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The U.S. Bilateral Investment Treaty Program: An Overview

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Abstract. This report provides an overview of the U.S. Bilateral Investment Treaty (BIT) program and highlights two issues that may be of additional congressional interest: the impact of BITs on U.S. direct investment abroad and whether U.S. BITs promote economic reform in partner countries.

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Summary

International trade flows are largely governed by multilateral agreements reached at the World Trade Organization, but no comparable rules exist for investment. In its place, the bilateral investment treaty (BIT) has emerged over the past several decades as the primary means for promoting and regulating foreign direct investment flows.

A BIT is a treaty of international law, which establishes a contract of mutual protection to private persons or firms in each other's territories. Incentives to sign BITs include the desire to protect overseas capital investment and to increase the opportunities for additional investments. In addition, foreign direct investment (FDI) host countries sign BITs primarily to promote inward FDI and signal to foreign investors that they will respect foreign property rights. Investors sometimes express concerns, however, that developing countries, where the quality of domestic institutions is weak, will make promises of protection to foreign investors prior to investment, only to change various terms (such as raising taxes, introducing various export quotas, or expropriation of assets) following the investment.

The United States established its BIT program in 1981, largely modeled on European BITs with developing countries that had been in place since the late 1950s. Since 1981, the U.S. BIT program has established international agreements with 47 countries. The U.S. government has also increasingly included investment chapters in its free trade agreements that mirror existing U.S. BITs.

U.S. BITs establish reciprocal requirements of mutual protection of foreign investments. Furthermore, the agreements guarantee an investor the right to seek international arbitration of investment disputes without requiring them to first pursue settlement through the local court system.

As the second session of the 110th Congress pursues its oversight of U.S. foreign investment, the U.S. BIT program may come under additional scrutiny. Some observers argue that the United States has not pursued an aggressive enough strategy in facilitating foreign protection for U.S. direct investment abroad and that U.S. companies may be at a competitive disadvantage with European firms, whose home countries have pursued BITs more aggressively than the United States. Others, however, raise concerns that since U.S. BITs are reciprocal agreements, they may limit the ability of the United States to impose certain regulations without the threat of liability before an international arbitration. Moreover, Congress has raised concerns that foreign investors should not be granted protections for their investments in the United States that are not available to U.S. domestic investors.

This report provides an overview of the U.S. BIT program and highlights two issues that may be of additional congressional interest: the impact of BITs on U.S. direct investment abroad and whether U.S. BITs promote economic reform in partner countries. It will be updated as events warrant.

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Introduction

Foreign investment issues have come under increasing U.S. and international scrutiny in recent years. Following the September 11th attacks, many Americans raised concerns about the potential security and economic impact of foreign investment in industries that may be sensitive to U.S. national security. In 2005, the China National Offshore Oil Company (CNOOC) dropped its proposed acquisition of Unocal oil company in light of such concerns.[1] In 2006, Dubai Ports World sold its recently acquired U.S. port operations in six U.S. cities due to congressional and broader U.S. concerns.[2] Regarding U.S. direct investment abroad, concerns are often raised by Members of Congress about potential negative domestic economic effects including job loss and decreased U.S. production.[3]

As the second session of the 110th Congress pursues oversight of U.S. foreign investment, the U.S. bilateral investment treaty (BIT) program may come under additional scrutiny. Since 1981, the U.S. BIT program has established international agreements with 47 countries. The U.S. government has also increasingly included investment chapters in its free trade agreements that mirror existing U.S. BITs. U.S. BITs establish reciprocal requirements of mutual protection of foreign investment. Furthermore, the agreements guarantee an investor the right to seek international arbitration of investment disputes without requiring them first to pursue settlement through the local court system.

Some observers argue that the United States has not pursued an aggressive enough strategy in facilitating foreign protection for U.S. FDI and may be at a competitive disadvantage with European countries, which have pursued BITs much more aggressively than the United States. “Bilateral investment treaties and the investment chapters of our FTAs are critical in protecting U.S. investment against unfair government action that undermines U.S. competitiveness. These instruments can facilitate, protect and increase foreign direct investment and trade,” testified Harold McGraw III, President and CEO of McGraw Hill and Chairman of the Business Roundtable, a lobbying and advocacy group for U.S. businesses, before the House Ways and Means Committee in January 2007 hearings.[4] He further noted concerns that in many key emerging markets including China, India, and Indonesia, U.S. foreign direct investment is not protected by a BIT.

