

Withdrawing from International Regimes: Bargaining Power in the Investment Treaty Regime

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*A thesis submitted for the degree of
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Abstract

Why do some states withdraw from international regimes? How do others successfully renegotiate the terms of international cooperation? This thesis investigates whether, and how, the changing bargaining power relations impact treaty-based cooperation in the international investment treaty regime. The institutional architecture to govern investments consists of a web of bilateral investment treaties (BITs). The investor-state dispute settlement (ISDS) mechanism embedded in most BITs has resulted in an accumulation of arbitration cases between host governments and foreign investors, and states have increasingly begun to question their investment treaties.

I argue that while states have learned about the true risks of investment treaties through ISDS, they must have sufficient bargaining power to act in response. Bargaining power is best understood as alternatives to the existing agreements. Alternative economic treaties and domestic investment laws facilitate foreign investment and decrease dependency on the existing agreements. Economic improvement can also bring confidence for a government that such alternatives can be developed. When sufficient alternatives are in place, a state can either exit the agreement, demand renegotiation, or conduct a strategic exit with intentions to renegotiate at a later stage. The optimal strategy for a revisionist state depends on the bilateral relationship between the states, and how important they consider their partnership.

I employ a mixed methods approach to provide evidence for my argument. I use data on bilateral investment treaties to show that bargaining power is associated with greater risk of BIT termination and renegotiation. Relative changes in economic power also condition the effects of ISDS on BIT outcomes. Interviews conducted with Ecuadorian and Indonesian policymakers show that governments are strategic in reflecting on their outside options when considering BIT reform. By examining the dynamics of investment treaty reform, this thesis contributes to a better understanding of change in international regimes governing the world economy.

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Abstract

Why do some states withdraw from international regimes? How do others successfully renegotiate the terms of international cooperation? This thesis investigates whether, and how, the changing bargaining power relations impact treaty-based cooperation in the international investment treaty regime. The institutional architecture to govern investments consists of a web of bilateral investment treaties (BITs). The investor-state dispute settlement (ISDS) mechanism embedded in most BITs has resulted in an accumulation of arbitration cases between host governments and foreign investors, and states have increasingly begun to question their investment treaties.

I argue that while states have learned about the true risks of investment treaties through ISDS, they must have sufficient bargaining power to act in response. Bargaining power is best understood as alternatives to the existing agreements. Alternative economic treaties and domestic investment laws facilitate foreign investment and decrease dependency on the existing agreements. Economic improvement can also bring confidence for a government that such alternatives can be developed. When sufficient alternatives are in place, a state can either exit the agreement, demand renegotiation, or conduct a strategic exit with intentions to renegotiate at a later stage. The optimal strategy for a revisionist state depends on the bilateral relationship between the states, and how important they consider their partnership.

I employ a mixed methods approach to provide evidence for my argument. I use data on bilateral investment treaties to show that bargaining power is associated with greater risk of BIT termination and renegotiation. Relative changes in economic power also condition the effects of ISDS on BIT outcomes. Interviews conducted with Ecuadorian and Indonesian policymakers show that governments are strategic in reflecting on their outside options when considering BIT reform. By examining the dynamics of investment treaty reform, this thesis contributes to a better understanding of change in international regimes governing the world economy.

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List of Abbreviations

ACIA	Association of Southeast Asian Nations Comprehensive Investment Agreement
ASEAN	Association of Southeast Asian Nations
BATNA	Best alternative to negotiated agreement
BIT	Bilateral investment treaty
BKPM	Badan Koordinasi Penanaman Modal (Investment Coordinating Board of Indonesia)
CNPC	China National Petroleum Corp
Cox PH	Cox proportional hazard
ECJ	European Court of Justice
ECT	Energy Charter Treaty
EKCP	East Kutai Coal Project
EU	European Union
FDI	Foreign direct investment
FE	Fixed effect
FTA	Free trade agreement
GDP	Gross domestic product
GoE	Government of Ecuador
GoI	Government of Indonesia
GSP	Generalized System of Preferences
IA-CEPA	Indonesia-Australia Comprehensive Economic Partnership Agreement
ICSID	International Centre for Settlement of Investment Disputes
IIA	International Investment Agreement
IMF	International Monetary Fund
IO	International organization

IPE	International political economy
IR	International relations
ISDS	Investor-state dispute settlement
LPM	Linear probability model
MAI	Multilateral Agreement on Investment
MFN	Most-Favored Nation
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PPP	Purchasing power parity
QoG	Quality of Government Standard Dataset
RCEP	Regional Comprehensive Economic Partnership
PRS	The Political Risk Services Group
SBY	President Susilo Bambang Yudhoyono
SRS	State regulatory space
TIP	Treaty with investment provisions
TPP	Transpacific Partnership Agreement
UNASUR	Union of South American Nations
UNCITRAL	United Nations Commission On International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WDI	World Development Indicators
WEP	World Economics and Politics Dataverse

1

Introduction

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Why do some actors withdraw from international regimes? How do some manage to successfully renegotiate their international commitments? International relations (IR) scholarship has provided great insights into why states join and act through different kinds of institutions, how international agreements are designed and negotiated, and how institutional cooperation may either collapse or survive. Despite expanding work on institutional change and evolution of global governance regimes, we do not yet fully understand why states sometimes withdraw from their international commitments in pursuit of their goals, and what the impacts

of such exits are on international cooperation.

