

The Domestic Institutional Determinants of International
Institutional Design: The Case of Bilateral Investment Treaties

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Introduction

The rational design of institutions research program in International Relations has provided scholars with a clear framework through which to understand variation in design features across institutions. This framework is unambiguously functionalist in nature; political leaders create institutions to solve problems. Rationalist explanations typically link the dynamics of a problem - its “situation structure” - to the institutional solutions that result. Although some progress has been made in recent years, what has yet to be answered definitively in extant research is why institutions that aim to solve the same or similar problems, should be structured differently in different domains. For example, Abbot and Snidal (2000) argue that high levels of institutional legalization will be favored by states in environments where the potential for opportunistic defection is high. However, we see variation in the design of trade agreements where the potential for opportunistic defection is similarly high (e.g. Yarbrough & Yarbrough 1987, Pevehouse & Buhr 2005). For example, Kahler (2002), argues that existing functionalist or demand-side explanations of global monetary institutions “fail to explain a crucial portion of observed institutional variation over time” (p.42). Kahler argues that this is because they fail to acknowledge that the preferences of states can vary.

Kahler’s criticism is well founded in this regard as is his assertion that “domestic politics and political economy offer a superior baseline for defining state preferences in functionalist models” (p.42). In notable surveys of the field, several prominent scholars have stressed that an important link exists between domestic politics and political institutions and international institutions (Kahler 2000, Martin & Simmons 1998), but very little research has been conducted into the effect of domestic political institutions on the design of international institutions. In international political economy, much focus has instead been on the role of domestic institutions in framing foreign economic policy (e.g. Mansfield, Milner & Rosendorff 2000). One notable exception is Bernhard and Leblang’s (1999) investigation of the effect of democratic electoral and legislative institutions on governments’ exchange rate mechanism preferences. A more recent study has uncovered that the probability of a state joining a preferential trading arrangement is inversely related to the number of the state’s veto points (Mansfield, Milner & Pevehouse 2007). Another study explicitly examines the effects of regime type on the legalization of preferential trading agreements’ (PTAs)

dispute settlement mechanisms (DSMs). They find that democracies are more likely to participate in PTAs with more legalized DSMs but do not offer a theoretical explanation for this relationship (Pevehouse & Buhr 2005).

This paper takes up Kahler's suggestion to look to domestic politics to determine the preferences of state leaders with respect to the design of international institutions. In particular, I look to domestic political institutions, primarily regime type, to explain why some states choose to conclude highly constraining bilateral investment treaties (BITs) that limit policy flexibility and others choose to conclude agreements that contain exceptions and loopholes that allow governments greater freedom to interfere in the activities of multinational enterprises (MNEs). The government-MNE relationship is characterized by time-inconsistency of preferences with governments unable to credibly commit to guarantee investors secure property rights and favorable investment conditions in the long run. Many have argued that the constraining power of democratic political institutions can help overcome this credible commitment problem. Drawing on existing studies, I posit that democratic institutions have mixed effects on governments' capacities to commit and that certain characteristics of the foreign direct investment issue area such as low issue salience to the average voter and strong incentives for governments to violate their commitments and manipulate the environment for MNEs tilt the balance towards democracies being less able to credibly commit. I then argue that institutions at the international level, in the form of bilateral investment treaties, can raise material costs, audience costs and issue salience and thus offer a genuine substitute for the imperfect commitment capacity of democratic domestic institutions. However, the issue is not one of simply swapping BITs in for domestic institutions. The design of BITs matters and the commitment challenges faced by democratic governments leads them and their treaty partners to strongly prefer highly constraining investment treaties and to reject investment treaties with weaker constraints. I test this argument on an original data set of measures of the level of constraint in BIT investment treatment provisions in a random sample of 2800 dyads.

Commitment and Direct Investment

The problem of time-inconsistency occurs in dynamic environments where policymakers have incentives to promise one thing and then do another after other actors have made decisions and/or taken actions based on these earlier promises (Maggi & Rodriguez-Clare 1998, Persson & Tabellini 2000). The “obsolescing bargain” that characterizes much FDI reflects such a situation (Vernon 1971, Moran 1995). Under the obsolescing bargain, multinational enterprises (MNEs) are often in a position to choose to locate operations in one of multiple possible locations around the world. Governments have significant incentives to attempt to attract these enterprises as their investments are a potential source of employment, tax revenue and technology transfer. Furthermore, FDI is an importance source of foreign exchange in developing countries facing balance of payments problems. Given the potential benefits of incoming FDI, potential host governments are often forced to compete to attract MNEs by offering fiscal inducements to investors before they invest in the hope that such benefits will tempt investors to locate in their state. These inducements range from tax holidays and export duty exemptions to investment grants and wage subsidies (Li & Resnick 2003).