At the same time, concerns about the security of U.S. direct investment abroad has been heightened by a potential backlash against foreign investment among some developing countries.[5]

[1] CRS Report RL33093, *China and the CNOOC Bid for Unocal: Issues for Congress*, by Dick K. Nanto et al.

[2] For more information on the Dubai Ports World scandal, see CRS Report RS21852, *The United Arab Emirates (UAE): Issues for U.S. Policy*, by Kenneth Katzman.

[3] For more information on U.S. foreign direct investment, direct investment abroad, and U.S. oversight, see the following reports by James K. Jackson: CRS Report RS21857, *Foreign Direct Investment in the United States: An Economic Analysis*; CRS Report RS21118, *U.S. Direct Investment Abroad: Trends and Current Issues*; CRS Report RL33388, *The Committee on Foreign Investment in the United States (CFIUS)*; and CRS Report RL33856, *Exon-Florio Foreign Investment Provision: Overview of H.R. 556*.

[4] Statement of Harold McGraw III, Chairman, President, and CEO, The McGraw-Hill Companies, and Chairman, Business Roundtable, and Chairman, Emergency Committee for American Trade, New York, New York, before the House Committee on Ways and Means, January 30, 2007. Available at http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5409.

[5] Karl Sauvant, “Chavez Strategy Points to Emerging Nation Rethink on Approach to FDI,” *Financial Times*, January 15, 2007.

In Venezuela, President Hugo Chavez nationalized several telecommunications and energy companies in early 2007. Unlike European companies, such as Paris-based Total-SA or London-based, British Petroleum., who are covered by European BITs with Venezuela (Venezuela is party to over two dozen BITs), American investors have little to no recourse. Several U.S.-based companies including Exxon Mobil, Chevron Corp., and ConocoPhillips have substantial energy investments in Venezuela. According to one U.S. lawyer who is involved in BIT arbitration, "I wouldn't be optimistic that the U.S. investors would be as fairly treated as they should be."[6]

Others, however, raise concerns that since U.S. BITs are reciprocal agreements, they may limit the ability of the United States to impose certain regulations without the threat of liability before an international arbitration. Moreover, Congress has raised concerns that foreign investors should not be granted protections for their investments in the United States that are greater than those available to U.S. domestic investors.

Thus, many observers argue that U.S. bilateral investment treaties need to strike a delicate balance between increasing protections for U.S. investment abroad and maintaining the ability of the U.S. government to regulate in the national interest. This report provides background information on the U.S. BIT program and the international proliferation of such agreements. Two issues that Congress may wish to consider as it evaluates future BITs currently under negotiation are whether U.S. BITs promote investment abroad, and whether U.S. BITs promote governance reforms in developing countries.

Background

Context

While international trade is largely governed by multilateral agreements reached at the World Trade Organization (WTO), no such international consensus exists for investment. Multilateral efforts to reach such a consensus, ranging from the post World War II Havana Charter to most recently the OECD's effort to reach a Multilateral Agreement on Investment in 1998 and attempts to include investment provisions in the Doha Round of WTO negotiations have failed.[7]

In its place, the bilateral investment treaty (BIT) has emerged over the past several decades as the primary means for promoting and regulating foreign direct investment flows. A BIT is a treaty of international law, which establishes a contract of mutual protection to private persons or firms in each other's territories. Incentives to sign BITs include the desire to protect overseas capital investment and to increase the opportunities for additional investments. Developing countries, on the other hand, sign BITs primarily to promote inward FDI and signal to foreign investors that they will protect foreign property rights. There is a concern that many developing countries, where the quality of domestic institutions is weak, may make promises of protection to foreign investors prior to investment, only to change various terms (such as raising taxes, introducing various export quotas, or expropriation of assets) following the investment.

[6] Peter Robinson, "Chavez Adds Legal, Insurance Risks for U.S. Companies," *Bloomberg.com*, January 10, 2007.