I address these larger questions central to the study of international cooperation in the context of the international investment regime. The most prominent institutional architecture to regulate international investments today consists of a web of bilateral investment treaties (BITs). Embedded in these treaties are the investor-state dispute settlement (ISDS) provisions, which grant extraordinary powers to foreign investors over sovereign states.¹ From the very first investment treaty between Germany and Pakistan in 1959, investment treaties have been at the center of global governance of foreign investment. The “grand bargain” of BITs since the onset of the regime has been to protect the interests of foreign investors abroad, carrying the promise of enhanced economic cooperation and foreign direct investment (FDI) for host governments in return.² This was especially the case for developing country governments wishing to get their share of the benefits brought by economic globalization.

However, the instruments of investment promotion have not fulfilled their promise in practice. On the contrary, BITs have increasingly resulted in ISDS cases against host governments without substantively improving FDI from partner countries.³ In 2017, the lowest number of BITs were negotiated since 1983 and the number of terminations exceeded the number of new agreements for the first time.⁴ This shift in the expansion of the investment treaty regime marks a turning point in the decades long rise of BITs to prominence in the global governance of international investments. The change has coincided with the rapidly accumulating legal disputes between investors and governments, as well as concerns about states’ ability to regulate domestically for the protection of the economy, environment, and public health. There is an emerging consensus that the investment treaty regime is badly in need of reform. Yet, only some states have unilaterally terminated their investment treaties, and often selectively. Why do some states prefer to withdraw from their

1. Bonnitcha, Poulsen, and Waibel 2017.

2. Salacuse 1990; Salacuse and Sullivan 2005.

3. Hallward-Driemeier 2003.

4. World Investment Report 2018: Investment and New Industrial Policies 2018, 88.

BITs? What stops other states from reforming their BITs, despite their changed sentiment towards them? What explains the patterns of successful renegotiations?

In this thesis I address the puzzling differences in states' approaches towards investment treaty reform, unexplained by the existing scholarship on the investment treaty regime. Specifically, I examine the constraints and incentives influencing states' decision-making in relation to their BITs. Applying existing theoretical tools of rational choice theory and scholarship on international cooperation, I investigate the role of bargaining power in states' decisions in relation to their investment treaties. By examining the recent decisions to withdraw from BITs, I wish to explore the explanatory power of rationalist bargaining logic as well as its limits in explaining outcomes in the investment treaty regime.

I argue that bargaining power is a crucial factor underlying change in the BIT regime. States decide whether to pursue reform of their BITs based on their alternatives, or outside options to each existing agreement. As some states have developed their alternatives to investment treaties by signing new economic agreements, or by attracting foreign investment through other means, they decrease their dependence on these instruments. As the actual and perceived alternatives to BITs improve, the old agreements become less attractive in comparison – especially when their risks become acknowledged. Alternatives to BITs therefore constitute states' bargaining power in investment treaty negotiations, as the terms of the old treaties need to be more favorable the stronger the outside options have become.

However, even a revisionist state with improved outside options will think twice before withdrawing from agreements with vital partners, because terminating BITs can send a hostile signal and damage its economic relationship with them, as well as foreign investors. Revisionist states are more likely to unilaterally terminate BITs with unimportant partners, while renegotiation is more likely in close partnerships. But despite their improved bargaining power, states can struggle to demonstrate a credible exit threat and convince partner states to renegotiate. They can therefore conduct strategic exit, whereby they unilaterally terminate the BIT and express their willingness for fresh negotiations afterwards. Withdrawal from BITs can therefore

serve two distinct purposes: exit from the commitments to the international regime, or a strategic exit to enable negotiation of more favorable terms in the future.

It may seem surprising to suggest that bargaining power should be brought to the center in explaining specific decisions concerning BITs. Bargaining power is often treated as a structural background factor, and merely "controlled away" in the analysis of policy outcomes. Yet, bargaining power can help understand governments' decision-making process and hesitation to act even when facing strong incentives against existing agreements. Furthermore, it can help in explaining the puzzling variation across different states on whether they take reform action, unexplained by alternative explanations.

Although change in bargaining power constitutes a necessary condition for the revisionist states to seek reform of their BITs, it is not sufficient in explaining every outcome in the regime. How exactly to conduct investment treaty reform, as well as where the partner states eventually end up regarding the governance of their investment relations is also influenced by various other factors. Conclusions of the rationalist theory are limited to highlighting that bargaining power is required for any state to initiate change in the first place, only after which other factors start to influence their exact choice of strategy. Despite these limitations, focusing on bargaining power can shed light on what options there are available for states seeking to change their treaty commitments.

An interdisciplinary approach to the study of the investment treaty regime has many advantages. The legal and political economy analysis on BITs can obtain valuable insights from international relations theory on institutionalized inter-state cooperation. Likewise, IR scholarship can benefit from the examination of investment treaties: BITs are a case of a single issue-area agreement with near-universal coverage (Figure 1.1), with many members joining, withdrawing, and adjusting their agreements overtime. Investment treaties therefore provide an excellent context in which to study which actors withdraw from international regimes and why.