Thus, before location, bargaining power is with the firm. After entry, however, bargaining power shifts to host state because FDI is often characterized by a relatively high degree of irreversibility and sunk costs (Jensen 2003, Moran 1999, Stasavage 2002). Thus, governments, having made significant concessions in the original bargain with investors, may now be tempted to renege on their promises and establish a new bargain involving policies that direct a greater share of the foreign enterprise’s revenue towards the government which it then may chose to redistribute to important constituents. Examples of such policy changes include: changes to performance requirements; direct expropriation, nationalization, and confiscation of foreign owned assets; and changes in capital taxation and regulation (Moran 1995, Henisz 2000, Jodice 1980). Investors, wary of the potential for such changing circumstances may be reluctant to invest. Thus, FDI-seeking governments have an incentive to find a way to credibly guarantee that the original terms of their investment contracts will be upheld.

The Benefits of Democracy

Nathan Jensen (2003) has argued that democratic political institutions at the domestic level provide a solution to the commitment problem outlined above. They do this by constraining the policy flexibility of the executive. Compared to autocracies, democratic regimes are characterized by checks and balances giving more actors a veto over policy changes which impairs the ability of the executive to reverse earlier commitments (see also Cowhey 1993, Leeds 1999). Democratic leaders must also maintain popular support to stay in power and thus are conscious of the audience costs of policy reversal. In Jensen's words, "if governments make agreements with multinational firms and renege on the contracts after the investment has been made, democratic leaders may suffer electoral costs" because commitment violations scare away further FDI (p.595). He does not deny that renegeing on commitments to FDI may be politically beneficial in the short run as increased income flows from policy changes can be directed to core political supporters. However, this is equally likely to be the case in autocracies as it is in democracies.

Jensen also acknowledges that strong property rights play a role in making government promises to foreign investors more credible, but the link between democracy, property rights with respect to FDI is made more strongly by Li and Resnick (2003). Drawing on earlier work by North and Weingast (1989) and Olson (1993), they argue that the effective political representation of diverse groups, meaningful legislature, electoral constraints and independence of the judiciary found in established democracies helps them attain strong property rights and uphold contracts, thereby protecting investments from "predatory banditry" by the executive. It is precisely because democracy itself rests on such institutions that established democracies display high levels of property rights protection.

Both Jensen, and Li and Resnick find empirical support for their arguments in cross-sectional statistical analysis. Working from the reasonable assumption that *ceteris paribus* investors will locate in places where policy shifts are less likely and property rights are more secure, they find that countries with strong property rights and democratic regimes attract more investment after controlling for other economic and political factors that influence investment location. However, there are reasons to believe that democratic institutions, as a solution to the commitment problem,

may not always be clear and effective. Indeed, many have argued that democracies are ill-equipped to keep their promises.

The Mixed Effects of Democratic Institutions

The literature on alliance commitments, while a step removed from considerations of property rights and economic policy, has proven to be a fertile battleground for debating the effect of democracy on the credibility of policy commitments¹. In possibly the most constructive contribution to this debate, Gartzke and Gleditsch (Gartzke & Gleditsch 2004) argue that the effects of regime type on commitment credibility are mixed, and several of the underlying political processes they identify are relevant to the FDI commitment problem. They argue that while democratic audiences can constrain their leaders and exert audience costs, this is conditional on the salience of the issue at hand to individual constituents because monitoring government behavior is a costly exercise. Thus, a decision to go to war or escalate an international crisis has high visibility and is salient for most of the electorate in a democracy and thus there may be, as Fearon (1994) argues, genuine audience costs from backing down from a previous position. On the other hand, citizens will not find it rational to become familiar with the minutiae of investor-state contracts and monitor the behavior of their elected leaders to see if they renege on their contractual obligations. Furthermore, while backing down in a crisis can have audience costs, as Jensen acknowledges there can be domestic audience gains from backing out of commitments to foreign investors. Indeed, many large scale acts of nationalization of foreign assets, from Nasser to Morales, have had a powerful populist dimension to them. Moreover, Jensen's suggestion that leaders would be punished for such actions is unpersuasive when one considers that renegeing on commitments to foreign investors is often costless for most constituents, in the short run, while they can potentially reap the gains of government policy shifts to redirect revenue streams away from investors and towards the state. This is especially true if one considers that the benefits of freely operating FDI are often targeted narrowly in certain regions and sectors of the host economy (Li & Resnick 2003). Even if this were not the case, it is a tall order to expect voters to make the connection between renegeing on

¹For an excellent review of this literature, see (2004)

contracts today and the consequences of reduced investment in the future, assuming that potential future investors are deterred by contract violations, and then for this to be influential in how they cast their votes at election time. Thus, arguments founded on the effect of popular audience costs should be treated with some scepticism.

