BILATERAL INVESTMENT TREATIES AS AN INVESTMENT PROMOTION MECHANISM: TESTING THE EFFECTIVENESS OF THE U.S. BIT PROGRAM

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ABSTRACT:

Bilateral Investment Treaties (BITs) have become a popular and widespread mechanism for protecting and promoting Foreign Direct Investment (FDI). An examination of the political economy of the U.S. BIT program, as well as their substantive and procedural provisions, indicates that they effectively promote the ceding of sovereignty over investment activity in exchange for participation in a liberal investment regime that is assumed to promote FDI. Indeed the U.S. program is exceptional in the strength of investor protections and treaty uniformity, making U.S. BITs an ideal candidate for examination by controlling for variation among treaty provisions. This study tests the assumption that U.S. BITs increase investment in the smaller signatory. Analysis of U.S. Direct Investment Abroad (USDIA) into co-signatories of U.S. BITs indicates that while sampled BIT signatories may attract an inordinate share of USDIA compared to their relative share of world GDP, there is insufficient evidence to conclude that this is due to the effect of the relevant BIT. There may, however, be a combination of economic, political, symbolic and military factors that more fully explain the decision to negotiate such treaties and these non-economic linkages might increase U.S. investment activity.

INTRODUCTION

Bilateral Investment Treaties (BITs) first emerged in the 1970s and 1980s as a legal mechanism to protect investments made by foreign entities of the signatory countries within the territory of the other. Although each agreement is unique, they generally emphasize protection for Foreign Direct Investment (FDI) rather than portfolio investment. From inconspicuous beginnings, enthusiasm for BITs gained momentum during the 1990s resulting in an expansion from 700 BITs in 1994 to more than 2000 by the end of the decade. Despite some recent exceptions of BITs existing between developing countries, the overwhelming majority of BITs are signed between a highly industrialized nation and a smaller developing nation. Although the investor protections within the agreements are legally provided for nationals of both signatories, in practice they typically only apply to the capital-exporting developed nation, as FDI rarely flows in the opposite direction. This leads us to the question of why smaller nations are interested in signing treaties that have little practical application for their citizens. Absent coercion, the answer is the implicit assumption that by signing a BIT such a nation will increase its ability to attract FDI flows from the other signatory.

This assumption is often stated within the language of BITs, although couched in terms that ponder a largely unfulfilled two-way capital flow (Sornarajah 2004). The BIT provides a benefit for the developed signatory in the form of protection against discrimination and expropriation of investments made by its citizens and corporations within the territory of the

other nation. Since the flows are generally one-way, though, this benefit is rarely experienced by entities of the developing nation. Indeed, a developing nation signatory must actually cede sovereignty over investment activity within its own territory, as BITs provide for arbitration by international tribunals when investors invoke the treaty to seek compensation for injury (Bradlow and Escher 1999). There is therefore no incentive for such countries to enter into a BIT unless they anticipate a benefit in the form of increased FDI from the developed signatory.

From the point of view of smaller BIT signatories, and other developing countries contemplating future BITs, it would then be helpful to determine whether such treaties really are successful in attracting increased FDI. If these treaties do not result in increased investment then one would have to question the logic of utilizing significant time and money on the diplomatic process of negotiating them. If these treaties do prove to facilitate FDI, however, then the next stage of analysis presents opportunities for sceptics to determine how beneficial such investment is, and whether or not the bilateral nature of the treaties promotes dependence on a single source of foreign investment (Kentor and Boswell 2003, 301-313). Conversely, increased investment from a BIT signatory might signal to other investors that the capital importer has a safe and conducive investment climate.[1]

Regardless of the implications for the investment attraction and diversification strategies of developing countries, it does seem clear that the first step in any future analysis should be to ascertain the validity of the aforementioned assumption. This study will test this assumption by looking at the flows of FDI investment from the United States to countries with which the U.S. has enacted a BIT. By examining flows before and after these treaties entered into force it should be possible to gain some insight into the effectiveness of BITs as mechanisms for attracting FDI.

HISTORY OF U.S. BIT PROGRAM

The U.S. BIT program was launched in 1977 emulating similar treaty programs conducted by European nations earlier in the decade, and was based on three goals of establishing international precedent regarding compensation for expropriation, protecting existing stocks of U.S. FDI, and providing a means to depoliticise international investment disputes (Vandevelde 1993, 5). The U.S. program emerged as a successor to the long running practice of protecting trade interests through bilateral treaties of "Friendship, Commerce and Navigation" (FCN), which had been signed with most U.S. allies since the 1780s.[2] While FCN treaties did not explicitly protect foreign investment, they did provide for the protection of individual aliens residing overseas for the purpose of establishing trading ventures (Sornarajah 2004, 209).