[7] See CRS Report RL32060, *World Trade Organization Negotiations: The Doha Development Agenda*, by Ian F. Fergusson.

The provisions of U.S. BITs are generally quite similar across countries. They are a combination of the substantive obligations of the investment treaty agreement and provisions allowing for international arbitration of commercial investment disputes. The former typically include national treatment and most-favored nation (MFN) treatment of foreign investors in the host country,[8] the right to transfer profits in hard currency to the home country, prohibition on the use of performance requirements,[9] and protection against direct and indirect expropriation.

BITs first emerged at the end of the 1950s, during a period of increasing developing country resistence to foreign investment. Prior to World War II, many of the world's major nations agreed that foreign investment should be protected by international law and that any taking of foreign property by a host country required appropriate compensation. Known as the Hull Rule (after former U.S. Secretary of State Cordell Hull), this policy evolved out of an investment dispute between Mexico and the United States regarding expropriation of various foreign agrarian and oil assets by the Mexican government between 1915 and 1940. In resolving the dispute, Secretary of State Hull put forth what would become the classic statement of full investment protection: "No government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate, and effective payment therefor."[10] Many analysts contend that this policy remained customary international law until the end of World War II.

Decolonialization and the rise of a group of Soviet states led to the collapse of any international consensus on the treatment of foreign investment. Many developing countries regarded foreign investment warily, since it gave foreign companies control over the means of production. Foreign investment was neo-colonialist and through it, they argued, the developed countries could interfere in the domestic policies of the host nation. Many countries turned inward, shunning foreign investment, expropriating foreign assets, and establishing import substitution policies that placed high tariffs on foreign goods in an attempt to stimulate local production of needed goods and services. According to one analyst, "In the period after World War II, as foreign investment gained momentum as an increasingly important international economic activity, foreign investors who sought the protection of international investment law encountered an ephemeral structure consisting largely of scattered treaty provisions, a few questionable customs, and contested general principles of law."[11]

The Proliferation of BITs

Responding to growing developing country opposition to foreign investment, several European countries began negotiating bilateral treaties to protect their individual investments. The first two

[8] National treatment means that imported and locally-produced goods should be treated equally—at least after the foreign goods have entered the market. For the United States, most-favored nation (MFN) status means equal—rather than exclusively favorable—treatment. For more information, see CRS Report RL31558, *Normal-Trade-Relations (Most-Favored-Nation) Policy of the United States*, by Vladimir N. Pregelj.

[9] Performance requirements are market distorting conditions imposed that a country imposes on foreign firms. Trade economists identify two main types of performance requirements: mandatory performance requirements and incentive-based performance requirements. Mandatory performance requirements are conditions or requirements that are imposed at the pre- and/or post-establishment phases of an investment. Incentive-based performance requirements are conditions that an investor must meet to secure a government subsidy or incentive.