The potential for popular support for, or at least popular ambivalence towards, government violation of commitments to foreign investors leads us to reconsider the effect of constraints and veto points on policy commitments. Recalling Arrow's (1951) impossibility theorem². Gartzke and Gleditsch point out that due to their need to respond to the wishes of large voting selectorates, democratic leaders confront the instability of cycling across coalitions of support needed to maintain power. This cycling across social choices can make democratic governments unstable business partners because even though they may have had support to grant foreign investors favorable conditions when first signing an investment contract, future winning coalitions may advocate different investment policies that could involve renegeing on previous promises. It is not uncommon for democratic leaders to seek office on a platform promising significant change to the status quo in the belief that a coalition can be built that supports it. Thus, a pro-market government may conclude contracts with investors that exempt them from certain tax obligations and performance requirements. However, they may be followed in office by a left wing government that wishes to remove the tax holidays on foreign investors and put in place measure that require the MNE to source inputs into its production processes domestically to stimulate employment in local upstream industries. It is important not to overstate the effects of cycling precisely because the constraints of democratic institutions, such as multiple veto points, help to overcome cycling induced instability by locking-in policies (see Shepsle & Weingast 1981). Thus, as Gartzke and Gleditsch argue, there is an inherent tension in democracies between the shifting preferences of the electorate and the willingness of political leaders to respond to them, and institutional constraints that make such responses difficult.

Thus far the discussion has focused on the relationship between the general selectorate and

²Arrow's theorem illustrates that it is impossible to obtain a clear social choice in any representative system, regardless of the voting rule used to aggregate the preferences of individual voters, without violating certain core assumptions about fairness. Thus, cycling over policy (the social choice) is unavoidable and the final policy decision adopted is a function of factors beyond the preferences of voters. (See also Riker(1982))

political leaders. However, numerous studies on the politics of trade and finance have stressed the importance that special interest groups and lobbies play in guiding (foreign) economic policy (e.g. Frieden 1988, Gowa 1988). Moreover, the support of special interest groups is sought after by rational office-seeking politicians trying to maximize electoral support and campaign contributions (Grossman & Helpman 1994). In addition, the members of interest groups, if large enough, can form important parts of supporting coalitions. With regard to their government's compliance with commitments, special interests are more likely to exercise influence where issue salience is low and complexity is high making it difficult and costly for constituents to easily monitor the extent of their government's commitments and their compliance behavior (Gartzke & Gleditsch 2004).

While I have argued above that this is the case for commitments in investor-state agreements, it is difficult to develop general expectations regarding interest-group activity surrounding FDI. Factor models used in trade are unsatisfactory. For instance, capital owners in capital scarce developing countries may be expected to lobby against incoming FDI as the increased supply drives down the price of capital. However, not all capital owners compete with incoming FDI. Some form alliances through joint-ventures and upstream and downstream industries may experience revenue growth through supplying inputs into the MNE's production processes or distributing and marketing the MNE's products. For example, one of the motivations for developing countries to try to attract FDI is that foreign firms bring knowledge and technology that can spillover into the domestic economy and improve efficiency of local firms. However, Aitken and Harrison(1999) have found that such spillovers tend to concentrate in joint-ventures between foreign and domestic firms and that competition from FDI can actually lower productivity in domestic competitors that are wholly domestically owned by lowering their market share and pushing per unit production costs below their optimal level. Finally, given the narrow sectoral nature of FDI, if capital is immobile across sectors, capital owners in industries where FDI is minimal will care little about the level of incoming FDI.

FDI and Incentives to Renege

More generally, there is strong evidence that the effects of FDI on host countries' political economies are inconsistent across sectors, regions, and time and that these effects are contingent on multiple factors. For example, one study has found that FDI strongly crowds in domestic investment in Asia, crowds out investment in Latin America and has a mixed effect in Africa (Agosin & Mayer 2000). Another study found that under certain conditions MNEs generate employment and in others they lower employment by crowding out domestic investors and requiring less labor themselves (Hanson 2001). Markusen and Venables (1999) on the other hand suggest the effect of FDI on local firms is dynamic. In the short-run they force domestic firms out of business. Over time, however, through technology spillovers to upstream linkages, inputs into production become so cheap as to make it possible for domestic firms to re-enter the market competitively and possibly force out MNEs. Finally, Gorg and Greenaway (2003) argue that the extent to which positive technology and productivity spillovers occur from FDI depends on the degree to which MNE operations are integrated into the local economy.

This brief snapshot of a rich and growing literature in economics on the effect of FDI on host economies highlights the difficulty in predicting the effects of FDI on interest group behavior. Undoubtedly there are winners and losers from FDI, but whether they fall easily along traditional interest group lines is difficult to determine *ex ante*. What is important to the note is that, governments are not helpless in the face of the uncertain effects of FDI. Rather, they can play a role in determining the extent and distribution of the costs and benefits of FDI. For example, a government can offer incentives to MNEs to establish linkages with domestic suppliers which can help offset the crowding out effects of MNEs and help governments maintain political support by creating winners to balance out the losers. Alternatively a government can raise taxes on increased MNE profits and use the increased revenue to compensate employees of firms that have been crowded out by foreign investors. The ability to manipulate the political economic consequences of FDI on growth, employment and government revenue is an important tool for governments trying to maintain a coalition of supporters that will keep them in power. Given that MNEs often demand low taxes and little government interference in their operations before entering a host country,

such manipulation involves altering the investment environment for MNEs in such a way that governments must breach the commitments they made to investors when first admitting them. Thus, a combination of shifting coalitions and strong incentives for government intervention in MNE's activities under democratic regimes makes investing in democracies a potentially precarious endeavor.