By the 1970s the FCN program was terminated due to a lack of additional countries willing to negotiate such treaties. Yet the three initial goals of the BIT program cited above became increasingly urgent in the international political climate of that decade. It was during this time that developing nations were pushing their vision of a New International Economic Order (United Nations 1974). One facet of this movement, as a response to perceived colonial exploitation, was domestic control over foreign investment. Specifically, in 1974 the UN General Assembly adopted the Charter of Economic Rights and Duties of States (CERDS), which contained a viewpoint on compensation for expropriation of foreign assets that was unpalatable to most capital-exporting nations, including the United States. The CERDS contains a provision that states compensation shall be provided according to the national law of the expropriating country. Article 2.2 (c) of CERDS indicates that every state has the right to "nationalize,

expropriate, or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that State considered pertinent." (United Nations 1975, 5) In other words, CERDS sought to not only to establish expropriation as a sovereign right, but also to eliminate any minimum international standard of prompt and adequate compensation.

This resolution of the General Assembly helps to explain the subsequent proliferation of BITs and the lack of progress toward a multilateral investment regime. Although developing nations are no longer clamouring for the New International Economic Order, they are unlikely to relinquish the standard of domestic control established under CERDS. Many nations are willing, however, to negotiate BITs, as their *ad hoc* nature limits the possibility that they will give rise to a general principle of compensation for expropriation.

Nevertheless, the U.S. BIT program has served to establish certain principles of investor protection that the United States has been unwilling to deviate from throughout the duration of the program. They also serve to protect existing stocks of U.S. investment. Finally, by establishing arbitration procedures, they allow the U.S. government to remove itself from the compensation process—thereby eliminating potential foreign policy complications that arise from government defence of individual investors.

The case has been made that the U.S. BIT program can be viewed as an ideological assertion of liberalism in the face of economic nationalism and Marxism (Vandevelde 1998). This viewpoint is closely related to contrasting approaches to economic development. Economic nationalism, as practiced through import-substitution industrialization, sought a "big-push" approach to economic development through retention of national control of economic sectors. Marxism and neo-Marxist dependency theorists have generally viewed foreign investment as neo-colonialism and focus on the distributional inequalities of liberalism.

The emergence of BITs in support of a liberal economic order can be placed within the broader context of evolving development policy, which in the 1960s and early 1970s took the form of import-substitution industrialization, which relied on state intervention to facilitate large-scale industrialization that would provide products substituted for exports. The overall failure of this approach led to a gradual shift in ideology toward free-market principles; this shift was given a boost by the successive debt crises brought about by the oil boom, petrodollar recycling and subsequent oil bust. The IMF began instituting structural adjustment policies as conditions on loans when dealing with these debt crises. The perceived success of such programs in combating hyperinflation and resolving the debt crises increased the prominence of those principles eventually referred to as the Washington Consensus.

The defining characteristic of liberal development policy is the relative emphasis placed on productive capacity versus redistribution. As liberal ideology began to assert itself in the 1980s and 1990s the initial goals of the U.S. BIT program became less urgent, because liberal principles relating to foreign investment prevailed. This led to a subtle shift in the logic associated with the BIT program, from the *protection* of investment to the *promotion* of investment, for the purposes of generating productive capacity and politically signalling alignment with the liberal economic order. At the heart of this new logic lies a fundamental emphasis on the trade-off between sovereignty and wealth. The emphasis on productive capacity leading to wealth generation goes against the sovereign right to nationalize or expropriate property for redistributive (or other less admirable) endeavours. Therefore, the logic must be that the wealth-creation benefits of the emerging liberal investment regime outweigh the costs of yielding national control of assets. The analysis reported in this study will seek to test this logic.

CONTENT OF U.S. BILATERAL INVESTMENT TREATIES

The liberal nature of U.S. BITs is embodied both in the substantive and procedural provisions. Vandevelde (1998) indicates three principles that characterize a liberal investment regime: investment neutrality, investment security and market facilitation.[3] This section will first identify the major substantive and procedural provisions of the U.S. model BIT to emphasize the consistency among treaties negotiated under the U.S. program; it will then elaborate on the residence of these treaties within the liberal principles described in the preceding section; and finally, it will introduce a more nuanced take on the wealth-sovereignty trade-off that undergirds the assumption tested in this study.

