY AND DEVELOPING COUNTRIES: MAKING OPENNESS WORK (Policy Essay No. 24, 1999); *see also* Leonce Ndikumana & Sher Verick, *The Linkages between FDI and Domestic Investment: Unravelling the Developmental Impact of Foreign Investment in Sub-Saharan Africa*, 26 DEV. POL'Y REV. 713 (2008) (arguing that the relationship between foreign and domestic investment is bidirectional).

166. Ewe-Ghee Lim, *Determinants of, and the Relation Between, Foreign Direct Investment and Growth: A summary of the Recent Literature*, 9–10 (IMF, Working Paper WP/01/175, 2001); Robert E. Lipsey & Fredrik Sjöholm, *The Impact of Inward FDI on Host Countries: Why Such Different Answers, in* DOES FOREIGN DIRECT INVESTMENT PROMOTE DEVELOPMENt? 23 (Theodore H. Moran et al. eds., 2005).

167. *See* Brian J. Aitken & Anne E. Harrison, *Do Domestic Firms Benefit from Direct Foreign Investment? Evidence from Venezuela*, 89 AM. ECON. REV. 605 (1999).

168. *E.g.*, LAURA ALFARO, FOREIGN DIRECT INVESTMENT AND GROWTH: DOES THE SECTOR MATTER? (2003), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.465.6169&rep=rep1&type=pdf; Laura Alfaro et al., *Does Foreign Direct Investment Promote Growth? Exploring the Role of Financial Markets on Linkages*, 91 J. DEV. ECON. 242 (2009); Usha Nair-Reichert, & Diana Weinhold, *Causality Tests for Cross-Country Panels: A New Look on FDI and Economic Growth in Developing Countries*, 63 OXFORD BULL. ECON. & STAT. 153 (2001).

169. *See* Eduardo Borensztein et al., *How Does Foreign Direct Investment Affect Economic Growth?* 45 J. INT'L ECON. 115 (1998).

have weak or no linkages to the rest of the economy.[170] Moreover, it remains possible for FDI to crowd out domestic investment as a result of the unequal competition between domestic firms and the more productive foreign firms.[171]

B. *Explaining FDI—Why Do MNCs Invest Abroad?*

Several models were proposed in economic theory and business economics to explain why MNCs may have recourse to FDI as a business strategy. As will be shown later, the common denominator among all these models is the emphasis they place on FDI as a means for MNCs' global expansion and their pursuit of economic "rents" in foreign markets. The consideration of these models sheds light not only on what MNCs gain from establishment in host states, but also on how the legal discourse on the design of BITs completely overlooks these gains.

Early neoclassical explanations of FDI were made using the portfolio theory of capital, which views FDI as a form of arbitrage. It was argued that, in the absence of risks or barriers, capital flows from countries with low interest rates to countries with high interest rates.[172] Nevertheless, the explanatory power of this theory was undermined by two empirical observations. The first is that, despite the higher returns to capital in other countries, the actual flows of capital across borders

170. The critique of the potential absence of "secondary multiplier effects" in the host economy which results from weak backward and forward linkages between FDI and local firms is widely recognized. *See* Hans W. Singer, *The Distribution of Gains between Investing and Borrowing Countries*, 40 AM. ECON. REV. 473, 475–76 (May 1950). *See generally* ALBERT HIRSCHMAN, THE STRATEGY OF ECONOMIC DEVELOPMENT (1958); Ari Kokko, *Technology, Market Characteristics and Spillovers*, 43 J. DEV. ECON. 279 (1994).

171. On FDI's possible crowding-out effect, see Koen De Backer & Leo Sleuwaegen, *Does Foreign Direct Investment Crowd Out Domestic Entrepreneurship?* 22 REV. INDUS. ORG. 67 (2003). FDI may expose host states to other risks including: the non-contribution to domestic capital formation in case foreign investors rely on local capital; upward pressure on exchange rates which renders national exports less competitive; corruption; and environmental degradation. In these situations, FDI may produce negative macroeconomic externalities that outweigh its benefits in host states. *See* Manuel R. Agosin & Ricardo Mayer, *Foreign Investment in Developing Countries: Does it Crowd in Domestic Investment?* 33 OXFORD DEV. STUD. 149, 153 (2000). *See generally* Stephen D. Cohen, *The Case against Foreign Direct Investment and Multinational Corporations*, *in* MULTINATIONAL CORPORATIONS AND FOREIGN DIRECT INVESTMENT: AVOIDING SIMPLICITY, EMBRACING COMPLEXITY 308 (Stephen D. Cohen ed., 2007).

172. CARL IVERSEN, ASPECTS OF THE THEORY OF INTERNATIONAL CAPITAL MOVEMENTS 93–144 (1935); *see also* George D.A. MacDougall, *The Benefits and Costs of Private Investment from Abroad: A Theoretical Approach*, 36 ECON. REC. 13 (1960).

were much more limited than what the theory suggested.[173] More importantly, the theory's prediction that capital flows would eventually slow down due to the convergence of capital returns in home and host states was not empirically corroborated.[174]

Other economists rely on classical trade theory to explain FDI on the assumption that FDI represents a form of trade in capital goods.[175] However, this explanation disregards the central assumption of the theory of comparative advantage that only final goods are tradable across borders.[176] Specifically, the Ricardian model assumes that all factors of production, including capital, remain locked within the trading economies.[177] The same can be said of the neoclassical trade model, also known as the Heckscher-Ohlin model, which is similarly premised on the immobility of capital.[178]

Such problematic disregard of the central assumptions of trade theory when analyzing FDI is not limited to the immobility of capital. The Heckscher-Ohlin model also assumes that the markets of the trading countries are perfectly competitive.[179] As a result, it is not imaginable under the model that a domestic firm would possess a unique advantage over other domestic firms. The model actually rules out this possibility altogether by assuming that technology is equally accessible to all producers. Yet, as will be explained later, FDI arises in some instances from the very possession of these special advantages. The presence of these

173. *See* Martin S. Feldstein & Charles Y. Horioka, *Domestic Saving and International Capital Flows*, 90 ECON. J. 314 (1979).

174. Vintila Denisia, *Foreign Direct Investment Theories: An Overview of the Main FDI Theories*, 2 EURO. J. INTERDISC. STUD. 104, 106 (2010); Ari Kokko, *Home Counties Effects of Foreign Direct Investment in Developing Countries* 4 (European Institute of Japanese Studies, Stockholm School of Economics, Working Paper No. 225, 2006), https://pdfs.semanticscholar.org/a2f9/494724daa90f5f6c222efe133b9551476780.pdf.

175. Some international economists posit that trade models explain international trade in both goods and factors of production, including capital, with the theories of FDI, expounded later in this section, merely complementing these models. For instance, Paul Krugman views the theory of international enterprises as encompassing answers to two questions. The first is about location, which he argues is largely explained by trade models. The second is about internalization to which the theories of FDI provide an answer. He, nonetheless, points out that the theory of international enterprises, also known as the economic theory of organizations, is still in its infancy. PAUL KRUGMAN, INTERNATIONAL ECONOMICS: THEORY AND POLICY 165–66 (8th ed. 2009).