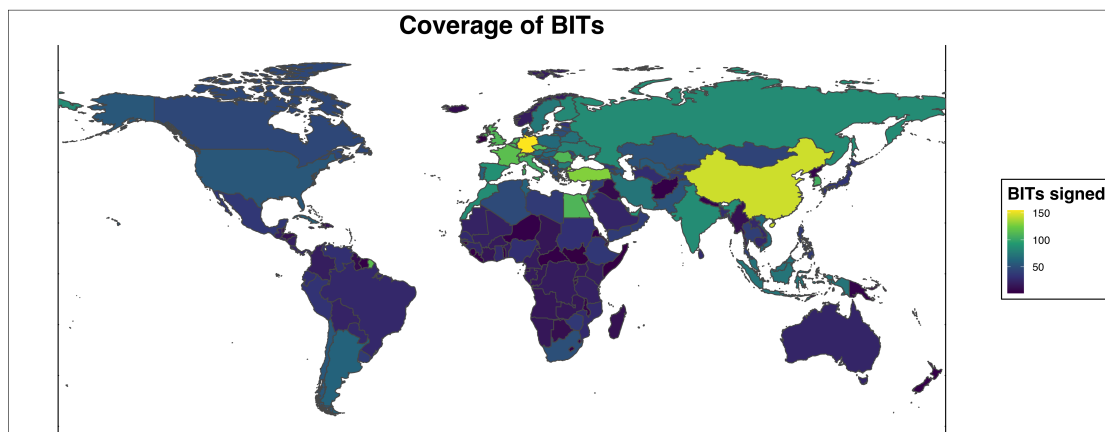


Figure 1.1: Coverage of bilateral investment treaties

I support my argument by analyzing data from the investment treaty database maintained by the United Nations Conference on Trade and Development (UNCTAD) and in-depth analysis of decisions to withdraw from BITs by Ecuador and Indonesia. I find that the bargaining power dynamic between BIT partners underlies decisions to withdraw and renegotiate investment treaties. When a state has incentives to reform their BITs for example because of facing ISDS cases and develops their actual or perceived outside options to BITs, they become more likely to initiate reform. Bargaining power constrains the decision-making of all states, regardless of their motivations for signing investment treaties in the first place, or the sources of their dissatisfaction.

This thesis contributes to the literatures on the investment treaty regime and international treaty-based cooperation. First, it highlights the importance of bargaining power as a key factor in shaping governments' actions regarding specific decisions regarding their investment treaties. The literature on investment treaty reform has so-far focused on legal features and various political motivations driving reform efforts of states. However, it has not been able to explain widespread inaction even when weaknesses of the existing system have become increasingly acknowledged. I draw attention to bargaining power constraints, which often result in states choosing the best of bad options and keeping the sub-optimal agreements.

Second, in separating incentives for reform from bargaining power constraints, my theory can consider separately the effects of assumptions of perfect information, bounded rationality, and learning. Existing accounts have considered the learning effects occurring as states have faced investment arbitration, and an extensive body of work focuses on how international bargaining dynamics shape the terms of international cooperation. I bring these two accounts together to illustrate, how alternatives to negotiated agreements determine whether change is likely following learning effects, regardless of what kinds of decision-making processes took place at the onset of cooperation.

The rest of this introduction proceeds as follows. Section 1.1 introduces the context of the BIT regime and presents the key research puzzle. Section 1.2 summarizes my key theoretical argument about bargaining power as alternatives and how it shapes states' decisions regarding their investment treaties. In Section 1.3 I describe the data and methods I use to support my argument. Finally, Section 1.4 presents the plan for the thesis.

1.1 International relations of the BIT regime

To build my argument about bargaining power in the investment treaty regime, I focus on the increasing efforts by states to either unilaterally denounce or attempt renegotiating their investment treaties, especially since the turn of the century. To understand the broader context for decisions regarding investment treaty reform, I begin by briefly outlining the conditions under which the BIT regime first emerged, as well as why perceptions of unmet promises and unintended consequences have begun to stir-up change in the regime.

1.1.1 Imbalanced origins

Some 3000 BITs form the backbone of an international regime for foreign investment, around which actors operate and form expectations.⁵ These tools of economic governance are formal agreements between two states, who mutually agree to respect

5. Krasner 1982.

a range of rights of private investors from the partner country.⁶ The main purpose of BITs has been the “Promotion and Reciprocal Protection of Investments”: capital exporters have incentives to invest abroad in seeking greater returns for their capital, while capital importing actors can benefit from attracting investment towards for example resource extraction and infrastructure development projects. Unfortunately, it is difficult for the host government to credibly commit to respecting foreign investors’ property rights after the investment has been made, as the incentives to expropriate or nationalize foreign investors’ assets are ever-present.⁷ Especially in the post-colonial era, European states wanted to protect their businesses abroad.⁸

Most of the early BITs were formed between major capital exporting states in Europe and capital importing states in the developing world, arguably to overcome such obstacles to cooperation. Formalizing cooperation through BITs has been thought to provide a credible commitment device for the host governments to “tie their hands” with respect to treatment of foreign investors.⁹ Joining an investment treaty can reassure foreign investors that if disputes with the host government were to emerge, they have the right to appropriate compensation and unbiased arbitration outside the domestic courts of the host.¹⁰

Especially developing countries hoped to attract badly needed capital through signing increasing numbers of BITs with major capital exporters through 1980s and 1990s. The beginning of global diffusion of BITs took place during the economic downturn in the late 1980s and early 1990s, which was also time of stagnant international bank lending.¹¹ This has been described to have led to a race-to-the-bottom dynamic amongst developing countries competing for foreign capital, each of them attempting to sign as many BITs as possible in order to attract foreign

6. Most BITs recognize investors’ right to fair and equitable treatment, national treatment, most-favored-nation (MFN) treatment, rights to monetary transfers, protection against expropriation, compensation from losses from internal disorder, as well as a dispute settlement mechanism.

7. Vernon 1971.

8. Concerns surrounding foreign direct investment became apparent through instances of nationalization of oil companies in Mexico in 1938 and Iran in 1952, the British-French Suez Canal Company in 1956, the property of US companies following the Cuban Revolution in 1959, and the copper industry in Chile in 1971.