Substantive Provisions

The broad definition of investment under the U.S. model BIT is defined in Article 1, and includes nearly every possible form including firms, equity and debt securities, loans, profit-shares, real estate, property, and contractual interests with capital commitments (United States Trade Representative 2004). Not only is investment broadly defined, but it is also broadly protected. Articles 3 and 4 protect investment with the traditional trade obligations of national treatment and most-favoured-nation treatment.[4] Article 5 establishes a minimum standard of treatment for investors, requiring the host governments to comply with customary international law. Article 8 protects investment from performance requirements, including such issues as local sourcing of raw materials or domestic content requirements. These four articles may be seen as serving the principle of investment neutrality.

Article 7 protects transfers and generally serves to restrict capital controls that might impact foreign investment. This article supports the principle of market facilitation. Articles 10 and 11 may also be viewed as market-facilitating, as they require publication of all national investment laws and transparency of all actions taken by a signatory with respect to the treaty, respectively.

It is generally accepted, however, that there are certain instances in which expropriation will occur, and, serving the principle of investment security, Article 6 deals with the issue of compensation. Direct or indirect nationalization or expropriation, or any other measure "equivalent to nationalization or expropriation" is prohibited unless the expropriation meets the four requirements of being: 1) for a public purpose, 2) on a non-discriminatory basis, 3) on payment of prompt, adequate, and effective compensation, and 4) in accordance with due process of law and Article 5. All four requirements must be met. Thus, the interpretive emphasis rests on the phrase "equivalent to (…) expropriation". Public health and safety regulations may be considered equivalent to expropriation if they adversely impact foreign investment, but they are allowed as long as the four conditions of Article 6 are met.

The model BIT explicitly addresses what areas are likely to be eligible for legitimate expropriation. Article 12 and Article 13 address environment and labour standards, respectively. Article 20 addresses the right of signatories to enact prudential financial regulations. This is a more recent innovation arising as a reaction to the widespread financial crises of the last decade, in which underdeveloped financial institutions were thought to play a contributing role in speculative bubbles, sell-offs and contagion. Finally, Article 14 allows for signatories to exempt certain "non-conforming" measures from the requirements of Articles 3, 4, 8 and 9 in the Annex to the treaty. The United States-Ukraine BIT, for instance, exempts land ownership in the Annex,

thereby potentially subjecting U.S. investors to discrimination in an industry such as agriculture. Similarly, the investment chapter of the U.S.-Singapore FTA exempts financial services from these standards.

Procedural Provisions

The procedural provisions of BITs deal with protocol for resolving investment disputes. If the parties cannot negotiate a resolution, the claimant may seek arbitration under the International Center for the Settlement of Investment Disputes (ICSID), a component of the World Bank Group. Both parties must agree on the three member arbitral panel. Generally, each side chooses one arbitrator, and then they must mutually agree on the third. The investor-state arbitral process of investment treaties has come under intense scrutiny, especially with regard to the investment provisions of NAFTA. This popular controversy is less about the erosion of sovereignty than about the inherent secrecy of the arbitration process. The lack of transparency is glaring; there is no public notification when a claim is filed, the proceedings are closed, and the decisions are publicized only at the voluntary discretion of the parties undergoing arbitration. This notable lack of transparency has proved to be particularly troubling to groups representing environmental interests, due to the fear that closed proceedings may effectively remove concern for public welfare from the entire process (Gaines 2003).

This impact on regulatory ability introduces an additional dimension of cost-benefit analysis to the initial sovereignty-wealth trade-off examined in this study. A more pertinent question, from the point of view of capital-importing signatories is whether the investor-state dispute settlement mechanism is an appropriate ceding of sovereignty in relation to the benefits of increased FDI. The purpose of this study is to test the assumption that these investment treaties succeed in attracting increased investment.

METHODS

Relative Share Ratio

In order to test the assumption that BITs increase flows of U.S. Direct Investment Abroad (USDIA) into co-signatories, this method attempts to examine the relative ability of BIT-signatories to attract USDIA as compared to non-BIT signatories in a given year. Methodologically, this requires the assumption that the amount of U.S. capital available for investment abroad is roughly fixed for any given year. This notion is contrary to conventional wisdom. Generally, the belief is that foreign investment may result from the diversion of domestic investment. However, recent research indicates that rather than diversion, foreign investment by U.S. multinationals might actually stimulate domestic investment (Desai et al. 2007).[5] This indicates that USDIA is not a substitute for domestic investment, and therefore makes more plausible the assumption that annual levels of capital available for investment abroad are roughly fixed.