Autocratic leaders on the other hand face a different calculus to democratic leaders when considering compliance with their commitments to foreign investors. Firstly, they do not face similar cycling of preferences as the maintenance of their position in power is not dependent on the formal aggregation of preferences through elections. Thus, while an absence of formal institutional constraints (i.e. fewer veto points) makes shifting policy easier, the consistency of their policies is likely to be enhanced by the need to maintain a small and often stable coalition of supporters. Secondly, audiences costs, to the degree that they exist, are less problematic because autocratic leaders only need to respond to the wishes of a small electorate and disapproval of the broader populace is not as consequential. Nevertheless, given the nature of the obsolescing bargain, autocratic leaders, untethered by domestic veto points and public opinion, are free to take advantage of immobile MNEs to the extent that it does not excessively deter further investment or disrupt the flow of revenues their supporters receive from FDI, directly, or through the government.

Overall, the preceding discussion of domestic regime type and democratic institutions in particular suggests that despite the optimism of some scholars, democratic political institutions contain counteracting elements that make them an imperfect solution to the commitment problem. Perhaps international institutional constraints can serve as an effective substitute.

Bilateral Investment Treaties: The International Alternative

International institutions are diverse in their membership, design and objectives and not all institutions are designed with the purpose of enhancing the credibility of commitments. However, the ability of international institutions to perform such a function has achieved broad acceptance in the institutionalist literature in International Relations. International institutions do this by making the consequences of renegeing on commitments more costly to governments. In some cases

they do this by increasing the probability that non-compliance with commitments will be detected by clearly specifying standards of conduct and facilitating the monitoring of state activity (Keohane 1984, Oye 1986). This increases the likelihood of detection and the risks that states will incur reputation and audience costs from non-compliance (Dai 2005). Some institutions such as the World Trade Organization's dispute settlement procedure contain a mechanism that allows audience costs to be accompanied by material costs from sanction or retaliation for violating commitments. Furthermore, institutions help facilitate issue-linkage which can raise the costs of defection in one issue area because defection may then be punished through loss of benefits in linked issue areas (Martin 1992).

The principal institution(s) governing foreign direct investment is an increasingly dense network of thousands of bilateral investment treaties (BITs). Attempts to consolidate these agreements into a single institution have been unsuccessful with states preferring to preserve their autonomy in negotiating with individual investment partners³. While BITs are concluded between governments, they primarily govern the conduct of governments towards their treaty partners private investors engaged in economic activity in their country.

In terms of issues covered, BITs are remarkably similar with the vast majority outlining government obligations to foreign investors in the following areas:

- Promotion of Investment
- Absolute Standards of Treatment
- Relative Standards of Treatment (e.g. Most-Favored Nation Obligations)
- Transfers of Capital
- Compensation for Losses Due to War and Civil Unrest
- Conditions and Compensation for Acts of Expropriation
- Pledge to Honor All Other Obligations to Foreign Investors

³The abortive attempt led by the Organization for Economic Cooperation and Development (OECD) to develop a Multilateral Agreement on Investment, abandoned in 1997, is the most prominent example of this

- State-State Dispute Settlement
- Investor-State Dispute Settlement

The first seven of these areas serve the institutional function of establishing acceptable standards of conduct. They generally aim to afford investors fair and equitable treatment, protect investor's property rights and promote an environment in which MNEs are free from discriminatory and predatory behavior by host governments. The pledge to honor other obligations is particularly important because it brings private contracts concluded between investors and governments under the protective umbrella of the treaty. The last provision listed, investor-state dispute settlement, provides the increased costs for violating these standards of conduct. Most BITs' dispute settlement clauses grant private investors the right to take host governments to arbitration directly (i.e. without the approval or assistance of their home governments) if they feel they have violated provisions of the BIT or, in some cases, if they have any investment related grievance. If the arbitrators find in favor of the investors, they have the power to order the states to pay compensation to the investors.

The costs of arbitration to governments are real. Legal costs alone are tens of millions of dollars which is substantial for developing countries with small economies. Arbitration awards can also be substantial. For example, in 2003, a Stockholm based tribunal awarded the Dutch-American firm, Central European Media (CME), 350 million dollars in compensation for what it judged was violation of a BIT between the Netherlands and the Czech Republic. This effectively doubled the Czech governments already record budget deficit for that year and led Czech leaders to consider raising the nation's value added tax. Such large awards and the actions governments need to take to pay them can also have the effect of triggering audience costs as the media is likely to publicize the outcome and constituents are forced to foot the bill.