9. Salacuse 1990.

10. Bonnitcha, Poulsen, and Waibel 2017.

11. Simmons 2014, 20.

investors.¹² Furthermore, some governments did not understand the risks resulting from extensive international arbitration provisions, and therefore were not fully aware of the implications of joining the regime.¹³ From the early onset, the “grand bargain” of BITs as facilitators of international cooperation therefore established underlying power asymmetries between signatory states.

BITs quickly became associated with general economic liberalization efforts internationally, and they formed important tools of economic diplomacy between countries of the North and the South. For newly independent and developing countries, joining the regime signalled the willingness of governments to partake in economic globalization. While alternative institutional arrangements were proposed in international forums, such as the multilateral agreement on investment (MAI) and a system of investment insurance, eventually BITs emerged from the critical juncture as the accepted solution to address the concerns of investors.¹⁴ Despite alternative regulatory solutions employed to a lesser extent since, such as state-investor contracts, private investment insurance, and efforts to include investment clauses into free trade agreements, BITs continue to form the core of global governance of international investment. They dominate investment governance due to the truly global coverage of states that are engaged in them; today, 182 countries and self-governing regions have signed at least one BIT.

1.1.2 Unmet promises and backlash against ISDS

Since the turn of the century, especially the ISDS provision included in most BITs has become increasingly controversial. Many states have perceived that the implicit promises of increasing FDI flows have not materialized, and the empirical evidence for this is mixed at best.¹⁵ Initially the dispute settlement mechanism was thought to be restricted to issues of direct expropriation, such as nationalization. However, modern ISDS practice has resulted in unexpected consequences: cases frequently address so-called indirect appropriation, where governments’ actions

12. Guzman 1998.

13. Poulsen 2015.

14. St John 2018.

15. Hallward-Driemeier 2003.

indirectly impact the value of investors' property in the country. For example, Argentina became the target of a large number of ISDS-challenges due to its efforts to manage the financial crisis of early-2000s: currency devaluation and other emergency measures hit foreign investors with severe financial losses who responded through legal means.¹⁶ Likewise, Germany's efforts to transform towards renewable energy sources by banning nuclear energy initiated ISDS cases with foreign investors into the energy sector,¹⁷ and Australia found itself in legal problems with Philip Morris and other tobacco companies following its policy to enhance public health by only allowing plain cigarette packaging.¹⁸ Most recently, the Netherlands faced an investor claim at the International Centre for Settlement of Investment Disputes (ICSID) as a response to its plans to end coal-fire energy production by 2030.¹⁹

ISDS is therefore increasingly employed not only when the host government is intentionally infringing the property rights of investors, as arguably was their original purpose, but when damage is done to their investments as a by-product of states' regulatory efforts. It has also been suggested that investors do not only resort to ISDS when facing legitimate grievances related to the host governments' actions, but use the provision strategically to extract settlement payments, or to deter possible future policy-decisions by the host government, which may be unfavorable to them.²⁰ These unintended consequences of investment arbitration have begun raising concerns about states' regulatory space.²¹ There is an increasing sense that BITs have granted investors extraordinary powers over sovereign states, and that the ISDS-practice is badly in need of reform.

The signing of new BITs has slowed down since the years of rapid accumulation, which peaked in 1996 when 217 BITs were signed in a single year. Although some new states that previously were not active in the regime have stepped up their

16. Calvert 2018.

17. *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany* 2011.

18. *Philip Morris Asia Limited v The Commonwealth of Australia* 2017.

19. Wehrmann 2021.

20. Pelc 2017.

21. Broude, Haftel, and Thompson 2018.

efforts to sign BITs with new partners,²² the overall expansion of the regime has stopped. In 2017, terminated BITs exceeded the new BITs signed for the first time. While the percentage of terminated BITs remains modest in comparison to the large stock of BITs signed since 1959, there is an increasing trend of efforts to terminate and renegotiate BITs (Figure 1.2).