This assumption is supported by the fact that roughly fixed annual budgets usually guide both greenfield investments abroad and cross-border acquisition strategies. FDI is supply-driven, with a certain proportion of a firm's capital allocated for investment abroad and then directed where it will achieve the greatest returns (Nocke and Yeaple 2004).[6] If this is the case then the relevant measure of investment is the share of global USDIA attracted by a nation each year rather than the nominal value of USDIA attracted by that nation each year.

By longitudinally comparing the relative share of global USDIA attracted by BIT-signatories with the share attracted by non-BIT signatories we can gain insight into whether these treaties help nations capture a larger slice of the roughly fixed pie of U.S. capital available for overseas investment in a given year. This is problematic, however, because the increased share of investment going to BIT signatories over time may simply be attributable to the increased number of treaties entering into force over the relevant time period. For this reason it is appropriate to compare the share of USDIA attracted by nations with the share of GDP (in the sample population) at the same period of time. By examining the change in this ratio over time we can discern whether BIT-signatories are better able to attract USDIA given their relatively smaller proportion of GDP.

This ratio was calculated for BIT and non-BIT signatories for every year from 1990 to 2004 resulting in two samples with 15 ratios each. The equation is given below:

$$\frac{\text{(USDIA flows to sample/Total USDIA flows to both samples)}}{\text{(GDP of sample/Total GDP of both samples)}}$$

The data on USDIA was obtained from the U.S. Bureau of Economic Analysis for 35 nations that received USDIA from 1990-2004. Of these nations 13 had a BIT that entered into force at some point during the period.[7] The GDP data was obtained from the World Bank Development Indicators Database. The change in ratio over time for each sample was determined by calculating a least-squares trend line. Finally, they were analyzed using the equivalence of means test.

It is prudent at this point to interject a note of caution regarding the *relative share ratio* method. This method is tailored specifically to identify the relative ability of a nation to capture a fixed amount of USDIA in a given year. This has the advantage of controlling for the possibility that the increase in the number of treaties over time will create a spurious correlation with increasing global flows of USDIA. Although the data set covers 35 nations over 15 years, the structure of the relative share ratio method results in two samples that have only 15 observations each. Readers are encouraged to keep an open mind before reaching broad conclusions based solely on this method.

Regression Analysis of Panel Data

The relative share ratio compares the relative ability of BIT versus non-BIT signatories to attract a yearly fixed share of USDIA. The regression analysis is more sophisticated in that it examines the presence and strength of an association between USDIA and the existence of a U.S. BIT (Dependent Variable) in the presence of other FDI determinants (Explanatory Variables).

Four studies purporting to test the relationship between the existence of BITs and flows of FDI have come to mixed conclusions. The study by Hallward-Driemeier (2003) found no significant relationship between the number of BITs signed with OECD countries and the level of FDI received from those countries over the time span 1980-2000. The Tobin and Rose-Ackerman study (2005), which also uses a panel from 1980-2000 found a negative correlation between the existence of BITs and FDI inflows. The recent Neumayer and Spess study (2005) did find a relationship between the presence of BITs and increased FDI inflows using a panel of 119 countries over the time span 1971-2001. Finally, Salacuse and Sullivan (2005) used two approaches to study the impact of U.S. BITs. First, they analyzed combined FDI inflows to more than 100 developing nations for three consecutive years. Second, they conducted a panel

regression for 31 countries over the time period from 1991-2000 and found a strong and significant relationship between the presence of a U.S. BIT and flows of FDI.

There is no consensus among the first three studies looking at global BITs as the first indicates no association, the second a negative association and the third a positive association. The fourth study by Salacuse and Sullivan should be judged separately. It looks only at U.S. BITs, which are exceptional in their pronounced economic liberalism and in the distinctive nature of U.S. foreign economic relations. The panel regression conducted here tests the findings of the time-series analysis conducted by Salacuse and Sullivan.

As this study will only focus on the effect of U.S. BITs on U.S. FDI, it does have the limitation of ignoring possible 'signalling' effects. These may occur if a U.S. BIT signals to investors from other developed nations that the host country intends to protect foreign investment. This then spurs non-U.S. FDI. Neumayer and Spess, in particular, emphasize the importance of this effect, but it seems probable that they overstate the importance of signalling when one considers the nature of a BIT. A BIT is a legal document providing protection only to entities of the signatory nations. If such a signalling effect occurs, it will likely be a result of successful U.S. investment, not merely the existence of a treaty. At best, signalling is at least one stage removed from treaty ratification. Thus, any increase in FDI from other developed nations would be preceded by an initial increase in U.S. investment in that country.