The argument that BITs increase the costs of reneging and therefore make commitments to fair and equitable treatment of foreign investors more credible is made most forthrightly by Buthe and Milner (2005) and Simmons, Elkins and Guzman (2006). Both sets of scholars argue that states sign BITs with a view to attracting foreign investment by credibly guaranteeing to provide a secure investment environment. Simmons et al. (2006) go further to argue that the competition for FDI

between governments has spilled over into the negotiation of BITs such that there is a competitive diffusion of BITs across host states. This suggests that governments, both host governments and investors' home governments, believe that BITs can substitute for imperfect domestic institutions and lock in government promises of favorable treatment towards foreign investors.

Domestic Institutions and Preferences Over BIT Design

Not All BITs Are Alike

Given the precarious nature of democratic commitments, democratic leaders who wish to lock in policy gains for key constituents are likely to be drawn to bilateral investment treaties. However, not all BITs are alike and it is important to take this variation into account. Unfortunately, however, the growing literature on bilateral investment treaties has almost universally treated BITs as homogenous in all meaningful respects. For example, to empirically evaluate the effect of BITs on FDI inflows Buthe and Milner (2005) simply sum the number of BITs the host country in question has signed. This assumes that one BIT is just as effective as another in attracting FDI. Meanwhile, Simmons et al.'s (2006) analysis of the factors that lead states to conclude BITs pools all treaties together.

Yackee(?), in one of the few studies to acknowledge that BITs vary on any dimension⁴, argues that they are essentially the same apart from provisions that relate to the states' pre-consent to investor-state dispute settlement. This is because most treaties contain most-favored nation provisions guaranteeing investors the best treatment a state offers to investors from any other country. This argument is misleading in several respects. Firstly, most-favored nation provisions in treaties only require that the signatories grant investors from their treaty partner treatment no less favorable than they grant to investors from any third state. This does not preclude variation in treatment across states and in the level of treatment different states choose to promise foreign investors. Secondly, most-favored nation provisions often include exceptions similar to those discussed

⁴Another noteworthy exception to the trend of treating all BITs as alike is an investigation of the design of bilateral investment treaties (BITs) by Allee and Peinhardt (2008). They employ hypotheses from the 2001 Rational Design volume of *IO* regarding the effect of uncertainty on the centralization and flexibility of institutions and test them on BITs' dispute settlement procedures, finding little support for the rational approach. Two of their indicators of "uncertainty about state behavior" involve some measure of regime type but below I offer a different argument regarding the potential effect of domestic political institutions on institutional design.

below regarding national treatment. Thus, the promise of most-favored nation may not always be complete. Finally, there are aspects of BITS that deal with treatment beyond most-favored nation treatment that can vary across BITs without violating most-favored nation commitments.

Bilateral investment treaties, while undoubtedly similar in structure, vary in subtle but important ways. Furthermore, these variations are substantive and have significant implications for the policy flexibility and autonomy that governments have towards foreign investors. In short, governments, while signing BITs, can build into treaties room to move along several dimensions. This often takes the form of exceptions to general principles, such as the principle of national treatment, the promise to treat foreign investors at least as well as local investors. Many governments sign treaties promising national treatment but with exceptions for certain types of policy (e.g. fiscal policy) and particular sectors of the host's economy. Fiscal policy is a major economic policy lever that governments are then free to use to manipulate the effects of foreign investment on the domestic political economy.

At this point, it is important to acknowledge the asymmetric nature of the FDI relationship between BITs. Most BITs are signed by states at different levels of economic development. This leads to asymmetric FDI flows between BIT partners with flows from the more developed state to the less developed state far outweighing those in the opposite direction. This means that considerations of the effects of FDI inflows on the domestic political economy and its consequences for political success are much more likely to affect the host state (i.e. the lesser developed state) than the home state.

Democracies

I argue that dyads in which the host state is a democracy will be more likely to conclude treaties that are more constraining and have fewer loopholes through which democratic host governments can respond to incentives to alter investment policy. This is desirable for home and host state alike. Firstly, if the host wants to conclude a binding formal agreement to protect investment we can infer that its executive is currently supported by a coalition and interest groups that favor, or do not object to, freedom of activity for MNEs. This executive has incentives to try and maintain

support in the short run by rewarding such supporters with treaties with fewer exemptions that can be exploited by subsequent governments whose preferences may be different. Similarly, the home state's executive has strong preferences when signing a BIT to ensure that it is truly effective in constraining cycling policy preferences in democracies. Indeed, such states may refuse to sign an agreement if they cannot secure a highly constraining BIT because they do not favor locking in a weak treaty. Given that fewer than four per cent of BITs have been ever been renegotiated, home state negotiators may wait until they can conclude a better agreement. Admittedly, this may cause the home government to give up the protection offered in a weaker than ideal BIT and it may have to wait a while if the executive in the host state is replaced by one less inclined to conclude a BIT. However, the time horizons in BITs are long, with the agreements' provisions often staying in force for a decade into the future after the agreement is abrogated. Thus, while BITs may not be for life, they do cast a long shadow into the future. These arguments lead to the following hypotheses:

H1: The probability of a dyad concluding a highly constraining BIT increases with the level of democracy in the probable host state.