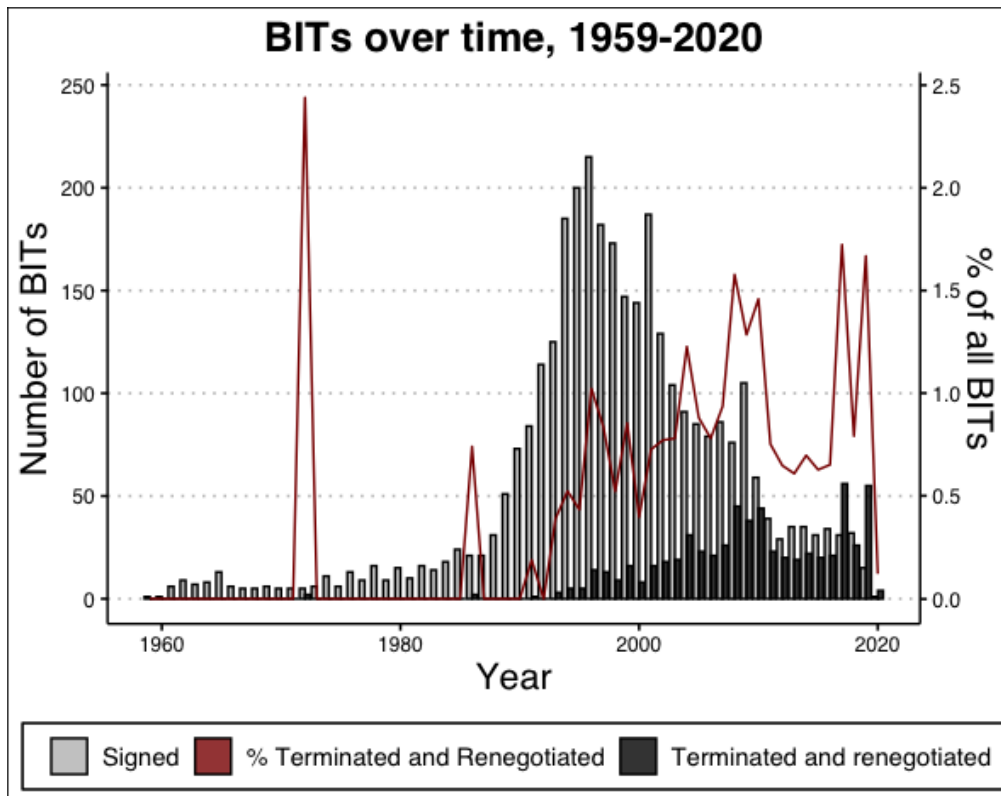


Figure 1.2: BITs overtime

The declining number of new BITs and the simultaneously increasing instance of ISDS cases have led to discussions about the so-called “backlash” against the dispute settlement mechanism.²³ Indeed, the shortcomings of the ISDS-provisions are well established and frequently expressed in international forums: there is an emerging consensus that ISDS unjustly and unintentionally limits states’ policy space to regulate domestically, for example to protect the environment, public health, or the economy. Empirically, the increasing number of terminated BITs closely tracks the accumulation of known ISDS cases (Figure 1.3).

22. For example, the United Arab Emirates has signed 10 new BITs since 2018.

23. Waibel et al. 2010; Peinhardt and Wellhausen 2016.

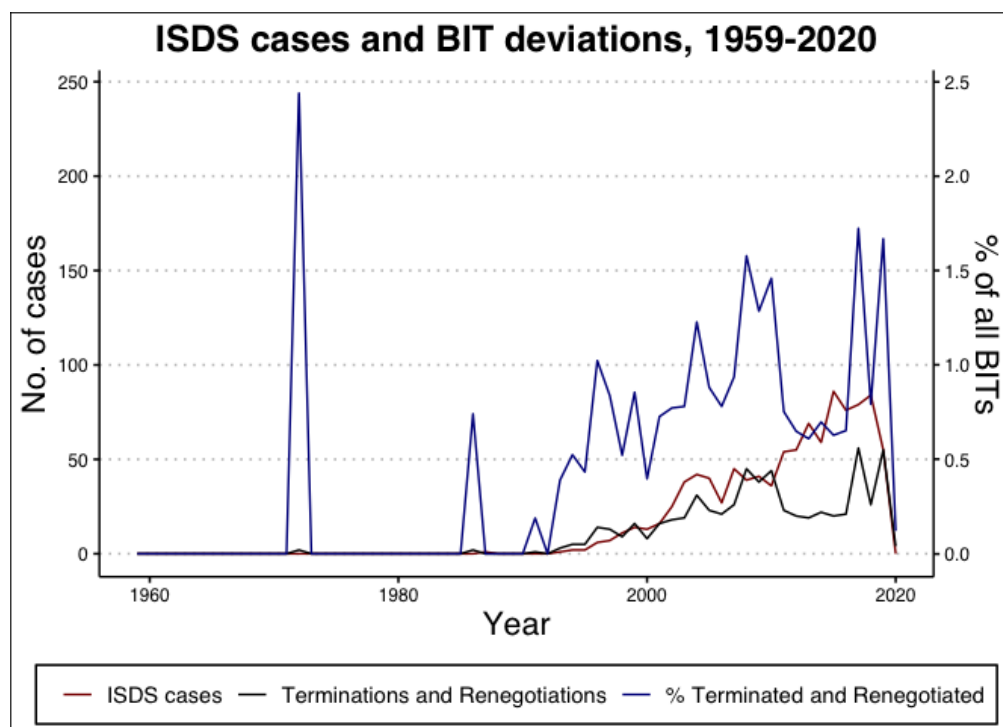


Figure 1.3: ISDS cases and BITs terminated over time^a

a. Includes ISDS cases brought based on BITs as reported by UNCTAD.

Past literature on investment treaty reform has explained changes in the BIT regime largely through states' experiences with ISDS. International political economy (IPE) scholars have investigated the effect of past international arbitration on outcomes in the regime: states have been found to stop signing new BITs after facing ISDS claims,²⁴ and they become motivated to renegotiate terms of their investment treaties after they learn new information about their legal and political consequences.²⁵ Because international arbitration makes governments realize the limitations ISDS clauses place on their ability to freely regulate foreign investment activities, or state regulatory space (SRS), "exposure to investment claims leads either to the renegotiation of IIAs in the direction of greater state regulatory-space or to their termination".²⁶

ISDS experience is however not sufficient in explaining the variation in governments' decisions to act regarding their treaty commitments. Cross-nationally,

24. Poulsen and Aisbett 2013.

25. Haftel and Thompson 2018.

26. Thompson, Broude, and Haftel 2019.

there is a weak association between ISDS cases a state has faced and how many BITs they have resorted to unilaterally terminate or renegotiate. Figure 1.4 shows that states at various levels of ISDS-exposure – both based on BITs and other treaties with investment provisions (TIPs) – have not terminated any BITs. On the other hand, some states have terminated and renegotiated treaties despite having faced none or relatively few arbitration cases. It is possible that governments learn about the risks of BITs when other states face disputes with investors and initiate BIT reform without having faced international arbitration themselves.²⁷ However, patterns of global ISDS do not explain why some governments have chosen to fight their legal battles within the system, while others have taken a radical approach to withdraw from all engagements with the regime.