It is sensible that the impact of a U.S. BIT should be greatest on U.S. FDI; therefore, the first level of analysis should be of relationships between U.S. BITs and U.S. FDI. By examining all BITs globally, the other three studies fail to account for variation among BITs signed by different developed nations. By only examining U.S. BITs, one can control for variety in the legal protection of property rights provided by different treaties. By affirming or disaffirming the findings of Salacuse and Sullivan with regard to the investment promotion capacity of U.S. BITs, this study will contribute to the growing understanding of the role investment treaties play in FDI decisions.

Dependent Variable

The dependent variable (*log flow)* will be yearly flows of U.S. Direct Investment into the host economy. To reduce the skewness of the data, it will be presented using a natural logarithm. This, however, presents a problem with regard to the small instances of negative values. Conceptually, it is unlikely that the increased investor-protections induced by a BIT will cause an outflow of investment. Therefore, it is reasonable to consider such instances of disinvestment as unrelated to the relationship under analysis. All negative flows have been re-coded as equal to $1 million U.S. (data reported in millions of U.S. dollars).

In order to deal with the danger that a relationship will be found significant simply because of the upward trend of FDI over the time period, an alternate dependent variable representing yearly USDIA flows as a share of total U.S. Direct Investment Abroad to all hosts will be used *(share of USDIA).* As this ratio does not trend over time it will be a good indicator of the ability of a host nation to attract an increased share of a fixed amount of USDIA. As a matter of due diligence, alternative regressions will also be run with absolute USDIA flows *(USDIA flow),* concentration of USDIA as a proportion of total FDI in host country *(USDIA concentration),* and share of USDIA normalized by the host country's GDP *(share by GDP).*

Explanatory Variables

The primary explanatory variable will be a dummy variable indicating the presence of a U.S. Bilateral Investment Treaty *(BIT dummy)*. Additionally, there will be a variable for *treaty age* to indicate whether there is a relationship between the length of existence of a BIT and the amount of investment received from the U.S. Control variables generally deemed to be determinants of FDI are also included. These include *population*, *population growth rate*, *GDP*, *GDP per capita*, GDP growth rate *(GDP growth)*, bilateral exchange rate *(exchange)*, and the rate of *inflation*. Total *FDI* from all sources was also included indicating the attractiveness of a host country to global investors. The GDP, growth and population variables give a sense of the market size and growth potential.[8] These are expected to be positively associated with USDIA flows. The exchange rate indicates the competitiveness of exports, and is expected to be positively associated with the dependent variable. The exchange rate may also provide an extremely rough indication of the relative difference in labour costs between the U.S. and the host country. This impact will contribute to the expected positive sign of the association. Finally, the inflation rate is a proxy for macroeconomic stability and is anticipated to be negatively associated with USDIA flows.

Although the choice of explanatory variables was constrained by the limited availability of reliable data, the literature on FDI determinants largely supports the choice of indicators for market size (Bandera & White, 1968; Lunn, 1980; Kravis & Lipsey, 1982; Wheeler & Mody, 1992; Billington, 1999) and growth rate (Bandera & White, 1968; Lunn, 1980; Schneider & Frey, 1985; Billington, 1999). There is a smaller consensus on the effect of exchange rate, with some studies finding a positive association (Edwards, 1990) and others a negative one (Froot & Stein, 1991). The use of the inflation rate as a proxy for stability has been consistent throughout similar panel regressions on BITs. Other likely determinants of FDI not included in this model are institutional fitness (Wilhelms 1998; Bénassy-Quéré et al. 2005), fiscal incentives (Blonstrom and Kokko 2003; Charlton 2003), infrastructure (Kumar 2001; Dollar et al. 2004), and education and skills (Nunnenkamp 2002; Miyamoto 2003).

RESULTS

Relative Share Ratio

This analysis indicates that the trend rate for the ratio of share of USDIA to share of sample GDP is higher for BIT signatories than for nations that do not have a bilateral investment treaty with the United States. Indeed, nations without a treaty experienced a decline in this ratio over the 15 year time span. The equation for nations with a BIT is $y = 0.1679x + 0.4713$. The equation for nations without such a treaty is $y = -0.031x + 1.0887$. The two-sample test for means confirmed these results indicating that the means for the samples are not equal (See Appendix 1).