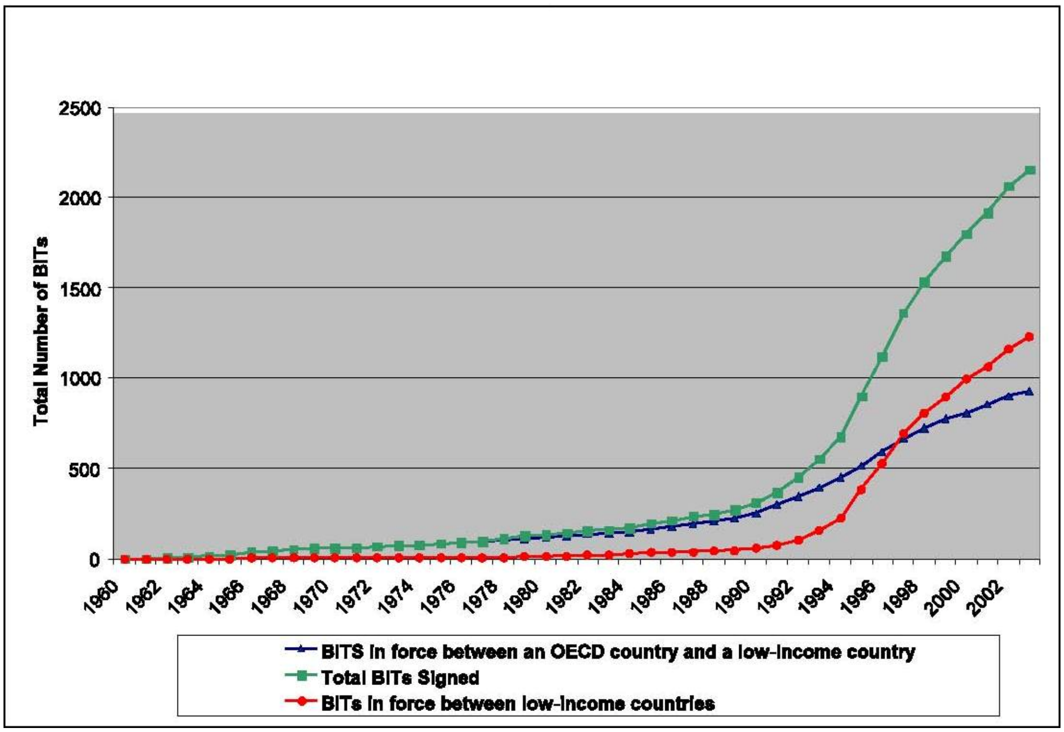
[10] Cited in Andrew Guzman,"Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties," *Virginia Journal of International Law*, Vol. 38, 1998, pg. 645.

[11] James Salacuse and Nicholas Sullivan, "Do BITs Really Work? An Evaluation of Bilateral Investment Treaties," *Harvard International Law Journal*, Vol. 46, Issue 1, pg. 68.

BITs were signed by Germany in 1959 with Pakistan and the Dominican Republic respectively. Other Western European countries quickly followed Germany's lead. By the mid-1960s, several European countries including France, the Netherlands, Denmark, and Norway had initiated BIT programs. Asian nations began to sign BITs in the 1970s; Japan signed its first BIT in 1977 with Egypt. They were followed by the United States, which initiated its BIT program in 1977. Following the fall of the Soviet Union, Central and Eastern European countries began signing BITs in the late 1980s and 1990s, and Latin American countries entered the arena in the 1990s.

The BIT network grew slowly over the first three decades. By the end of the 1980s, 385 BITs had been signed.[12] This changed by the end of the 1980s. From the late 1980s through the present, BITs have proliferated rapidly, both between developed and developing countries and between developing countries **(Figure 1)**. By the end of the 1990s, 1,857 BITs were in place involving 173 countries. As of the end of 2005 there were 2,495 such agreements spanning the globe.

Figure 1. The BIT Explosion: 1990-2005



Source: Tobin and Rose-Ackerman, When BITs Have Some Bite: The Political Economic Environment for Bilateral Investment Treaties.

While the majority of BITs are still between developed and developing countries, an increasing trend is that more BITs are being negotiated between developing countries. By the end of 2005, 26% of all BITs were between developing countries. Including the former Soviet States (Commonwealth of Independent States (CIS)) and South East Europe (SEE), this figure rises to 40%. This is likely a consequence of developing countries increasingly becoming a source of

[12] Bilateral Investment Treaties Quintupled in the 1990s, TAD/INF/PR/077, December 15, 2000, United Nations Conference on Trade and Development. Available at http://www.unctad.org/Templates/webflyer.asp?docid=2655&intItemID=2023&lang=1.

foreign investment. The share of outward foreign investment from developing countries has steadily grown over the past several years, amounting to $117 billion, or about 15% of world outflows in 2005. At the same time, there are very few BITs between developed countries, with the notable exception of the North American Free Trade Agreement (NAFTA), whose investment chapter closely mirrors a BIT. The general understanding for the lack of BITs between developed countries is the lack of investment risk, as well as the possible exposure to frivolous dispute claims. These issues were among the obstacles that prevented the creation of a Multilateral Agreement on Investments at the OECD in the late 1990s.[13]