176. DAVID RICARDO, PRINCIPLES OF POLITICAL ECONOMY AND TAXATION 91–92 (3d ed. 2001) (1821).

177. John H. Williams, *The Theory of International Trade Reconsidered*, 39 ECON. J. 195, 196–197 (1929).

178. MICHAEL P. TODARO & STEPHEN C. SMITH, ECONOMIC DEVELOPMENT 583 (11th ed. 2012).

179. *Id.* at 582.

advantages allows domestic firms to make, rather than simply take, the prices of their products domestically and to seek "rents" internationally by way of physical establishment in foreign countries.

Furthermore, the Heckscher-Ohlin model does not offer any insight about the domestic regulatory context of the countries involved in trade despite this context's influence on the flow of goods (including capital goods) across borders. This is because the model assumes that governments are simply passive and that trade takes place among "atomistic and anonymous producers."[180] By contrast, FDI typically takes place in highly regulated environments in both home and host states, with regulation occasionally constituting one of the motivations for FDI.

For these reasons, trade models are viewed in business economics as suitable explanations for international trade, understood as a single exchange of final goods and services across borders, but without much relevance to FDI. In fact, FDI is considered somewhat antithetical to international trade because physical establishment allows firms to internalize foreign markets of capital goods instead of engaging in trade across borders.[181] Accordingly, business economists offer alternative accounts of why firms invest overseas.

The first theory of FDI in business economics was developed by Stephen Hymer in 1960 and was based on industrial organization economics rather than the returns to capital.[182] The theory identifies several motivations for FDI, the most prominent being the circumvention of competition among similar firms and the internalization of the production of intermediate goods within firms. The former motivation gives rise to horizontal integration while the latter leads to vertical integration. In both cases, firms benefit from replacing decentralized international trade in intermediate goods with centralized decision-making processes executed through their own affiliates.[183]

Hymer also noted that FDI can be motivated by the possession of a special advantage such as cheap factors of production, innovative and efficient production techniques, superior marketing capacities, and

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180. *Id.*

181. JOHN H. DUNNING & SARIANNA M. LUNDAN, MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY 97 (2d ed. 2008).

182. Hymer's argument was first made in his PhD thesis but was not published until 1976. *See* Stephen H. Hymer, The International Operations Of National Firms: A Study Of Direct Foreign Investment (May 14, 1960) (unpublished Ph.D. dissertation, Massachusetts Institute of Technology) http://hdl.handle.net/1721.1/27375; STEPHEN H. HYMER, THE INTERNATIONAL OPERATIONS OF NATIONAL FIRMS: A STUDY OF DIRECT FOREIGN INVESTMENT (1976) (published).

183. *Id.* at 37–39.

unique products. Due to these advantages, firms can overcome the cost of establishment overseas and even outperform local firms in host states. They engage in FDI in this case in order to pursue the "rents" given rise to by their monopolistic ownership of these advantages. Similar to the two previous types of FDI, advantage-driven FDI emanates from a market failure in the form of a departure from, rather than an enforcement of, competition in both home and host states.[184]

Another major explanation of FDI in business economics came in 1966 when Raymond Vernon introduced the product life-cycle theory to explain the production patterns of American MNCs. He argued that products go through three stages: innovation, growth, and standardization, with FDI appearing only in the later stages. In the first stage, new products are produced in limited quantities and at high costs, mainly to meet domestic demand in the United States or other developed countries through exports.[185] Later, products become more standardized, and producers grow more concerned with lowering costs in order to preserve their market shares.[186] Increasing demand in other developed countries is met in this stage through direct investment in these countries; consequently, exports of the product from the United States decline.[187] In the final stage of the product life-cycle, products are completely commodified, and competition for their production peaks. Downward pressure on prices pushes producers to start producing in developing countries, and the main goal of FDI shifts from preserving market shares to increasing efficiency and lowering production cost.[188]

While the three stages of Vernon's theory applied perfectly to the cross-border activities of American MNCs in the post-war period, later developments in these MNCs' international activities eroded the theory's explanatory power in the American context. Nonetheless, it remains a plausible explanation for the activities of other countries' MNCs.[189]

The latest explanation of FDI is the one formulated by John Dunning in 1977, which was later called the eclectic paradigm.[190] It

184. *Id.* at 41–46.

185. Raymond Vernon, International Investment and International Trade in the Product Cycle, 80 Q. J. ECON. 190, 194 (1966).

186. *Id.* at 196.

187. *Id.* at 200.

188. *Id.* at 203.

189. Raymond Vernon, *The Product Cycle Hypothesis in a New International Environment*, 41 OXFORD BULL. ECON. & STAT. 255, 265–67 (1979).

190. John Dunning, *Trade, Location of Economic Activity and the Multinational Enterprise: A Search for an Eclectic Approach*, *in* THE INTERNATIONAL ALLOCATION OF ECONOMIC ACTIVITY 395 (Bertil Ohlin et al. eds., 1977). The theory is better understood as an explanation of production abroad

combines insights from both the macroeconomic trade theory and the microeconomic theory of industrial organization. In the absence of a comprehensive model of FDI, which also considers the cross-border movement of final goods and services, i.e., international trade *sensu stricto*, Dunning's paradigm stands to be the most capable of grasping the intricacies of MNCs' decisions to conduct FDI.

According to Dunning, the relocation of part of MNCs' production abroad depends on three types of monopolistic advantages, each of which represents a market failure (i.e., a departure from competition) in host states. The first is the ownership of a special asset which is not available, or at least not available on equally favorable terms, to local firms in host states. The model refers to this asset as the "specific-ownership advantage" or "O."[191] The second is the existence of a location-specific advantage in host states, or what Dunning calls "L." This includes factor endowments as well as domestic legal, political, and financial institutions.[192] The third advantage "I" arises from the firms' internalization of foreign markets of intermediate goods as an alternative to appropriating these goods through international trade. It also encompasses the direct exploitation of the O advantages in host states' markets instead of merely licensing them or resorting to exports.[193] Finally, a cognitive element should be present: the firm must be convinced that international production will be conducive to its long-term profit-maximizing strategy.[194]

Building on his eclectic paradigm, Dunning provides a typology of four types of FDI based on the specific goal of MNCs' establishment in host states.[195] The first is resource-seeking FDI which takes place when MNCs seek to acquire specific resources that are not available at home or in international markets on comparable terms. The second is market-seeking FDI which aims to penetrate new markets. The third is efficiency-seeking FDI which enables MNCs to take advantage of the differences in the relative costs of factors of production in different

regardless of how this production is financed. Foreign affiliates sometimes finance their productive activities in host states through the latter's domestic financial markets rather than their parent companies. *See* DUNNING & LUNDAN, *supra* note 181, at 95.

191. *Id.* at 96.

192. *Id.*

193. *Id.* at 99.

194. *Id.* at 100.

195. John Dunning, *Trade, Location of Economic Activity and the Multinational Enterprise: A Search for an Eclectic Approach*, *in* THE INTERNATIONAL ALLOCATION OF ECONOMIC ACTIVITY 395, 404–05 (Bertil Ohlin et al. eds., 1977). An earlier version of this taxonomy was suggested by Jack Behrman. *See* JACK BEHRMAN, THE ROLE OF INTERNATIONAL COMPANIES IN LATIN AMERICA: AUTOS AND PETROCHEMICALS (1972).

countries or to achieve economies of scale and scope. The fourth is asset-seeking FDI whereby MNCs acquire a strategic asset which reinforces their ownership-specific advantages or weakens those of their competitors.[196]

C. *FDI and the Economic Growth of Home States*

In contrast with what we saw before in relation to host states and foreign investors, neither economic theory nor business economics provides any formal modeling of the advantages of outward FDI for home states. These advantages are rather understood as ancillary to the benefits national firms derive from expanding their business activities to other countries. Nonetheless, multiple hypotheses have been made as to why home states might support exporting capital to other countries irrespective of the gains of their national firms from FDI.