Regression Analysis of Panel Data

The regression analysis of the panel data consisting of 35 developing, transitional, or newly-industrialized nations failed to find a relationship between the presence of a BIT and the level of USDIA in the host country (see Appendix 2). This is true for all possible dependent variables. In addition to the natural logarithm of USDIA flows, alternative regressions were run with alternate dependent variables, including absolute USDIA flows, share of USDIA in the host

country as a proportion of total USDIA worldwide, concentration of USDIA as a proportion of total FDI in the host country, and share of USDIA normalized by the host country's GDP.

The control variables were generally significant and of the expected sign with larger and wealthier countries receiving a higher proportion of USDIA. The best fit model used absolute USDIA flows as the dependent variable and exhibited a coefficient of determination of 0.6640. In the best fit model, the variable inflation was inconsistent in the direction of its relationship to the dependent variable. The exchange rate and population variables were not significant (see Appendix 2). Finally, the moderate to low fit of the models indicates that important explanatory variables are missing. With regard to incentives for direct investment these probably relate to measures of institutional quality and/or political risk.

Interestingly, the *treaty age* variable showed a significant and positive association with the dependent variable when presented as absolute dollar flows. This indicates that there might be a relationship between how long a treaty has been in force and the amount of investment received from the U.S. This relationship was not found when using the alternate dependent variable *share of USDIA* which was included to control for the possibility that an association would appear merely because of the upward trend of FDI over the time period.

CONCLUSION

The central question raised in the introduction to this study is this: why do capital-importing nations negotiate investment treaties with little practical application for their citizens? As capital tends to flow in only one direction between BIT signatories, the legal protections are generally only exercised by entities of the capital-exporting nation. The answer to this question appears to be the assumption that such a treaty will attract investment, with the expectation of wealth creation due to increased FDI. This can be viewed as a trade-off between sovereignty to dictate over investment activity within a nation's own territory and the wealth creation that (hopefully) occurs as a result of opening up a developing nation to foreign investment. This study, which examined the evolution of the U.S. BIT program, supports the notion that treaty negotiation has shifted from the desire to *protect* investment to the desire to *promote* investment. Thus, linking investment attraction to a specific bilateral relationship becomes a goal of both signatories, and, more importantly, the signing of a BIT sends a signal that the nation strives to be a modern member of the liberal economic order.

The results from the relative share ratio and panel regression analysis provide three pieces of information that add nuance to our understanding of the investment promotion capability of U.S. BITs. First, the relative share ratio method examining the ratio of share of total USDIA for a given year to share of total GDP for BIT signatories and non-signatories does indicate that nations with a BIT in force are better at attracting USDIA relative to their GDP. This is especially compelling considering the growth of GDP over this period. While non-BIT nations experienced greater growth of GDP, BIT nations were better at attracting USDIA relative to their GDP. This indicates the presence of some sort of association between BITs and the ability to attract U.S. investment. Second, the regression analysis does not support this association, as there was not a relationship between the presence of a BIT and the flow of USDIA. Third, the results of the panel regression did show an association between how long a BIT was in force *(treaty age)* and the absolute value of USDIA flows into host nations. However, the dependent variable designed to control for increasing total USDIA was not related to the *treaty age* variable. This does not correspond with the findings of Salacuse and Sullivan.

There are two potential explanations for the different results found in this study and those found by Salacuse and Sullivan: the models use different variables, or the two samples tell different stories. The model used in this study uses similar explanatory and dependent variables as Salacuse and Sullivan. The major difference lies in the data source for USDIA flows. Salacuse and Sullivan use data from the OECD *International Investment Statistics Yearbook 1980-2000* while this study uses more recent data from the U.S. Bureau of Economic Analysis. Another possible explanation is that the results are highly dependent on the choice of sample. The Salacuse and Sullivan study includes 32 nations in the sample of which 23 also appear in the present sample of 35 nations. Whether the difference is sample-dependent or data-source-dependent, the inconclusive and contradictory results caution against making premature conclusions about the investment promotion capacity of U.S. BITs. This is especially true since all BIT studies to date have been hindered by limited data and the use of complex regressions that require assumptions that may or may not prove tenable as the body of evidence grows more robust and our understanding of the determinants of FDI becomes more complete.

The contradiction of these results indicates that, although BIT signatories do not appear to attract more USDIA than non-signatories, there may be something else at play explaining the relative ability of BIT signatories to attract USDIA *as a proportion of their GDP*. One possibility is that BITs may often result from non-economic relationships with the U.S. This existence of non-economic concerns is confirmed by Vandevelde (1993, 11-13) in his detailed examination of the second round of BIT negotiations focused on post-Soviet Eastern European nations. He also cites the earlier Grenada and Panama treaties as examples where political and symbolic motivations trumped any true economic concerns.