The explosion of bilateral investment treaties is fundamentally a consequence of the rapid growth of FDI to developing countries (**Figure 2**). In response to increased capital flows to developing countries, developed country capital exporters sought increased protection for the investments while developing countries, contradicting their earlier opposition to foreign investment, competed with each other to host the growing levels of FDI, which is now the largest form of resource transfer to developing countries. In 2005, FDI to developing countries reached a record level of $237.5 billion, about 2.8% of developing countries' aggregate GDP.[14]

The U.S. Bilateral Investment Treaty Program

Following European success with BITs in the 1960s, the United States established its BIT program in 1977 and completed its model text in 1981; its first agreement was in 1982 with Panama. The program is jointly administered by the Department of State and the United States Trade Representative (USTR). Since 1982, the United States has concluded 46 BITs, 40 of which have entered into force (**Table 1**).

[13] CRS Report 97-469, *Multilateral Agreement on Investment: Implications for the United States*, by James K. Jackson.

[14] World Bank, *Global Development Finance 2006*, pg. 54.

Table 1. United States Bilateral Investment Treaties

Country	Date Signed	Country	Date Signed	Country	Date Signed
Albania	January 11, 1995	Egypt	March 11, 1986	Morocco	July 22, 1985
Argentina	November 14, 1991	El Salvador[a]	March 10, 1999	Mozambique	December 1, 1998
Armenia	September 23, 1992	Estonia	April 19, 1994	Nicaragua[a]	July 1, 1995
Azerbaijan	August 1, 1997	Georgia	March 7, 1994	Panama	October 27, 1982
Bahrain	September 29, 1999	Grenada	May 2, 1986	Poland	June 1, 2000
Bangladesh	March 12, 1986	Haiti[a]	December 13, 1983	Romania	May 28, 1992
Belarus[a]	January 15, 1994	Honduras	July 1, 1995	Russia[a]	June 17, 1992
Bolivia	April 17, 1998	Jamaica	February 4, 1994	Senegal	December 6, 1983
Bulgaria	September 23, 1992	Jordan	July 2, 1997	Slovakia	October 22, 1991
Cameroon	February 26, 1996	Kazakhstan	May 19, 1992	Sri Lanka	September 20, 1991
Congo (Brazzaville)	February 12, 1990	Kyrgyzstan	January 19, 1993	Trinidad and Tobago	September 26, 1994
Congo (Kinshasa)	August 3, 1984	Latvia	January 13, 1995	Tunisia	May 15, 1990
Croatia	July 13, 1996	Lithuania	January 14, 1998	Turkey	December 3, 1985
Czech Republic	October 22, 1991	Moldova	April 21, 1993	Ukraine	March 4, 1994
Ecuador	August 27, 1993	Mongolia	October 6, 1994	Uruguay	November 4, 2005
				Uzbekistan[a]	December 16, 1994

a. Indicates that treaty has not entered into force

Goals and Basic Provisions

When conceived, the primary goal of the U.S. BIT program was to bolster the U.S. position that the Hull Rule remained customary international law and that any expropriation must receive full compensation. In addition to creating an international standard that would protect the investment of its nationals, the United States seeks to use the BIT program to facilitate investment by prompting market liberalizing reforms in its treaty partners. This is in contrast to many European BITs, which are less demanding than the United States on several BIT provisions including restrictions on performance requirements, protection against expropriation, and monetary transfers.[15]

Although U.S. BITs differ slightly among themselves, they broadly provide six basic benefits:

- The better of national treatment or most favored nation treatment for the full life cycle of investment (from its establishment or acquisition, through its management, operation and expansion, to its disposition);
- Clear limits on the expropriation of investments and provisions for payment of prompt, adequate, and effective compensation when expropriation takes place;
- Quick transfer of funds into and out of the host country without delay using a market rate of exchange;
- Limited use of trade-distorting performance requirements (such as local content rules or export quotas);
- The right to submit an investment dispute with the treaty partner's government to international arbitration; and
- The right to engage the top managerial personnel of the investor's choice, regardless of nationality.