The support of outward FDI by home states is best illustrated by the publicly-sponsored investment guarantees and political risk programs found in both developed and developing capital-exporting countries. The main goal of these programs is to incentivize national firms to invest abroad by offering information about investment opportunities in other countries and providing risk assessment and political risk insurance.[197] Examples of these programs include the International Development Finance Corporation in the United States, the Export Credits Guarantee Department in the United Kingdom., Nippon Export and Investment Insurance in Japan, the China Export and Credit Insurance Corporation, the Export Credit Guarantee Corporation of India, and the Export Credit Insurance Corporation of South Africa. Likewise, the World Bank Group provides similar services through the Multilateral Investment Guarantee Agency.

One compelling explanation of why home states support outward FDI is that investing abroad helps national firms remain globally competitive by preserving global market shares and maintaining a sustainable revenue growth. This is specifically the case because the expansion into foreign markets allows firms to achieve economies of both scale and scope.[198] The former materializes when firms lower their total costs by spreading fixed costs over larger quantities of output, the sales of

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196. DUNNING & LUNDAN, *supra* note 181, at 67–74.

197. *See generally* KATHRYN GORDON, OECD, INVESTMENT GUARANTEES AND POLITICAL RISK INSURANCE, OECD INVESTMENT POLICY PERSPECTIVES (2009).

198. C. Fred Bergsten, Thomas Horst & Theodore H. Moran, *American Multinationals and American Interests*, *in* 15 MARKET STRUCTURE AND INDUSTRIAL PERFORMANCE 260, 261 (Claudio Frischtak & Richard S. Newfarmer eds., 1994).

which are not only limited to the home state. The latter enable firms to constantly enhance the mix of products they sell globally.

Another possible reason of home-state support of outward FDI is that, in many instances, the penetration of foreign markets is not possible through exports from home states but only through the direct sales of foreign affiliates in host states.[199] In the service sector, for instance, foreign firms cannot effectively compete with local firms except through physical establishment. This accentuates the importance of foreign establishment for developed home states given the fact that services currently represent the bulk of their MNCs' overseas economic activities.[200]

Scholars also note the diverse benefits home states obtain from the overseas activities of MNCs, even if a portion of the profits from these activities remains abroad. First, direct establishment in foreign countries, especially for the purpose of horizontal integration, allows MNCs to "export" low-skilled jobs to those countries while adding better-paying, capital- and skill-intensive jobs to the economies of their home states.[201] Second, the sales of affiliates increase, rather than decrease, exports from home states, mainly in the form of exports of intermediate goods from parents to their affiliates.[202] The positive effect of FDI on home states' exports is reinforced by the fact that most of what foreign affiliates produce is not exported back to their home states.[203] Finally, establishment in foreign countries allows MNCs to accumulate knowledge of foreign markets' structures and consumers' preferences, which generates positive spillover effects back home.[204] Empirically, although the studies of the effects of outward FDI on the economies of home states show mixed results, they generally lend support to the above-mentioned benefits.[205]

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199. MATTHEW J. SLAUGHTER, HOW U.S. MULTINATIONAL COMPANIES STRENGTHEN THE U.S. ECONOMY 14 (Business Roundtable & United States Council Foundation, Spring 2009), https://www.uscib.org/docs/foundation_multinationals.pdf.

200. *Id.* at 13.

201. J. David Richardson, *Uneven Gains and Unbalanced Burdens? Three Decades of American Globalization*, *in* THE UNITED STATES AND THE WORLD ECONOMY: FOREIGN ECONOMIC POLICY FOR THE NEXT DECADE 111, 113 (C. Fred Bergsten & Peterson Institute eds., 2005).

202. James K. Jackson, *U.S. Direct Investment Abroad: Trends and Current Issues*, CONG. RES. SERV. 2017, at 4–5 (Cong. Res. Serv. No. RS21118, 2014).

203. *Id.* at 11–12.

204. Kokko, *supra* note 174, at 7–13.

205. Empirical studies on the effects of foreign affiliates on home states' economies focus on how the affiliates' activities impact home states' exports and domestic employment. Economists investigate whether production abroad complements or substitutes the exports of firms in home states, including the affiliates' parents. They also look at whether the jobs created abroad

D. *A Holistic View of Growth as a Foundation of Redesign*

Despite the reference made to economic growth or development in the preambles to BITs, very little is said in the bodies of these treaties about how this objective can be put into effect. Even in the rare cases where economic development is mentioned in the main text, it is only added as a defense to the disciplines of BITs.[206] Consequently, some scholars note that a "striking feature of BITs is the multiplicity of provisions they contain that are specifically designed to protect foreign investments, and the absence of provisions specifically designed to ensure economic growth and development."[207]

One possible explanation of this aspect of the design of BITs is that the drafters of these treaties assume that the protection of foreign investors, which arguably helps attract larger flows of FDI, would automatically lead to economic growth in host states. But as we saw before, the positive contribution of FDI to the economic growth of host states is far from automatic. Rather, it depends on the quality of host states' institutions as well as the virtuous linkages formed between foreign investors and domestic firms.

For this specific reason, the current design of BITs is problematic from a growth perspective because it limits the ability of host states to forge such virtuous linkages. Many BITs, following U.S. BITs, prohibit the imposition of performance requirements on foreign investors while carving out an exception for taxes from the disciplines of BITs.[208] This means that host states still enjoy an unfettered freedom to offer fiscal

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substitute or complement jobs at home. No definitive empirical answer is given in the literature to either of these questions, since the exact outcome depends on contextual circumstances, such as whether MNCs engage in horizontal or vertical integration in foreign markets. Yet in general, the studies support complementarity rather than substitution between the affiliates' sales abroad and home states' exports. They also indicate a limited degree of substitution between the jobs created abroad and those available at home. *See* Kokko, *supra* note 174, at 23; Raymond J. Mataloni, Jr., *American Multinationals and American Interests 40 Years Later: What Have We Learned From Research Using BEA Data?*, SURV. CURRENT BUS., Nov. 2017, at 3–4. https://apps.bea.gov/scb/pdf/2017/11-November/1117-american-multinational-enterprises-research-using-bea-data.pdf.

206. UNCTAD, INTERNATIONAL INVESTMENT RULE MAKING 79 (2008). *See, e.g.*, Article 2 of the additional Protocol of the Indonesia-Switzerland BIT (1974) which allowed Indonesia to derogate from its commitment to provide national treatment to Swiss investors "in view of the present stage of development of the Indonesian economy."

207. Patrick Robinson, *Criteria to Test the Development Friendliness of International Investment Agreements*, 7 TRANSNAT'L CORP. 83, 84 (1998).