H2: The probability of a dyad concluding a low constraining BIT decreases with the level of democracy in the probable host state.

Autocracies

The situation for non-democracies is different to that of democracies. As outlined above, autocratic states have stable preferences and institutions are not required to prevent cycling across preferences and lock in policy. Furthermore, stable autocracies have long time horizons and therefore have disincentives to mistreat investment or perform the bait and switch that is central to the obsolescing bargain. This is because while such behavior may be beneficial in the current period, they may be subjected to punishment in the form of reduced investment in subsequent periods. Such reputation costs are attenuated in democracies where time horizons can be limited to winning the next election. However, their base of support is small but powerful and therefore they have incentives to avoid strong commitments just in case they need to act to protect the economic interests of members of their coalition due to shifting economic circumstances. Given that empirically, autocracy and

democracy are measured on a single scale, my empirical expectations for the relationship between autocracies and BIT design are reflected in hypotheses 1 and 2.

Data and Methods

Dependent Variable: The Relative Constraining Power of BIT Provisions

The hypotheses presented in the previous section are tested using a random sample of 2800 dyads. A subset of the provisions of all BITs concluded by dyads within the sample between 1960 and 2006 were coded along numerical scales that represent levels of policy constraint for signatory states⁵ Information on the dates of BIT signings and BIT texts were obtained from the UN Conference on Trade and Development's (UNCTAD) online treaty database and the Kluwer Arbitration Online's investment treaty database⁶

Construction of the coding scheme (outlined in the appendix) was guided by the UN Conference on Trade and Development's (2007) *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking*, an impressively detailed article by article review of trends in BIT drafting and their implications for states and investors. The subset of provisions chosen to be coded relate to the following: 1) Admission of Investment; 2) Most Favored Nation Treatment; 3) National Treatment; 4) Tax/Fiscal Policy. These four areas were selected for several reasons. Firstly, they all have a direct influence on the freedom host governments have to implement and adjust policies towards foreign and domestic investors and manipulate the allocation of costs and benefits of foreign investment activity. Secondly, they are less open to variations in legal interpretation and stylistic variations than other BIT provisions. The third reason is that there is genuine variation across BITs in these areas whereas in others there is little meaningful variation worth investigating. For instance, there is almost universal consensus regarding what the acceptable conditions for expropriation are and how investors should be compensated (UNCTAD 2007).

Codes for the four categories were then combined and collapsed into three level scale of policy

⁵Obtaining the texts of all BITs in the sample has proven to be very difficult. Of the 2800 sample dyads, 412 signed BITs between 1960 and 2006. However, I was only able to obtain the texts of 264 of those BITs. To avoid biasing the statistical results, dyads with missing BIT texts were dropped from the analysis.

⁶It should be noted that Kluwer Arbitration's source for the BIT texts is the Penn State Institute of Arbitration Law and Practice.

constraint: High, Medium and Low. The distribution of treaties across these three levels is presented in Table 1.

Table 1: Distribution of Levels of Policy Constraint of BIT Treatment Provisions

Constraint Level	Number of BITs	Percentage of BITs
High	103	40
Medium	80	30
Low	78	30
Total	261	

Monadic Independent Variables

Monadic independent variables are those in the model that measured characteristics of the individual members of each dyad. For the monadic variables a distinction is drawn between host and home states. The host state is the member of the dyad with the lower GDP per capita⁷. All time varying independent variables are lagged one year.

Democracy: The main independent variable in the model is the host states' level of democracy. The home state's level of democracy is also included. Both are measured using the PolityIV Democracy-Autocracy Score from -10 to 10 (Marshall & Jaggers 2006).

LGHostGDP: The log of the host country's GDP is used as a control variable because it the level of development can potentially effect the contents of BIT provisions. For example, a more economically developed host may be less willing to push for a less constraining BIT as they believe that domestic firms are capable of competing with foreign investors. On the other hand, developed economies are desirable investment locations and so home states may be more willing to concede fewer constraints to a more developed BIT partner to ensure that an agreement is concluded. The home country's level of development is not included in the model because it is highly correlated the with the wealth gap variable discussed below. GDP data is obtained from the World Bank's World Development Indicators.

Experience: It is possible that a state's experience with BIT negotiations can influence its ability to negotiate more advantageous treaties (i.e. less constraining in the case of host states).