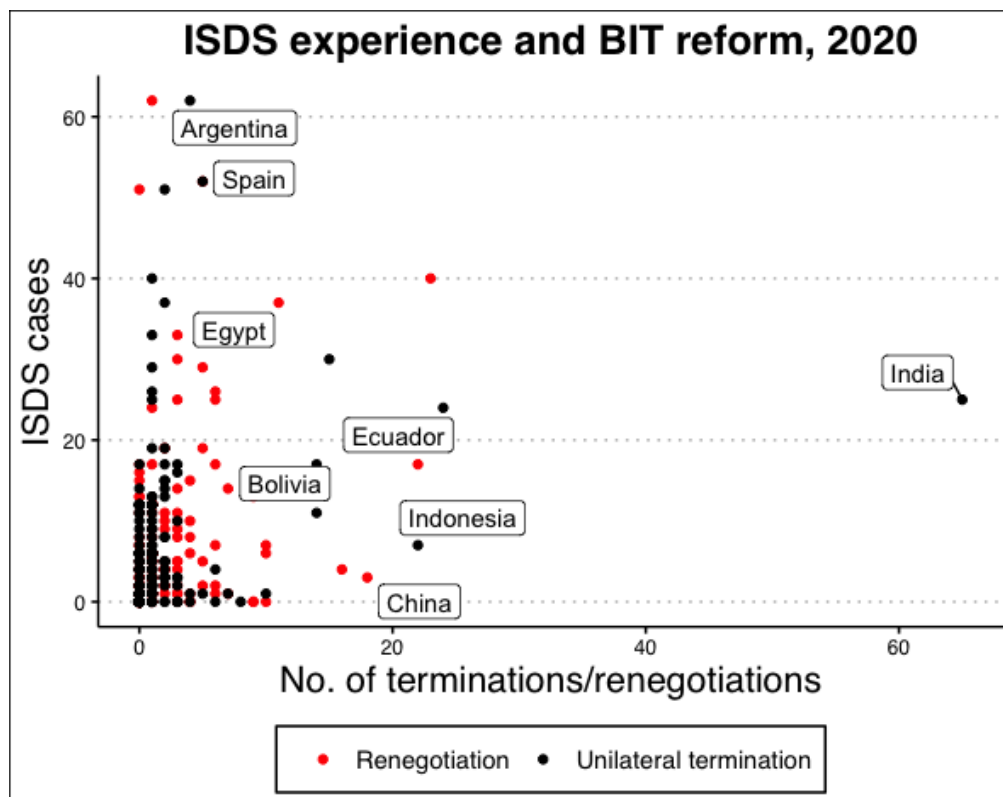


Figure 1.4: States by number of ISDS cases faced and the number of terminated and renegotiated BITs

27. Haftel and Thompson 2018.

1.1.3 Insights from past literature

My analysis of what explains the variation in states' decisions regarding their BITs relies on three distinct literatures. The first focuses on the broad dynamics of cooperation under international regimes and how they are shaped through negotiations. Second, I draw from the past literature on the role of power in the investment treaty regime to build my argument about why states keep, terminate, or renegotiate their BITs. Finally, I outline the specific decision-making logics states have been argued to employ in the context of BITs. I will briefly outline the insights drawn from these literatures in turn.

Cooperation and negotiating international agreements

When international relations scholarship first problematized patterns of cooperation among egoistical actors under anarchy, a new branch of scholarship began to study the dynamics of cooperation between independent states.²⁸ Study of international cooperation became heavily influenced by the study of economics and decision-theory, where the key insight was to begin to examine under what conditions cooperation is sustainable without the presence of centralized enforcement, and to expand this to different international issue-areas.²⁹ Insights from game theory, and the changing realities of economic globalization increased the scope of interesting questions beyond security, out of which the so-called neoliberal institutionalist approach emerged.

The paradigm of rational design of international institutions in turn began to investigate ways in which design of international agreements and organizations (IOs) can enhance international cooperation beyond what would emerge spontaneously.³⁰ By tailoring international agreements, states can address specific cooperation problems hindering the pursuit of mutual gains and manage the ever-present uncertainties in the world.³¹ For example, commitment problems prevalent in cooperative agreements can be addressed by including enforcement mechanisms

28. Keohane and Nye 2011; Keohane 1984.

29. Axelrod 1984; Axelrod and Keohane 1985; Oye 1986.

30. Abbott and Snidal 1998; Koremenos, Lipson, and Snidal 2003.

31. Koremenos 2005.

into international agreements. These design provisions may punish or generate reputational costs on defectors, and therefore change the incentives of actors to adhere to the cooperative equilibrium.³² While rational-institutionalist research has traditionally adapted assumptions of expected utility-maximizing actors and perfect information, they have not been limited to them: international relations theory has increasingly relaxed some of the assumptions of rational choice, accounting for example for bounded rationality, loss aversion, and behaviouralism.³³

Because formal agreements can assist states in overcoming cooperation problems, their careful design can help to maintain cooperative arrangements. However, these agreements are strongly shaped by the power dynamics between actors, as well as the strategic interactions they inevitably engage in. In any issue area, the actors must first agree on the terms of cooperation, i.e. overcome a bargaining problem. The shadow of the future of continued interactions can not only make enforcing agreements easier, but also make establishing an agreement harder in the first place.³⁴ Recent research has turned its attention to explaining the relatively rare instance of states withdrawing from international organizations,³⁵ with exit from international agreements being part of wider dynamics of the so-called globalization backlash.³⁶ However, once established, terminating international agreements is costly. When states sign up to international agreements they are likely to lock themselves into the agreements for long periods of time, raising the stakes of international negotiations. Understanding how such agreements come into being is therefore of vital importance.