Many BITs, including those of the United States, include a national security "escape clause." For example, Article 18 of the U.S. Uruguay BIT states that each party to the treaty has the right to restrict "access to any information the disclosure of which it determines to be contrary to its essential security interests" and to apply measures "that it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests."[16]

The 2004 Model BIT

The U.S. model treaty has been revised several times, most recently in 2004. Prior to this, the United States negotiated BITs on a 1994 model text based on the North American Free Trade Agreement's Chapter 11 on investment. Chapter 11 of NAFTA codified the main elements of U.S. bilateral investment treaties including national treatment, most favored nation status, fair and

[15] Salacuse and Sullivan, op. cit. 73.

[16] Treaty Between the United States of America and the Oriental Republic of Uruguay Concerning the Encouraging and Reciprocal Protection of Investment. Available at http://www.ustr.gov/assets/World_Regions/Americas/South_America/Uruguay_BIT/asset_upload_file582_6728.pdf.

equitable treatment, restrictions on performance requirements, and binding international dispute arbitration.[17]

In the decade since NAFTA's passage, concerns emerged in both Canada and the United States about the extent of investor coverage, especially in cases of indirect expropriation, or government regulation that under the Agreement might be subject to dispute settlement. Unlike other U.S. BITs, where the United States is the primary foreign investor, NAFTA guaranteed investor protection between two developed countries (Canada and the United States), with significant amounts of cross-border investment. Subsequently, several major cases have been brought before the NAFTA tribunals, some of which have led to monetary damage awards against Canada and Mexico. No damages have yet been levied against the United States.

Nonetheless, responding to U.S. concerns that the types of protection granted to foreign investors by NAFTA may have been written too broadly, and that foreign investors may receive more favorable treatment for their NAFTA investor-state dispute claims than Americans would under U.S. law, Congress directed the Executive Branch in the Trade Act of 2002 (P.L. 107-210) to revise various provisions in its investment agreement negotiations to reach a better balance allowing U.S. sovereignty to legislate in its national interest. According to one analyst, if there is a right to compensation for all government action that may decrease the value of a foreign investment, "the result could have a chilling effect on the willingness of governments to take regulatory actions necessary for the health and welfare of their citizens, including environmental regulatory actions."[18] There is also concern about this ability to regulate on the part of developing countries.

In the Trade Act of 2002, Congress mandated several negotiating objectives to narrow the scope of investment protection. The act stated that the principal U.S. negotiating objective on foreign investment is to reduce or eliminate barriers to investment, "while ensuring that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States, and to secure for investors important rights comparable to those that would be available under United States legal principles and practice." Some observers raise concerns however that since the majority of existing U.S. BITs—and likely future BITs—will be with developing countries, where the overwhelming amount of investment flows will be unidirectional, narrowing the protections offered to U.S. investors abroad may be problematic. If a change in developing country attitudes toward foreign investment spurs a new round of nationalization of key sectors in developing countries, the rights of U.S. citizens to seek redress may be curtailed.

Incorporating congressional objectives, the 2004 model BIT contains several additions including narrowing the definition of investment covered under the agreement, minimum standard of treatment, detailed provisions on investor-state dispute settlement, and transparency of national laws and proceedings, as well as articles addressing environmental and labor standards.[19]

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[17] See CRS Report RL31638, *Foreign Investor Protection Under NAFTA Chapter 11*, by Robert Meltz.

[18] David Gantz, *The Evolution of FTA Investment Provisions: From NAFTA to the United States-Chile Free Trade Agreement*, American University International Law Review, 2004, p. 685.

[19] Murphy, Sean D. "New U.S. Model Bilateral Investment Treaty," United States Practice in International Law 2002-2004.

The U.S. business community opposed any possible changes that might weaken investor protections. Environmental non-governmental organizations and labor groups, on the other hand, raised concerns that it did not go far enough in promoting good international standards of conduct. The Department of State's Advisory Committee on International Economic Policy released a report in March 2004 that summarized many of the diverging views on the BIT program and the new model BIT:

> Generally speaking, Members who represent companies with investments abroad principally want to ensure that the model BIT provides effective protection for U.S. investors and their investments from arbitrary, discriminatory, or unreasonable government measures that undermine the value of their companies' investments.
>
> ... Members who represent environmental and labor organizations believe ... that the model BIT should include obligations to change domestic laws to raise standards, when necessary, for environmental protection and the protection of workers' rights. Further, these Members believe that the draft model BIT should obligate investors to meet those standards. Members who represent labor groups object to any treaty that would facilitate outbound investment that would cause jobs or production to be transferred out of the United States.[20]

The draft model BIT was introduced in November 2004, despite these concerns, and was used as the basis for the U.S.-Uruguay BIT. The Bush Administration is currently negotiating BITs with Pakistan and Rwanda.