⁷This practice mimics the approach by Simmons et al.

Therefore, experience is included in the model and it is measured by the number of treaties the each state had signed before they signed the treaty in question. Experience take three values: 1, 2 and 3, corresponding to less than five treaties signed, between five and ten treaties signed and more than 15 treaties signed respectively.

LGRegionalBits: Simmons et al. find strong evidence of the diffusion of BIT signing through processes of competition and learning. This measure takes the log of the number of BITs in force in the host's region and the home state's respectively as an extremely crude measure of diffusion pressures. The assumption is that learning and competition will be strongest with one's regional neighbors and that as the number of BITs in force in the region grow, this creates greater pressure on states to conclude more BITs.

Dyadic Independent Variables

Dyadic independent variables represent characteristics of the dyad.

Region: Economic interactions typically decline with the distance between actors. Therefore, as more cross-border direct investment is to be expected between members in close proximity (i.e. within the same region), there is a possibility that regional neighbors will find it more beneficial to conclude agreements that govern that interaction. The variable is dummy, coded 1 if the both members of the dyad are in the same region. Data on regional membership is taken from Hadenius and Teorell (2005).

Colony: Strong economic ties between former colonial powers and their colonies following decolonization are not uncommon. This density of economic interaction often involves FDI and states may be inclined to conclude BITs for the reasons discussed above with respect to the region variable. Furthermore, colonial bonds may extend into less restrictive treaties as a history of established ties and networks removes some of the political risk that BITs try to combat. The variable is dummy, coded 1 if the dyad had a shared colonial history. Data on colonial history is taken from Hadenius and Teorell (2005).

Dyadic Trade: Dyadic FDI data is typically very poor and virtually non-existent for dyads involving two non-OECD countries. Thus, dyadic trade serves as a proxy for the level of economic

exchange and investment between dyad partners which, as discussed earlier above, may influence dyads' propensities to conclude BITs. Trade is obtained from Barbieri, Keshk and Pollins (2008)

Joint Alliance Membership: This dummy variable is coded 1 if both dyad members are members of the same alliance. Dreher and Jensen (Dreher & Jensen 2007) find that U.S. allies receive more favorable conditions from the IMF than non-allies and this finding suggests that allies may be more willing to conclude less constraining BITs with allies than with states with whom they are not alliance partners. Alliance membership data is obtained from Leeds(2005).

Wealth Gap: In the previous section, I noted that autocracies prefer less constraining BITs and home states prefer more constraints. The final results, the BIT provisions, are the result of a bargain between the two states and the wealth gap (the difference in GDP per capita between the home and host) is a proxy for the relative bargaining power of each party. When the gap is large, this typically reflects the size of the home state's economy and thus the home state has a much greater ability to persuade the host state to accept a more constraining BIT. This is because it has the potential to engage in a high level of investment in the host state.

Method

The method employed is a competing risks Cox proportional hazards model. A simple cross-sectional analysis of the determinants of BIT content is unsuitable because states do not simply choose among different types of investment treaty. They also choose whether or not to sign a treaty at all. The Cox model allows us to examine both whether dyads conclude a BIT and also what kind of BIT they conclude. Cox models are also preferable because BIT signings are very similar to single-failure duration models in that they, in most cases, occur only once. Four separate models are estimated, a pooled model where all types of treaty are included in the model, and then a separate model for each type of treaty (high, medium and low constraint). Each is estimated using the same covariates as the pooled model. Changes in the estimates across these models indicate that the covariates exert different effects on the likelihood of treaty conclusion for different types of treaty.

Results

The estimates for the competing risks Cox Model are presented in table 2. Please note that the estimates are presented as coefficients and not as proportional hazards. Therefore, a negative sign on a coefficient indicates a negative correlation between the risk of failure (signing a BIT) and the covariate.

Table 2: Cox Competing Risks Model of Levels of Policy Constraint of BIT Treatment Provisions

	Pooled	High Const.	Med Const.	Low Const.
Polity (Home)	0.038** (0.017)	0.049 (0.035)	0.067* (0.038)	0.017 (0.026)
Polity (Host)	-0.025** (0.012)	0.039* (0.021)	- 0.027 (0.021)	-0.105*** (0.023)
Region	-0.728*** (0.255)	-0.358 (0.376)	-1.227** (0.490)	-0.464 (0.494)
Colony	0.709*** (0.259)	0.835** (0.400)	1.274*** (0.443)	-0.094 (0.551)
Alliance	0.655*** (0.197)	0.531* (0.304)	0.595* (0.335)	0.388 (0.438)
Wealth Gap	0.0001* (0.000)	0.0001 (0.000)	0.0003* (0.000)	-.0000* (0.000)
Log(GDP) (Host)	0.193*** (0.066)	0.048 (0.110)	0.297*** (0.111)	0.204* (0.120)
Experience (Host)	0.831*** (0.130)	0.961*** (0.199)	0.563** (0.234)	0.933*** (0.259)
Experience (Home)	0.843*** (0.098)	1.404*** (0.179)	0.725** (0.173)	0.224 (0.180)
Dyadic Trade	-0.0001** (0.000)	-0.0002 (0.000)	-0.0001 (0.000)	-0.000 (0.000)
Log(RegionalBITs) (Home)	0.114** (0.055)	0.017 (0.067)	0.159 (0.139)	0.294** (0.134)
Log(RegionalBITs) (Host)	0.033 (0.037)	0.021 (0.054)	0.194 (0.118)	-0.114* (0.061)
Log-Likelihood	-1023	-424	-354	-348
N	35305(221)	35305(90)	35305(70)	35305(61)