Corroborating the historical analysis of Vandevelde is an inventive empirical approach by Neumayer (2006) in which he uses various variables to measure source-country political interest in BIT host-countries. The variables used include number of years the host-country was a colony of the other signatory, a political similarity variable based on voting patterns in the UN General Assembly, and a variable measuring the share of U.S. military grants received by the host as a percentage of worldwide U.S. military grants, to measure the role of military interests in BIT signing. His results confirm the role played by the former colony variable for BIT programs.[9] The political similarity variable is not significant for the U.S. BIT program but, not surprisingly, the U.S. military grant variable is both strong and significant, indicating that military strategy plays a role in the decision of whether or not to conduct BIT negotiations.

It is plausible that the motivations for negotiating BITs are a combination of multiple economic, political, symbolic and military factors. Furthermore, the evidence does not suggest any one dominant factor. The historical analysis presented earlier also identifies a changing motivation from one based largely on the desire to protect investors to a more ideological motivation pushing a liberal development model. The Neumayer article mentioned above also finds an association between developing-country need and the likelihood of signing a BIT. This supports the idea that the wealth-sovereignty trade-off is being pushed as a model for liberal development. Although this study questions the wisdom of the wealth-sovereignty trade-off, the various other political, symbolic and military motivations may be sufficiently pressing to induce capital-importers to enter such agreements even in the absence of evidence that they will become more attractive to foreign investors. These other motivations may help explain why BIT signatories appear better able to attract U.S. investment when one considers their relatively smaller economic weight.

Ideally, an improved regression model could be built including variables that indicate both institutional and political attractiveness. The major impediment to this, however, is the notable lack of adequate and reliable statistics. In the meantime, further research should seek to refine the understanding of the distinguishing factors among the BIT programs of developed nations, in order to begin contrasting the relative effectiveness of the various programs. Up to this point all studies have either focused on BITs generally or as with the present study only on the U.S. program. It would be useful to develop a more nuanced understanding of the various motivations and outcomes of the different programs. In the meantime, while this study does not suggest that nations which sign BITs with the U.S. are better at attracting U.S. investment than other developing nations, they do appear to punch above their relative economic weight

[1] This signaling effect is emphasized in the study by Neumayer and Spess discussed further in the methods section of this study.

[2] The first FCN treaty was signed with France in 1778. See K. J. Vandevelde *United States Investment Treaties: Policy and Practice* (1992).

[3] Vandevelde goes on to argue that most BITs are actually more characteristic of economic nationalism than liberalism. He concedes, however, that the U.S. BIT program is significantly more liberal than the international norm as the U.S. adheres to very high standards of neutrality and security and has rarely derogated from its model BIT. See Vandevelde, K.J. "Political Economy of a Bilateral Investment Treaty." *The American Journal of International Law,* 92 (4), (Oct. 1998), pp. 621-641.

[4] National treatment is nondiscrimination between foreign and domestic investors. Most-favored nation treatment is nondiscrimination between foreign investors from different countries.

[5] The authors find that an increase in USDIA is positively associated with domestic investment indicating that multinational expansion abroad complements rather than detracts from their domestic economic activity.

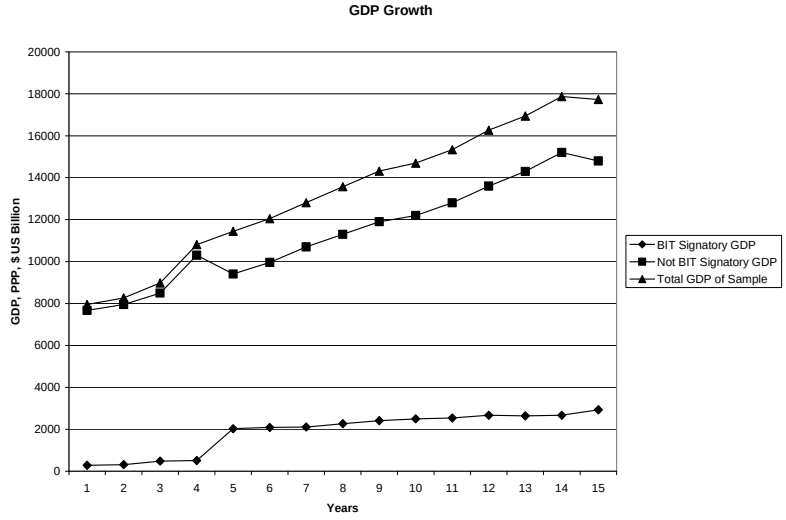
[6] Their research suggests that the fundamental choice is between whether to conduct greenfield investment abroad (building one's own plant) or acquiring existing overseas assets. Coupled with the research by Desai et al. this supports the assumption that firms choose among FDI strategies/locations rather than between domestic and foreign investments.