Two distinct literatures on economic negotiations are relevant for building my theory: the international political economy (IPE) and negotiation theory approaches. IPE scholars have largely focused on how different structural factors and attributes of the state parties shape negotiation outcomes, such as the interplay between international and domestic factors, the economic power of states, and

32. Downs and Jones 2002; Barrett 2009.

33. Faber 1990; O'Neill 2001; Mintz 2007; Hafner-Burton et al. 2017.

34. Fearon 1998.

35. Gray 2018; Borzyskowski and Vabulas 2019.

36. Walter 2021.

their relationship with the other party to the negotiations.³⁷ On the other hand, negotiation theory focuses on the strategies employed by negotiators, and how they can shape outcomes of reached agreements.³⁸ Both prove vital in understanding the course of certain bargaining interactions: structural and state-level factors shape the strategies available for each party in international negotiations as well as negotiation outcomes,³⁹ but the skillful employment of negotiation strategies can help a disadvantaged party to punch above its weight in bargaining. Considering the two attributes vital for negotiation outcomes is particularly relevant for analyzing the negotiating position of weaker states. Models of asymmetric and hegemonic bargaining, as well as analysis of attributes and circumstances that help the underdogs to receive significant concessions have been of keen interest to IR and international law scholars.⁴⁰

My approach to conceptualizing and operationalizing bargaining power combines aspects of IPE and negotiation literatures: observable, structural, and state-level factors shape the outside options that negotiating parties have, which in turn provide a wider set of strategies that can be employed in attempting to achieve favorable outcomes in negotiations.⁴¹

While my analysis of investment treaty politics focuses on examining the extent to which bargaining over economic agreements explains ongoing changes, economic cooperative benefits may not always be the driving motivation behind treaty politics. For example, states may be more motivated to sign economic agreements with foreign policy and military allies⁴², or with countries that have good reputations.⁴³ There may also be ideological reasons for which states choose to cooperate with certain partners over others, with some states willing to sign and maintain agreements with autocracies⁴⁴ or populists.⁴⁵ Such alternative explanations

37. Schelling 1960; Allee and Elsig 2016.

38. Fisher and Ury 1981; Lax and Sebenius 1985; McKibben 2015.

39. Odell 2018.

40. Kivimäki 1993; Narlikar 2003; Benvenisti and Downs 2007; Urpelainen 2011; Schneider 2011.

41. I expand the conceptualization of bargaining power in Section 2.2.

42. Powers 2004; Long and Leeds 2006.

43. Gray 2013; Gray and Hicks 2014.

44. Debre 2021a, 2021b.

45. Voeten 2021.

can help to explain variation in treaty outcomes that are beyond the scope of the bargaining power theory.

Power and investment agreements

Second, an expanding branch of literature has focused on how power shapes international economic agreements, to which this thesis contributes. The employed conceptions of power range from analytical conceptions of bargaining power to economic and political power, bureaucratic capacity of states, and the structural power of business in the global economy.

To define power in negotiations, power as an “act that is designed to cause another party to move in a desired direction” is commonly employed.⁴⁶ However, it runs into a problem of defining who was powerful in negotiations based on the bargaining outcome,⁴⁷ often placing too much emphasis on preferences and negotiation outcomes at the expense of the strategic and structural setting where negotiations take place.⁴⁸ An alternative conceptualization of bargaining power overcomes the issue by defining it as the best alternative to negotiated agreement (BATNA): it suggests that every negotiator’s leverage in bargaining is dependent on how strong their outside option to the negotiation is.⁴⁹ The conceptualization separates bargaining outcomes from bargaining power, as a negotiator can concretely pursue alternatives to the agreement under negotiation, making her able to demand better terms.⁵⁰

The sources of alternatives are highly context dependent, often specific to the negotiation at hand. However, since the early scholarship on economic negotiations, scholars have found that bargaining outcomes reflect the material costs and benefits faced by the parties in the negotiation.⁵¹ Because large economies usually reap the largest benefits from cooperative agreements, they are also able and willing to spend more resources for achieving their favorable outcomes. However, the least

46. Zartman and Rubin 2002.

47. Odell 2018, 28.

48. Frieden 1999.

49. Fisher and Ury 1981.

50. For example, some African governments have successfully leveraged Chinese lending to bargain harder in negotiations with traditional donors. Zeitz 2019.

51. Schelling 1960; Schoppa 1999.

powerful actors tend to be heavily dependent on the global economy as well as compete with each other for example for market access, foreign investment, and development aid. Hence, they are often motivated to accept terms demanded by powerful partner states.⁵² Such actors can be characterized as having weak BATNA if no outside option is preferable to whatever agreement is offered by the other party to negotiation.