Issues for Congress

Congress plays an active role in developing and implementing the nation's policy on direct investment through the Senate's constitutional responsibility to ratify treaties. Different from free trade agreements (FTAs), which require a full vote of Congress, or trade and investment framework agreements (TIFAs), which require no congressional action, BITs, as international legal treaties, require Senate ratification.[21] Congress may opt to consider several policy issues as it considers new bilateral investment treaties. In addition to the Pakistan and Rwanda BITs, the Administration has suggested that it may consider concluding a BIT with China as part of the Treasury Department's Strategic Economic Dialogue (SED). Furthermore, the U.S. government is increasingly including investment chapters that closely model U.S. BITs in its bilateral free trade agreements. Recently concluded FTAs with Singapore, Chile, Australia, the Central American countries and the Dominican Republic (DR-CAFTA), Panama, Morocco, Bahrain, and Oman all include investment chapters. The United States had begun BIT negotiations with South Korea; however, these discussions were folded into broader FTA negotiations in February 2006.

Two particular issues that may be of significant congressional interest are the impact of U.S. BITs on U.S. direct investment abroad and whether BITs promote economic reform in developing countries.

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[20] Report of the Subcommittee on Investment Regarding the Draft Model Bilateral Investment Treaty, presented to the Advisory Committee on International Economic Policy, January 30, 2004. Available at http://www.ciel.org/Publications/BIT_Subcmte_Jan3004.pdf.

[21] CRS Report 97-896, *Why Certain Trade Agreements Are Approved as Congressional-Executive Agreements Rather Than as Treaties*, by Jeanne J. Grimmett. For more information on FTAs, see CRS Report RL31356, *Free Trade Agreements: Impact on U.S. Trade and Implications for U.S. Trade Policy*, by William H. Cooper.

Do U.S. BITs Promote Investment Abroad?

The presence of a bilateral investment treaty is one of many factors that might contribute to a company's decision to pursue direct investment abroad. Exchange rate effects, taxes, the level of trade protection, the quality of foreign institutions, availability of skilled labor, and the availability of infrastructure all contribute to both whether a company's decision to become a multinational enterprise, and where it decides to invest.

Some Members of Congress, and Americans more broadly, raise concerns that direct investment abroad may hurt overall U.S. economic welfare by shifting U.S. jobs to developing countries, which may have weaker labor and environmental standards then the United States. Such losses may be exacerbated by the presence of a bilateral investment treaty, they argue, if such treaties promote investment abroad at the expense of domestic investment.

Several economic studies have looked at the impact of BITs by comparing changes in foreign direct investment flows against a variety of independent variables including market size, political and economic institutions, the overall country environment for investment, per capita income, the presence of natural resources, total population, and the presence of a BIT. Many early studies found no significant connection between the presence of a BIT and increased FDI flows.[22] However, more recent research suggests that under certain circumstances, signing and ratifying a BIT does leads to increased investment. Tobin and Rose-Ackerman find in their 2006 study of OECD country BITs with developing countries that BITs do have a positive impact on FDI flows to developing countries, but the impact is highly dependent on the political and economic environment of the host country.[23] The positive impact of signing a BIT is strengthened as a country's economy or political environment for investment improves. Neumayer and Spess, in a study looking at BITs between 119 countries over the period 1970 and 2001 find that developing countries that sign BITs with developed countries receive more FDI than countries that do not pursue these treaties.[24] Contradicting Tobin and Rose-Ackerman, however, they find that BITs may substitute for good domestic institutional policies.