208. On the prohibition of performance requirements, see, for example, U.S. Model BIT, *supra* note 103, art. 8; Canada- Cameroon BIT art. 9 (2014); Japan-Myanmar BIT art 6.6 (2013). On the tax exception, see U.S. Model BIT, *supra* note 103, art. 21; Canada-Egypt BIT art. XII (1996); Italy-Georgia BIT art. 3.3 (1997).

incentives (e.g., tax holidays) to attract FDI, but they can no longer use performance requirements to catalyze the generation of positive spillover effects in their economies. Although the record of the latter policies is mixed, late industrialized countries have historically used a mix of fiscal incentives and performance requirements to accelerate the learning processes of their domestic firms and to reinforce the linkages between these firms and foreign investors.[209] The limitations BITs impose in this regard are therefore especially significant in host states characterized by weak institutions, limited absorption capacity, and meager resources that can be used as subsidies. Accordingly, a pro-growth redesign of BITs would enable host states to play a more active role in forming virtuous linkages between foreign and domestic firms through performance requirements or any other comparable means.[210]

Furthermore, the design of some BITs does not account for the possibility that FDI might not be beneficial overall to host states in some situations. Traditionally, pre-admission screening was used to ensure that the incoming FDI would not give rise to harmful competition with domestic firms or lead to any other negative macroeconomic consequences.[211] While most BITs still allow host states to screen FDI by limiting the protection of foreign investors to the post-admission phase, several leading capital exporters are in favor of limiting these screening powers. The 2012 U.S. Model BIT, for instance, seeks to eliminate these powers altogether by extending national treatment to the pre-establishment phase of investment.[212] Undoubtedly, pre-admission screening may result in unfounded discrimination against foreign investors in some situations. Yet from a growth perspective, it is the only means available to host states that would allow them to avoid the possible harmful effects of

209. Ari Kokko, *Globalization and FDI Policies*, *in* THE DEVELOPMENT DIMENSION OF FDI: POLICY- AND RULE-MAKING PERSPECTIVES, UNCTAD 29, 30 (2003); Dani Rodrik, *The Past, Present, and Future of Economic Growth*, 57 CHALLENGE 5, 33 (2014).

210. In fact, the wisdom of the 1990s is being reconsidered in the policymaking world today. Prominent international bodies, such as UNCTAD, have begun to call on host states to revive some of the policies they were forced to give up under BITs, with a view to strengthening linkages between FDI and domestic firms. UNCTAD, STRENGTHENING LINKAGES BETWEEN DOMESTIC AND FOREIGN DIRECT INVESTMENT IN AFRICA 7 (2013) (recommending that African countries promote joint ventures and encourage local input-sourcing).

211. Agosin & Mayer, *supra* note 171, at 159–60. For an example on the use of investment screening in developed countries, see Fabrizio Di Benedetto, *A European Committee on Foreign Investment?* COLUM. FDI PERSP.—PERSP. ON TOPICAL FOREIGN DIRECT INV. ISSUES, no. 214, Dec. 2017, at 2, http://ccsi.columbia.edu/files/2016/10/No-214-Di-Benedetto-FINAL.pdf.

212. U.S. Model BIT 2012, *supra* note 103, art. 3 (mandating that "[e]ach Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment . . . of investments in its territory").

FDI. Interestingly, the opposition to the proposed restrictions on home states' screening powers comes mainly from developed rather than developing countries.[213]

Apart from host states, the importance of FDI for the global expansion of MNCs' activities and for the economic growth of home states is completely overlooked in both the design of BITs and the legal debate about this design. It should thus come as no surprise that most investment lawyers reduce investment agreements to a mere bargain to protect foreign investors in host states in exchange for the benefits the latter are supposed to always derive from FDI. Rather than sustaining the current design of BITs, a holistic approach to the relationship between FDI and economic growth would warrant a revision of this design. Specifically, it would require that attention be paid to the economic advantages of FDI for foreign investors and home states.

Regarding home states, since their gains from outward FDI are largely aligned with those of their MNCs, both home states and MNCs can be viewed as a single party to investment relationships whose interests may occasionally be at odds with the interests of host states. From a normative perspective, the fact that home states and foreign investors along with host states stand to gain from outward FDI lends support to some formula for sharing the unforeseeable costs inherent in FDI among all three parties. Sharing FDI costs along these lines can, of course, be limited to the cases where no bad faith or recklessness may be attributed to host states, as was suggested above.

As for foreign investors, we saw that all the models that explain why they invest overseas indicate that FDI is indispensable for their global expansion. More importantly, the models show, as is best illustrated by Dunning's typology, that MNCs' motivations for FDI can greatly differ. From a growth perspective, it is important to note that the four types of FDI mapped out by Dunning's typology are beneficial for MNCs, but they largely vary in terms of their contribution to the economic growth of host states. This is mainly because they create different backward and forward linkages between MNCs and domestic firms. Hence, they are not equally capable of producing positive spillover effects in host states.[214] On a spectrum of how beneficial FDI can be for the economic growth of host states, efficiency- and asset-seeking FDI would stand on

213. Peter Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?* 2000 INT'L LAW. 1033, 1041–43 (2000).

214. *See generally supra* note 171.

the more beneficial end, resource-seeking FDI would be on the opposite end, and market-seeking FDI would lie in-between.[215]

Despite the overall neglect of the theories of FDI in the investment law literature, the typology of the MNCs' motivations for engaging in FDI made its way to the legal debate about design. However, Dunning's quartet is not invoked to recalibrate or diversify the legal protection BITs accord indiscriminately to the four types of FDI. Instead, it is cited by some lawyers to make a case for further sweeping liberalization of host states' admission policies, specifically by providing foreign investors with pre-establishment national treatment in host states.[216]

A growth-oriented reform of the design of BITs would reassess the symmetrical protection they give to all four types of FDI.[217] The expansive definition of investment in BITs guarantees that the less growth-friendly types of foreign investment, such as resource-seeking FDI, are treated on an equal footing with the other types that are more growth-inducing.[218] An alternative design of BITs, which is more committed to growth, would stratify the legal protection of foreign investors depending on their contribution to the growth or development of host states. It would accord better treatment to greenfield or brownfield investment than short-term investment which merely seeks to benefit from higher returns to capital in host states. It would also ensure that host states enjoy a larger regulatory space in relation to the less beneficial types of FDI and would require foreign investors involved in these types of FDI to abide by stricter standards.

215. In Africa, the structural adjustment programs implemented by many countries in the 1980s and 1990s contributed to a general trend of deindustrialization in the continent. One of the most notable consequences of this transformation was that resource-seeking FDI became the primary form of investment that the continent attracts. The very few linkages this type of FDI creates with local firms, coupled with its upward pressure on exchange rates, supports the conclusion that, from a development perspective, FDI has not been beneficial overall to many host states. U.N. CONFERENCE ON TRADE AND DEVELOPMENT, ECONOMIC DEVELOPMENT IN AFRICA: RETHINKING THE ROLE OF FOREIGN DIRECT INVESTMENT 31–35 (2005); *see also* UNCTAD, STRENGTHENING LINKAGES BETWEEN DOMESTIC AND FOREIGN DIRECT INVESTMENT IN AFRICA 7–8 (2013) (arguing that African countries should not focus on indiscriminately attracting FDI but on implementing national development agendas that take into account the spillover effects of FDI as well as its forward and backward linkages with domestic firms).

216. Ignacio Gómez-palacio & Peter Muchlinski, *Admission and Establishment*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 242–45 (Peter Muchlinski et al. eds., 2008).

217. For a striking example from investment arbitration case law of this symmetrical treatment, see Fedax N.V. v. The Republic of Venezuela, ICSID Case No. ARB/96/3, Award (Mar. 9, 1998).