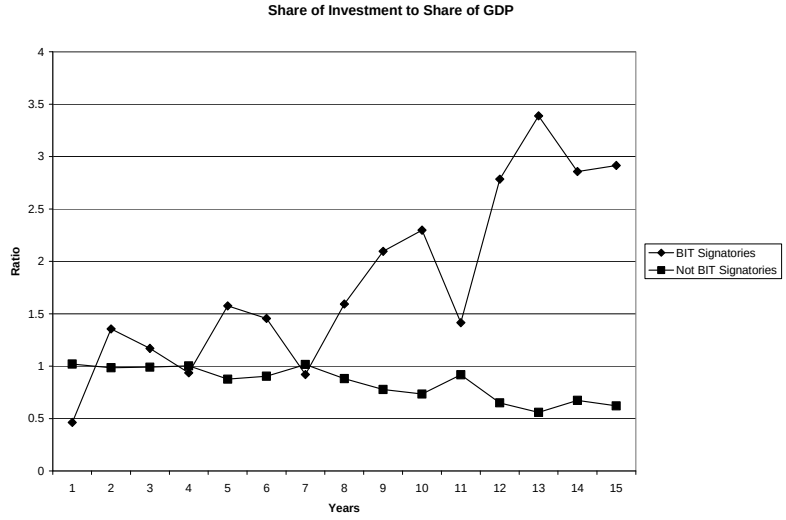
[7] Of these ten had BITs and three (Mexico, Chile and Singapore) signed Free Trade Agreements with an investment protection section nearly identical to the language contained within a U.S. BIT.

[8] These relate to a gravity model of investment flows.

[9] The association is true for Germany, Great Britain, France and Italy but cannot be tested for the U.S. as it has not concluded any BITs with its few former colonies.

APPENDIX 1: SHARE OF USDIA COMPARED TO SHARE OF SAMPLE GDP





T-Tests					
Variable	**Method**	**Variances**	**DF**	**t Value**	**Pr > |t|**
Ratio	**Pooled**	Equal	28	4.30	0.0002
Ratio	**Satterthwaite**	Unequal	14.9	4.30	0.0006

Equality of Variances					
Variable	**Method**	**Num DF**	**Den DF**	**F Value**	**Pr > F**
Ratio	**Folded F**	14	14	29.63	<.0001

APPENDIX 2: REGRESSION ANALYSIS OF PANEL DATA

Cross Sections 35; Time Series 15					
Dependent Variable	**Model R-Square**	**BIT Variable t Value**	**BIT Variable p Value**	**Treaty Age t Value**	**Treaty Age p Value**
log flow	0.4167	0.43	0.6687	1.65	0.1005
USDIA flow	0.6640	0.79	0.4304	1.71	0.0879*
USDIA concentration	0.1671	-0.03	0.9758	-0.13	0.8935
share of USDIA	0.6523	0.73	0.4628	0.41	0.6855
share by GDP	0.6439	0.96	0.3362	0.02	0.9866

Best Fit Model; Dependent Variable = USDIA flow		
Explanatory Variables	**t Value**	**p Value**
BIT dummy	0.79	0.4304
FDI, net inflows	9.10	<.0001***
GDP	-2.39	0.0173**
GDP per capita	3.14	0.0018***
GDP growth	0.80	0.4256
Inflation	1.87	0.0616*
exchange	-0.27	0.7899
population,	1.15	0.2513
population growth rate	-0.45	0.6498
treaty age	1.71	0.0879 *

*** Significant at .01 level
** Significant at .05 level
* Significant at .10 level

APPENDIX 3: COUNTRIES INCLUDED IN SAMPLE

Share of USDIA Compared to Share of Sample GDP and Panel Data Set (35 Countries)

Argentina
Barbados
Bermuda
Brazil
Chile
China
Colombia
Costa Rica
Czech Republic
Dominican Republic
Ecuador
Egypt
Guatemala
Honduras
Hong Kong
Hungary
India
Indonesia
Jamaica
Korea, Republic of
Malaysia
Mexico
Nigeria
Panama
Peru
Philippines
Poland
Russia
Saudi Arabia
Singapore
Thailand
Trinidad and Tobago
Turkey
United Arab Emirates
Venezuela

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