Number of BITs/Failures for each model are included in parentheses in the bottom (N) row.

*** $p < 0.01$ ** $p < 0.05$ * $p < 0.1$

The results illustrate the benefits of employing a competing risks model and differentiating across treaties. The pooled model finds that dyads with more democratic host states have a higher

risk of concluding an investment treaty than non-democratic host country dyads. However, this result masks a complex underlying process that is exposed by the other models where we see that dyads with more democratic host states have a higher risk of signing highly constraining treaties and lower risk of signing low constraint investment treaties when compared to less democratic host state dyads. These effects are statistically significant at the 0.1 and 0.01 levels respectively. This provides some tentative support for the hypotheses presented above.

Of the other variables few display a meaningful pattern across the three types of treaty. Home state experience is one exception with the coefficient decreasing with the level of policy constraint. In all cases the estimates are statistically significant at the 0.01 level and indicate that democratic host state dyads experience a higher risk of signing each type of BIT than non-democratic hosts state dyads. However, this higher risk is larger for more constraining BITs. This is unsurprising as a more constraining BIT is the preferred outcome for most home states and thus, home states with BIT experience and that are thus disposed towards concluding BITs are likely to be quicker to obtain their ideal outcome, when possible.

The estimates in the pooled model indicate that the regional and trading partners face lower hazards of signing BITs in general. This could be because other institutions such as regional integration agreements or preferential trading agreements are substituting for BITs. States with a shared colonial heritage and alliance partners face greater risks of signing BITs (statistically significant at the at the 0.05 level) but these non-economic bonds do not influence whether those BITs are more or less constraining. A similar relationship applies for home and host state experience with the BIT signing process, where greater experience is associated with greater risks of concluding more BITs.

Overall, the models provides support for the argument that dyads in which the host state is more democratic are more likely to sign highly constraining treaties and less likely to sign low constraint treaty when compared to dyads in which the host state is non-democratic.

Conclusion

This paper has attempted to weave together two closely related literatures on the effects of international and domestic political institutions on governments' abilities to commit to economic policies. Much separate work has been done in the two research programs but few scholars have attempted to explore the links between institutions at the international and domestic levels and how they related to the problems of credible commitment. This paper has attempted to do this by portraying international institutions in the issues area of treatment of foreign direct investment as a potential substitute for imperfect domestic constraints on executive discretion. This paper has also attempted to use the incentive structures that executives face at the domestic level as determinants of their preferences over the level of constraint in international institutions designed to serve as substitutes. The empirical results are not clear cut but there is some evidence that a complex relationship exists in which treaty negotiators are willing to use international treaties as substitutes for domestic institutions but only to the extent that those substitutes are truly effective and constraining. This is perhaps not surprising given the long shadow of international institutions such as BITs and the costliness of negotiating an imperfect treaty.

Appendix: Coding Scheme

For all four treaty dimensions coded, higher numbers are indicate a higher degree of policy flexibility for host governments. Exceptions in noted in the National and Most-Favored Nation Codes do not include exceptions just for tax and fiscal policy because that is already covered in the tax variable.

Table 3: Tax Policy

Code	Content of Treaty Provision
1	No mention of tax or fiscal policy OR Tax policy addressed only in the context of treaty exemptions for double taxation agreements.
2	Tax/fiscal policy exempt from most-favored nation and/or national treatment provisions OR exempt from all parts of the treaty

Table 4: Admission of FDI

Code	Content of Treaty Provision
1	Investors are guaranteed most favored nation and/or national treatment.
2	No requirements to admit investment OR Admission is contingent on domestic legislation and policy.

Table 5: Most Favored Nation Treatment of FDI - Post-Establishment

Code	Content of Treaty Provision
1	Most-Favored Nation Without Exceptions
2	Most-Favored Nation With Exceptions
3	No Most-Favored Nation Commitments

Table 6: National Treatment of FDI - Post-Establishment

Code	Content of Treaty Provision
1	National Treatment Without Exceptions
2	Most-Favored Nation With Exceptions
3	National Treatment Contingent on Domestic Legislation
4	No National Treatment Commitments

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