218. It is noteworthy that the oil, gas, and mining sector has historically contributed the largest number of investment disputes decided by ICSID tribunals. ICSID CASELOAD – STATISTICS (2018), *supra* note 63, at 12.

VI. Economic Efficiency and Comparative Advantage

This section addresses economic efficiency and the theory of comparative advantage simultaneously since they are intertwined in both economic theory and the debate about the design of BITs. Among all the extra-legal theories of design, these two economic models are not only the most common but also the most complex. Their complexity arises from the fact that the lawyers who invoke them see in BITs, and generally in the current investment regime, more than a mere mechanism for the settlement of investment disputes. For these lawyers, BITs represent a building block of a broader governance scheme of the global economy whose primary aim is to achieve an efficient allocation of resources, including capital, across borders. By definition, the analysis of the design of BITs through this lens requires lawyers to engage in an interdisciplinary debate about the economic goals of the regulatory model embodied in these treaties—a topic that falls beyond the interest and expertise of most lawyers in the field.

A comprehensive critique of the ways in which economic efficiency and comparative advantage are deployed in the legal debate about the design of BITs cannot be fully laid out in this Article. Nevertheless, this section discusses at length the centrality of these economic models to the question of design. The section begins by noting the distinct ways in which these models have been invoked in the literature to explain and justify the design of BITs. Next, it shows how the critics of the investment regime accept these models either explicitly or implicitly, thereby solidifying their importance as theories of design. The section closes by proposing a roadmap for future critical research on the role of both models as theories of design.

A. *Efficiency and Comparative Advantage as Theories of Design*

Since 1983, reference to economic efficiency has constantly been made in the U.S. Model BITs. Besides the protection of national investors in the territory of host states, the preambles to these Model BITs uniformly provide that "a stable framework for investment will maximize effective utilization of economic resources."[219] Yet within the

219. Kenneth J. Vandevelde, U.S. International Investment Agreements (2009) (mentioning preambles to the 1983, 1984, 1987, 1991, 1992, 1994, 2004 Model BITs); *see also* U.S. Model BIT 2012, *supra* note 103.

broader universe of BITs, to name efficiency as a treaty objective stands as an exception, rather than the rule.[220]

In the literature, some protagonists of the current investment regime maintain that the design of BITs is motivated by the pursuit of economic efficiency—a view that does not necessarily conflict with the common perception of these treaties as a means to protect national investors abroad. They argue that BITs not only protect foreign investors in host states but also create a liberal international economic order under which capital can flow freely across borders.[221] Two hypotheses are offered for how the design of BITs performs this dual function of protecting foreign investors and laying down the foundations of a global regime of investment based on economic efficiency and comparative advantage.

The first is an argument that was addressed earlier in this Article as part of the discussion of the model of dynamic inconsistency.[222] The argument holds that BITs are designed to provide foreign investors with credible commitments against post-establishment mistreatment by host states. This guarantee allows FDI to flow freely across borders in pursuit of higher returns in other countries. Absent these credible commitments, FDI flows would arguably not occur in the first place or at least would not be of the same magnitude. Hence, it is claimed that BITs efficiently allocate FDI in the global economy.

This argument originated with Andrew Guzman's famous analysis of the design of BITs. While comparing the Calvo doctrine and the U.N. General Assembly resolutions on the NIEO with BITs, Guzman makes a case for the superiority of the latter as a legal framework for the regulation of FDI on the basis of economic efficiency. He asserts that:

> Subject only to transaction costs, a BIT regime will cause capital to be invested where it stands to earn the greatest return. Thus, the cost of investing is reduced, more investment will take place, and the investment that does occur will be allocated in

220. One of the few exceptions in this regard is the 2007 Norwegian Model BIT which adopted a similar language: "Desiring to contribute to a stable framework for investment in order to maximize effective and sustainable utilization of economic resources." Norwegian Model BIT preamble (2007).

221. *See, e.g.*, Alvarez, *supra* note 38, at 3–5 (viewing the provision of heightened protection to American investors abroad and the efficient allocation of capital through undistorted markets as the twin goals of the BITs regime). Alvarez notes that the 1984 U.S. Model BIT "focuses like a laser beam on reducing or eliminating government abuses of power and regulation in order to get prices right so that the market could operate unimpeded." *Id.* at 5.

222. *See supra* notes 125–127 and accompanying text.

an efficient manner. BITs, therefore, yield an *efficient* allocation of capital.[223]

The second line of argument, which refers to economic efficiency and comparative advantage, suggests that BITs are necessary to discipline specific harmful measures to which host states can have recourse vis-à-vis FDI. Lawyers in this scholarly strand characterize these measures as either "distortions" of the global allocation of FDI or "barriers" to its free flow across borders. The former measures manipulate the cost of investment in order to attract FDI to or away from specific host states, while the latter completely prevent investors from having access to profitable investment opportunities available in other jurisdictions. By restraining both types of measures, these lawyers argue, BITs reinforce global economic efficiency because they help allocate FDI according to host states' comparative advantages and not pursuant to arbitrary regulatory interventions in markets.[224] Viewed in this light, the design of BITs is thought to achieve a purely economic, apolitical goal.[225]

This last conceptualization of the relationship between the design of BITs on the one hand, and economic efficiency and comparative advantage on the other hand, is more common in the investment law literature. It underlies some of the arguments made in defense of the overall regulatory scheme embodied in BITs. For instance, José Alvarez succinctly summarizes the theoretical underpinnings of the early U.S. BITs program as follows:

223. Andrew Guzman, *Explaining the Popularity of Bilateral Investment Treaties*, *in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATY, DOUBLE TAXATION TREATIES AND INVESTMENT FLOWS 73, 92 (Karl P. Sauvant & Lisa E. Sachs eds. 2009).

224. *See e.g.*, Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L.J. 469, 476–77 (2000). Vandevelde specifically condemns tariffs, customs unions, and free trade areas because they interfere with the otherwise comparative-advantage-based allocation of FDI. He argues that "[l]iberals would note that tariff-induced foreign direct investment might lead to less efficient outcomes because such tariffs can encourage investment in sectors of the economy in which the host state does not have a comparative advantage. Further, when no genuine comparative advantage exists, the foreign investment is sustainable only so long as the market continues to be protected. Protective tariffs enacted by a member of a customs union or a free trade area similarly diminish efficiency when they divert trade to member states that have no comparative advantage in the goods traded. Meanwhile, the tariffs themselves impose added costs on local consumers, effectively transferring wealth from the local consumers to the foreign investor along with domestic producers." *Id.* at 476–777.

225. Kenneth J. Vandevelde, *Of Politics and Markets: The Shifting Ideology of the BITs*, 11 INT'L TAX & BUS. L. 159, 160–61 (1993) (asserting that "[t]he function of the BIT was to insulate private investment from politically driven foreign or domestic public policy – in effect, to depoliticize investment matters by placing the protection of private investment under an apolitical legal regime."); *see also* Gómez-palacio & Muchlinski, *supra* note 216, at 242–343.