While recent studies suggest that BITs may promote U.S. direct investment abroad, data has not supported the argument that direct investment abroad replaces domestic investment.[25] This

[22] For example, Mary Hallward-Dreimeier, "Do Bilateral Investment Treaties Attract FDI? Only a Bit...and They Could Bite," World Bank Policy Research Working Paper 3121, June 2003, and Susan Rose-Ackerman and Jennifer Tobin, "Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties," Working Paper, Yale Center for Law, Economics, and Public Policy 2005. Papers are available respectively at http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2003/09/23/000094946_03091104060047/Rendered/PDF/multi0page.pdf and http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID557121_code603.pdf?abstractid=557121&mirid=1.

[23] Susan Rose-Ackerman and Jennifer Tobin, "When BITs Have Some Bite: The Political Economic Environment for Bilateral Investment Treaties," Yale Law School, November 2006. Available at http://www.law.yale.edu/documents/pdf/When_BITs_Have_Some_Bite.doc.

[24] Eric Neumayer and Laura Spess, "Do bilateral investment treaties increase foreign direct investment to developing countries?," *World Development*, October 2005. A pre-publication version is available at http://eprints.lse.ac.uk/archive/00000627/01/World_Dev_(BITs).pdf.

[25] Raymond J. Mataloni, Jr. and Daniel R. Yorgason, "Operations of U.S. Multinational Companies, Preliminary Results From the 2004 Benchmark Survey," *Survey of Current Business*, November, 2006. Available at http://bea.gov/scb/pdf/2006/11November/1106_mncs.pdf. See also Mihir Desai, C Fritz. Foley, James Hines, "Foreign Direct Investment and Domestic Economic Activity, National Bureau of Economics Research Working Paper 11717, p. 2. Available at http://www.nber.org/papers/w11717.

argument assumes that the total global production of a company is fixed, and thus any overseas production must be compensated for by a decrease in the amount of production at home. However, while economy-wide evidence has not supported this argument, economists have observed its impact on various sectors of the U.S. economy.[26]

Do U.S. BITs Promote Reform in Developing Countries?

A distinct goal of U.S. BITs is to promote the adoption in developing countries of market-oriented policies that treat private investment, both foreign and domestic, in a non-discriminatory, transparent, and open way. BIT proponents argue that signing a BIT will spur countries to improve domestic courts and create an environment that is more enticing for foreign investment. It is unclear, however, to what extent pursuing a BIT has this effect. Some analysts raise concerns that BITs may substitute for local institutions and, rather than improve host country governance, may lead to reductions in the quality of local institutions. Rather than create an incentive for further reform, a BIT may actually decrease incentives for developing countries to improve their local courts. Preliminary evidence appears to support this assertion.

Since foreign investors in a country with which the United States has signed a BIT can bypass domestic courts and seek international arbitration of investment disputes, a key lobbying constituent for local institutional reform is removed. This can lead to a system where foreign investors have access to effective and efficient dispute settlement, while local investors are required to use potentially corrupt local courts. According to one analyst, the proliferation of BITs

> inflicts a double whammy on law reform efforts in developing states, first by dulling the interest of foreign investors in building good domestic rule of law institutions and then by encouraging foreign investors to devise alternative institutional arrangements that are inimical to the development of sound regulatory institutions and policies.[27]

Alternatives to BITs proposed by some analysts include increased reliance on alternative multilateral investment protection mechanisms. Existing investor protection mechanisms include the World Trade Organization's General Agreement on Trade and Services (GATS), Trade Related Investment Measures (TRIMs), or the Trade Related Aspects of Intellectual Property (TRIPs).[28]

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[26] For more information, see CRS Report 98-39, *Foreign Investment Treaties: Impact on Direct Investment*, by James K. Jackson.

[27] Ronald Daniels, "Defecting on Development: Bilateral Investment Treaties and the Subversion of the Rule of Law in the Developing World," March 23, 2004, p. 3. Available at http://www.unisi.it/lawandeconomics/stile2004/daniels.pdf.

[28] For more information on GATS, see CRS Report RL33085, *Trade in Services: The Doha Development Agenda Negotiations and U.S. Goals*, by William H. Cooper; on TRIMs, see CRS Report RS20448, *Foreign Investment Issues in the WTO*, by James K. Jackson; on TRIPs, see CRS Report RL33750, *The WTO, Intellectual Property Rights, and the Access to Medicines Controversy*, by Ian F. Fergusson.

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