> The United States sold its BIT in this period as an essential (but minimal) building block to a free market economy and to the construction of the rule of law. Signing a U.S. BIT, we said, would send a signal that a country had accepted the basic premises of liberal economic theory – namely that free liberal capital flows would yield, consistent with the insights of David Ricardo, the most efficient use of resources and the greatest productivity.[226]

Other scholars rely on the same understanding to establish a connection between specific provisions of BITs and economic efficiency. For instance, some scholars rationalize extending national treatment to the pre-establishment stage of investment by stating that:

> This approach offers the best access to markets, resources, and opportunities for multinational enterprises and other foreign investors interested in the locational advantages of the host country. It allows for investment decisions to be made on *purely economic grounds* as it obviates the existence of discretionary regulatory mechanisms that may prohibit entry or offer it only on conditions that reduce the overall value of the investment to the investor.[227]

A similar view informs Ibrahim Shihata's commendation of the U.S. BITs because, unlike European BITs, they grant foreign investors pre-establishment non-discrimination rights. This makes the U.S. BITs, according to him, better suited to support the market allocation of FDI. He, accordingly, notes that "[t]hese treaties are based on international investment policy aimed at reducing foreign government actions that *impede* or *distort* investment flows and at developing an international system, based on national treatment and most-favored-nation principles, that permit investment flows to respond more freely to *market forces*."[228]

The "distortion of market forces" in the FDI market also motivates some scholars to condemn performance requirements as a tool of

226. Alvarez, *supra* note 38, at 5.

227. Gómez-palacio & Muchlinski, *supra* note 216, at 242–43 (emphasis added). Later in the same article, the authors argue that "[t]here is little doubt that the full liberalization approach is better suited to these imperatives. It opens up the host country to investment and allows for a reduction of regulatory *barriers* to entry and establishment, thereby making the decision to invest a more *efficiency-led* decision which tends to enhance *economic welfare*." *Id.* at 253 (emphasis added).

228. Ibrahim F.I. Shihata, *Recent Trends Relating to Entry of Foreign Direct Investment*, 9 ICSID REV. FOREIGN INV. L.J. 47, 56 (1994) (emphasis added).

investment policy because "[s]creening and review mechanisms condition entry or establishment of new investments on the investor's acquiescence to on-going requirements with respect to local sourcing, export promotion, and other undertakings. These requirements can be sufficiently burdensome to discourage investors from investing, likewise causing a *distortion of market forces*."[229]

For these scholars, the prohibition of performance requirements in BITs improves allocative efficiency because it averts the "disruptive effect" of these requirements on "open trade and investment flows." They consequently reason that:

> Performance requirements imposed on an investor by law, or by review or screening mechanisms, may have a disruptive effect on trade and investment patterns. In addressing the performance requirements issue explicitly and apart from other barriers to open trade and investment flows, the drafters of the Model BIT believed that elimination of such requirements is of particular concern in creating a mutually acceptable, open investment environment.[230]

In the same vein, the dispute settlement provisions of BITs are lauded as a means to efficiently allocate FDI across borders. Scholars argue that ISDS ensures the settlement of disputes that arise between foreign investors and host states in a neutral, depoliticized way.[231] By shielding investment against political interventions, BITs arguably avoid disruptions of FDI flows to the capital-deprived regions of the world.[232] Therefore, it is widely held in the literature that the ISDS system is not only beneficial to home states, but rather makes all states better off.[233]

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229. K. Scott Gudgeon, *United States Bilateral Investment Treaties: Comments on their Origins Purpose and General Treatment Standards*, 4 BERKLEY J. INT'L L. 105, n.78 (1986) (emphasis added).

230. *Id.* at 126–27.

231. Shihata, for instance, argues that "ICSID should not be solely regarded as a mechanism for the settlement of investment disputes. Its paramount objective is to promote a climate of mutual confidence between investors and states favorable to increasing the flow of resources to developing countries under reasonable conditions." Ibrahim I. Shihata, *Towards a Greater Depoliticization of Investment Disputes: The Roles of ICS1D and MIGA*, at 5–6, World Bank Working Paper 34898 (Jan. 1, 1992), http://documents.worldbank.org/curated/en/33593146831528 6974/pdf/Towards-a-greater-depoliticization-of-investment-disputes-the-roles-of-ICSID-and-MIGA.pdf; *see also* Jan Paulson, *Third World Participation in International Investment Arbitration*, 2 ICSID REV. 19 (1987).

232. SCHILL, *supra* note 146, at 5–6.

233. Charles N. Brower & Stephen W. Schill, *Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?* 9 CHICAGO J. INT'L L. 471, 496 (2009).

The perceived role of BITs in disciplining "distortions" and "barriers" even informs some critical perspectives on design. While accepting this role in principle, some advocates of the current investment regime argue that BITs do not actually go far enough in this direction since they still allow host states to interfere with the FDI flows they receive. This gives rise to "inefficient allocations" of FDI according to these scholars. Kenneth Vandevelde, for example, contends that:

> The interventionist measures permitted by the BITs are antithetical to economic liberalism. For example, in their failure to create a right of establishment for investors, the BITs acquiesce in government screening that may result in *inefficient allocations* of resources. Consequently, host states may screen out investments that would introduce efficiency-enhancing technology in order to protect a labor-intensive, but *inefficient*, domestic industry that employs more people. Much the same can be said of the BITs' tolerance of other interventionist tactics, such as local participation requirements, trade-diverting customs unions, protective tariffs and tax incentives. In each case, the BIT permits the host state to choose *economically inefficient* behavior in furtherance of its *political* goals.[234]

B. *The Models in the Critical Discourse*

While the critics of the investment regime take issue with various aspects of BITs, none of their critiques directly speak to economic efficiency or comparative advantage as theories of design. Debating the balance BITs strike between the rights of foreign investors and host states is the closest that critics get to discussing these economic rationales. In those debates, however, the critics accept the aforementioned rationales either explicitly or implicitly, thus leaving the efficiency and comparative-advantage justifications of BITs' design unchallenged.

Some critiques of the imbalance of rights in BITs underscore the "unfairness" resulting from the asymmetry between the protections

234. Kenneth J. Vandvelde, *The Political Economy of a Bilateral Investment Treaty*, 92 AM. J. INT'L L. 621, 634 (1998) (emphasis added). This sharp distinction between the "economic" and the "political" is evident in Vandvelde's critique of the overall regulatory model embodied in BITs: "The subordination of economic considerations to political considerations is a defining feature of economic nationalism. The BITs place a great deal more importance on protecting the interests of home state investors and preserving the *political* prerogatives of the host state than on promoting *economic efficiency*." *Id.* at 634 (emphasis added).

accorded to foreign investors and the powers reserved for host states.[235] For some scholars, especially those who adopt a third-world approach to international law, such unfairness is so significant as to warrant the conclusion that the investment regime embodies neo-colonialism in international economic relations.[236] Similar critiques emanate from a Marxist view, assuming that international investment law is a means to restrain the domestic laws of host states for the sake of the global accumulation of capital.[237]

Another version of the imbalance critique is motivated by concerns about democracy and public interest. Scholars and activists from developed home states maintain that BITs prioritize the protection of investors' economic interests abroad over the realization of public interest at home. They justify their objection to BITs by the regulatory chill these treaties impose on domestic regulators even in developed countries. To these critics, this represents a serious encroachment on national democratic institutions.[238] Remarkably, despite the difference in their immediate focus, the two preceding versions of the imbalance critique accept or at least do not challenge the economic justifications of the design of BITs.[239]

The argument that BITs are not conducive to the development of host states (discussed in the previous section) provides the third version

235. *See* Olivia Chung, *The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-State Arbitration*, 47 VA. J. INT'L L. 953 (2007); York University, *Public Statement on the International Investment Regime* (Aug. 31, 2010), http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/.

236. *See* James T. Gathii, *War's Legacy in International Investment Law*, 11 INT'L COMMUNITY L. REV. 353 (2009); *see also* Ibironke T. Odumosu, *The Law and Politics of Engaging Resistance in Investment Dispute Settlement* 26 PENN STATE INT'L L. REV. 251, 256 (2007).

237. Bhupinder S. Chimni, *International Institutions Today: An Imperial Global State in the Making*, 15 EUR. J. IND. L. 1, 7 (2004).

238. *E.g.*, PUBLIC CITIZEN AND FRIENDS OF THE EARTH, NAFTA CHAPTER 11 INVESTOR-TO-STATE CASES: BANKRUPTING DEMOCRACY LESSONS FOR FAST TRACK AND THE FREE TRADE AREA OF THE AMERICAS (2001); OECD, *"Indirect Expropriation" and the "Right to Regulate" in International Investment Law* (OECD Working Papers on International Investment, 2004/04), http://dx.doi.org/10.1787/780155872321; Choudhury, *supra* note 90; Caroline Henckels, *Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration*, 15 J. INT'L ECON. L. 223 (2012); Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA's Investment Protection and the Misguided Quest for International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30 (2003); Charles H. Brower, *Obstacles and Pathways to Consideration of the Public Interest in Investment Treaty Disputes*, *in* YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY 2009 347 (Karl P. Sauvant ed., 2008).

239. Sornarajah, for instance, argues that "[o]pponents are likely to ask whether, even if the economic theories are sound, the political and other considerations should not be taken into account in devising a global policy on foreign investment." SORNARAJAH, *supra* note 140, at 52.

of the imbalance critique. For the development-oriented critics, BITs do not create a reasonable balance between the dual goal of liberalizing and protecting FDI and host states' need for regulatory space to implement national development policies.[240] In response, some investment lawyers advocate for the reformulation of specific provisions in BITs so as to make these treaties more development-friendly.[241] Others make a case for eliminating some of the restrictions BITs impose on host states for the benefit of foreign investors.[242] Less ambitious proposals call for the interpretation of BITs in a way that takes economic development into consideration as a treaty objective.[243] Nonetheless, none of these recommendations address the claimed economic underpinnings of the design of BITs or clarify how the goal of development can be reconciled with the efficient allocation of FDI across borders.

The last version of the imbalance critique is grounded in the fragmentation of international law.[244] The possible tensions between host states' obligations toward foreign investors and the duties these states owe to their domestic population is sometimes framed as an imbalance between the goals of BITs, understood as purely "economic," and the "non-economic" policy objectives enshrined in other subfields of international law.[245] The proponents of such duality attempt to reshape the

240. *See* Luke Eric Peterson, *Bilateral Investment Treaties and Development Policy-Making, International Institute for Sustainable Development* (2004), https://www.iisd.org/pdf/2004/trade_bits.pdf; Tarcisio Gazzini, *Bilateral Investment Treaties and Sustainable Development*, 15 J. WORLD INV. & TRADE 929 (2014).

241. *See* SORNARAJAH, *supra* note 140, at 229; Genevieve Fox, *A Future for International Investment? Modifying BITs to Drive Economic Development*, 46 GEO. J. INT'L L. 229 (2014).

242. *E.g.*, Joshua Boone, *How Developing Countries Can Adapt Current Bilateral Investment Treaties to Provide Benefits to their Domestic Economies*, 1 GLOBAL BUS. L. REV. 187 (2011); HOWARD MANN, KONRAD VON MOLTKE, LUKE ERIC PETERSON & AARON COSBEY, IISD MODEL INTERNATIONAL AGREEMENT ON INVESTMENT FOR SUSTAINABLE DEVELOPMENT, INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT (2005), https://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf; Ursula Kriebaum, *Regulatory Takings: Balancing the Interests of the Investor and the State*, 8 J. WORLD INV. & TRADE 717 (2007).

243. *See* Felix O. Okpe, *Endangered Element of ICSID Tribunal Practice: Investment Treaty Arbitration, Foreign Direct Investment, and the Promise of Economic Development in Host States*, 13 RICH. J. GLOBAL L. & BUS. 217 (2014).

244. *See generally* Andreas Fischer-Lescano & Gunther Teubner, *Regime-Collisions: The Vain Search for Legal Unity in the Fragmentation of Global Law*, 25 MICH. J. INT'L L. 999 (2004).

245. KATIE BACHARACH, ADDING A BIT OF LABOR PROTECTION TO OUR BITS (2013), http://www.gjil.org/2013/11/adding-bit-of-labor-protection-to-our.html; PETERSON & GRAY, *supra* note 72, at 35; Joshua Frank Curtis, *The 'Economics of Necessity', Human Rights and Ireland's Natural Resources,* 7 IRISH Y.B. INT'L L. (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2416783; Rayan Suda, *The Effect of Bilateral Investment Treaties on Human Rights Enforcement and Realisation*, *in* TRANSNATIONAL CORPORATIONS AND HUMAN RIGHTS 73 (Olivier De Schutter ed.,

rights and obligations of the parties to investment relationships by insisting that human rights, labor standards, environmental protection, and public law should be recognized as relevant bodies of law under international investment law.[246] Yet, similar to the previous versions of the imbalance critique, these recalibration arguments do not pierce the veil of the economic logic attributed to the design of BITs.

In addition to academic debates, economic efficiency and comparative advantage hold considerable sway in the world of policymaking. The two models shape the perspective of prominent international organizations on BITs' design, even those one might expect to be critical of the contemporary investment regime, such as the United Nations Conference on Trade and Development (UNCTAD). Despite its historical role as an advocate for the interests of developing countries in international trade negotiations, UNCTAD explicitly accepts economic efficiency as the overarching rationale of the design of BITs in its official publications.[247]

For instance, UNCTAD's publication on admission and establishment makes a case for non-discrimination with regard to establishment by arguing that:

> The underlying rationale for granting rights of establishment for foreign investors is to allow the *efficient allocation* of productive resources across countries through the operation of market forces by avoiding *policy-induced barriers* to the international flow of investment. In this sense it can be said that rights of

2006); Sheldon Leader, *Human Rights, Risks, and New Strategies for Global Investment*, 9 J. INT. ECON. L. 657, 678–79 (2006); Peter Muchlinski, *Corporate Social Responsibility, in* THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 637, 638–39 (Peter Muchlinski et al., eds., 2008); Patrick Dumberry & Gabrielle Dumas-Aubin, *When and How Allegations of Human Rights Violations Can Be Raised in Investor-State Arbitration*, 13 J. WORLD INV. & TRADE 349, 358–60 (2012). *But see* James D. Fry, *International Human Rights Law in Investment Arbitration: Evidence of International Law's Unity*, 18 DUKE J. OF COMP. & INT'L L. 77 (2007).

246. *E.g.*, Lance Compa, *The Multilateral Agreement on Investment and International Labor Rights: A Failed Connection*, 31 CORNELL INT'L L.J. 683 (1998); Amr A. Shalakany, *Arbitration and the Third World: A Plea for Reassessing Bias under the Specter of Neoliberalism*, 41 HARV. INT'L L.J. 2 (2000); Caroline E. Foster, *A New Stratosphere? Investment Treaty Arbitration as 'Internationalized Public Law*, 64 INT'L & COMP. L.Q. 461 (2015).

247. Since 1964, UNCTAD has actively taken part in international trade negotiations. Currently, it is one of the main intergovernmental organizations which provide developing countries with technical assistance on issues related to international economic law and policy. It carries out its mandate by publishing periodic reports and providing policy recommendations, especially with respect to the drafting of international economic agreements and the formulation of national trade and investment policies. *See* UNCTAD, BEYOND CONVENTIONAL WISDOM IN DEVELOPMENT POLICY: AN INTELLECTUAL HISTORY OF UNCTAD 1964–2004 (2004).

> establishment attempt to avoid discriminating between foreign and domestic investors and/or investors from different home countries.[248]

A similar view informs UNCTAD's publication on the most-favored-nation treatment, which rationalizes this standard by stating that:

> By prohibiting differentiated treatment as regards the competitive framework, the MFN treatment clause establishes a level field amongst the relevant players and avoids *market distortions*, favouring a sound competitive environment, thus contributing to the *economic objective* of the IIA.[249]

C. *The Missing Debate*

The preceding exposition shows that the critics of BITs do not engage with economic efficiency and comparative advantage as theories of design. Their critiques are external rather than internal to these two important design justifications, leaving the purported embeddedness of BITs' design in economics unchallenged.[250] The critics may even inadvertently validate the claims about such embeddedness whenever they emphasize the "economic" character of BITs that, according to them, should be counterbalanced by "non-economic" goals.

The imbalance critiques motivated by concerns about inequality or public interest are a good case in point. Scholars who entertain these views do not address the argument that the efficient allocation of FDI across borders justifies the obligations imposed on host states by BITs. Likewise, they do not debate whether the specific government measures disciplined by BITs are distortive or corrective of the global allocation of FDI. The essence of their critiques is that, irrespective of any economic justifications, the pursuit of important non-economic objectives, such as fairness in international economic relations or democratic governance in developed home states, calls for a reform of BITs.

248. UNCTAD, *Admission and Establishment*, 2002 UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS 11 (emphasis added).

249. UNCTAD, *Most-Favored Nation Treatment*, UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS 32 (2002) (emphasis added).

250. For similar external critiques of economic efficiency in the debates about domestic law, see Frank I. Michelman, *Norms and Normativity in the Economic Theory of Law*, 62 MINN. L. REV. 1015 (1977).

The same can be said of the critique that BITs do not strike the right balance between the liberalization and protection of FDI and the development of host states. The gist of this critique is that more weight should be given to development in international investment law. Yet this says little to nothing about the economic arguments put forward by the BITs' advocates and may in fact corroborate them. The call for an occasional sacrifice of efficiency or departure from comparative advantage for the sake of development implies that the design of BITs is, in principle, tied to the former models. The fragmentation critique of BITs is no different. Stressing the need for a better balance between the so-called economic goals of international investment law and the non-economic policy objectives of the other subfields of international law buttresses, rather than undermines, the alleged economic underpinnings of the design of BITs.

Without scrutinizing the claim that the design of BITs is grounded in economic theory, all versions of the imbalance critique can be easily dismissed. As shown by the instructive theoretical debates about domestic law, the conventional rejoinder to the external critiques of efficiency is that the critics' redistributive agendas can be achieved through a less costly and a better targeted intervention that does not compromise the efficient allocation of resources.[251] Perhaps this is why challenges to the main provisions of BITs, such as the prohibition of performance requirements, are simply banished by the BITs' advocates as "bad economics."[252] A similar response can be given specifically to the fragmentation critique: the investment regime deals with an economic issue, namely the allocation of FDI across borders, and is not suited to deal with the non-economic questions arising from human rights, labor standards, environmental protection, and democracy. Furthermore, it can be argued that the pursuit of redistributive agendas in international investment law through the backdoor of these other subfields of international law is "inefficient."

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251. *See generally* ARTHUR OKUN, EQUALITY AND EFFICIENCY: THE BIG TRADEOFF (1975). Musgrave offers one of the earliest statements of this view. RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE 3-27 (1959) (drawing a distinction between the allocative and the distributive functions of government). In the field of lawmaking, the argument was first developed by Shavell. *See* Steven Shavell, *A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation?*, 71 AMER. ECON. REV. 414 (1981); *see also* Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994).

252. Barton Legum, *Understanding Performance Requirement Prohibitions*, *in* CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION: THE FORDHAM PAPERS 2007 53, 57–58 (Arthur W. Rovine ed., 2008).

An alternative approach to the analysis of economic efficiency and comparative advantage as theories of design would be to explore whether the design of BITs can *actually* be explained by these economic models. It would question the sharp dichotomy established in the literature between the market allocation of FDI and the allocation resulting from regulatory interventions, with the former being portrayed as apolitical and efficient and the latter as political and arbitrary.[253] Underlying this distinction is a more profound argument, which should also be closely examined, about the possibility of easily differentiating between the government measures which create or correct markets and those which distort them.[254] Finally, and assuming that these models can explain the design of BITs, such an internal enquiry would look into the reform program inspired by these models by laying out its pros and cons and by highlighting any internal indeterminacies it might have.

Addressing these points is indispensable for any proposal that seeks to reimagine the investment regime while tackling the most important justifications of the design of BITs in the literature—namely, economic efficiency and comparative advantage. Clearly, this is a highly challenging task that must be left to future work.

VII. Conclusion

At the present moment of uncertainty in international investment law, international investment lawyers are deeply engrossed in discussions about the future. The legal protection foreign investors are entitled to receive under international law was, in the recent past, a matter of consensus. Now, the reform of the investment regime is so divisive that the continuation of the old unanimity has become a far-fetched hope. The regulatory model embodied in BITs will most likely persist in the foreseeable future, but novel models for the governance of FDI are also on the rise.

Despite the fact that BITs are being reconsidered by an increasing number of states, most investment lawyers continue to be solely preoccupied with dispute settlement. This Article sought to shift the focus of the debates about the reform of international investment law to the substance of BITs, considered in this Article under the rubric of "design." It offered several hypotheses as to why this topic is constantly overlooked in mainstream scholarship. More importantly, it pointed

253. This distinction premises the U.S. negotiation objectives concerning foreign investment. *See* Trade Act 2002, Pub. L. No. 107-210, § 2102 ¶ 3 (2002).

254. Alvarez, *supra* note 38, at 6.

out the ways in which the overemphasis on dispute settlement contributes to the normalization of the design of BITs, thus keeping the reconsideration of this design out of the realm of possible reforms of international investment law.

This Article critically engaged with four extra-legal theories offered in present literature to rationalize the design of BITs. The first was the theory of political risk, as modeled by obsolescing bargains and dynamic inconsistency, while the second was economic growth or development. The Article explored the extent to which these theories explain the design of BITs. It concluded that the explanations these theories provide are partial at best. Normatively, the Article argued that instead of supporting the current design of BITs, these theories warrant its reform. It went on to detail the aspects of design that should be reconsidered if these theories are to be fully accepted as theories of design.

As for the other two justifications of BITs' design—economic efficiency and the theory of comparative advantage—the Article described in detail two different ways in which these economic models are deployed by the pro-BITs scholars in the design debate. It highlighted the great influence that these two models wield in both scholarly literature and policymaking, noting the lack of a systematic scrutiny of their role as theories of design. The Article concluded by offering a roadmap for further research in this area as a necessary step towards reimagining contemporary international investment law.