Empirically, such asymmetric political and economic relations between negotiating states have been especially influential in shaping the architecture of the BIT regime. Powerful governments, which often are the home states to firms that invest abroad, are more likely to successfully include delegation of ISDS authority to international tribunals in their BITs, while countries that are heavily dependent on the global economy are more likely to accept such provisions.⁵³ Economic power asymmetry between states bargaining over BITs has been found to be a strong predictor of the extent and type of access to international arbitration.⁵⁴

Power of the negotiating states also tends to shape the legal language of investment agreements: both the most powerful and the weakest states have been found to copy-paste legal text from pre-existing templates in new agreements. While the powerful states wish to spread their preferred rules globally, the weakest states rely heavily on model treaties due to their low-capacity to draft new agreements.⁵⁵ Recent research has also found that state capacity and the strength of a governments negotiating bureaucracies form a crucial element of power, which shapes negotiation outcomes in investment agreements.⁵⁶

Bargaining power in international negotiations can also lie in the domestic political sphere. Domestic audiences can effectively limit the extent to which compromises can be made, narrowing the bargaining window available at the international level.⁵⁷ Likewise, leaders as well as the coalitions that provide them

52. Elkins, Guzman, and Simmons 2006.

53. Allee and Peinhardt 2010.

54. Allee and Peinhardt 2014.

55. Allee and Elsig 2019.

56. Berge and Stiansen 2016; Berge 2021.

57. Putnam 1988.

with political power can shape the bargaining power of the state.⁵⁸ Depending on the domestic political context, certain options might therefore be available regarding specific international negotiations, and the different sources of bargaining power can therefore make for different bargaining outcomes.

Beyond the power of the specific negotiation dynamics, the structural power of the global economy has also been investigated as a source of promoting provisions that enable extreme business liberalization, also relevant for dynamics in the investment regime.⁵⁹ Some find that domestic businesses lobby their governments to adopt investment protections in both international and domestic laws.⁶⁰ Specific power dynamics can also skew the contents of cooperative agreements to such an extent that they are not actually mutually beneficial nor Pareto-improving. It is not inevitable that agreements make both signatory states better off; instead, weaker parties can face the choice between agreeing to undesirable obligations on the one hand, and the even worse option to be left outside the agreement. The most powerful states in the world economy have such power to "go-it-alone", whereby they can establish their preferred arrangements with or without the cooperation of the weakest states.⁶¹

Power in its various conceptualizations has therefore been a rich source for explanations on the outcomes of the rules governing the global economy. It therefore provides a fruitful direction to search for explanations for so-far unexplained outcomes in the investment treaty regime. If power has helped to shape the form the investment treaty regime has taken, it is likely to play a crucial role also in explaining the ongoing changes today.

Rational and boundedly rational decision-making and learning

The final branch of literature that forms the basis of my analysis concerns the ways in which governments make decisions regarding their international economic diplomacy. Two broad theoretical approaches can be adopted in explaining the spread and popularity of BITs. They rely on different understandings about the

58. Mattes, Leeds, and Matsumura 2016.

59. Gwynn 2016.

60. Maurer 2013; Wellhausen 2015.

61. Gruber 2000.

decision-making processes of states, their governments' officials, as well as domestic interest groups empowering these national-level actors.

First, the *rationalist* explanations for the purpose and popularity for these international legal instruments implies that they were initially established to address the cooperation problems surrounding international investment.⁶² Rationalist explanations include the accounts of BITs as credible commitment devices, and how limitations in legal agreements can lead to the race-to-the-bottom dynamic amongst developing countries competing for foreign capital.⁶³ Given the possibility that domestic politics heavily shapes international outcomes,⁶⁴ research on BITs has also investigated the impact of domestic dynamics on regime-level outcomes: for example, the rent-seeking motivations of authoritarian leaders can drive signing BITs,⁶⁵ or attempts to signal competence to domestic audiences in the face of a civil conflict.⁶⁶ Common for the rationalist accounts are assumptions utility-maximizing motivations of actors, where BITs are considered as a means to an end in pursuit of some form of benefit for the leaders, government, or the wider society, as well as loosely defined assumptions of perfect information on behalf of the actors involved. BITs are therefore considered to be a result of cost-benefit analysis, with a variety of possible mechanisms.

Others have argued that the theories explaining the dynamics of early investment treaties exaggerate the extent of rational decision-making by states when joining the investment regime. The *bounded rationality* perspective largely builds on the rationalist accounts.⁶⁷ However, it posits that real-world leaders do not engage in a careful calculation of expected utilities of their policy decisions. People, and therefore states, are more likely to resort to mental short-cuts optimizing time and effort, and therefore likely to fall into cognitive biases in their decision-making. The implication of such an assumption is that most states were not fully aware

62. Abbott and Snidal 1998; Koremenos, Lipson, and Snidal 2003; Koremenos 2005.

63. Salacuse 1990; Guzman 1998; Salacuse and Sullivan 2005; Tobin and Rose-Ackerman 2011; Salacuse 2017.

64. Putnam 1988; Milner 1997; Lake 2009.

65. Arias, Hollyer, and Rosendorff 2018.

66. Billing and Lugg 2019.

67. Simon 1983, 1985; Faber 1990.

of the true costs and benefits of BITs when they first signed up to the regime.⁶⁸ Especially many capital importing countries had little understanding about the economic and legal implications of the treaties, and mainly relied on BITs as tools of economic diplomacy – anything beyond the explicitly stated good intentions to encourage investment cooperation was not discussed or bargained over in any meaningful way. The explanation has been deemed compelling for why especially developing countries signed BITs given little evidence of their FDI attracting ability, and the costs of allowing unprecedented rights for private investors to initiate costly arbitration at international tribunals.

Defining which logic states have used in their decision-making *a posteriori* is challenging both theoretically and empirically, as it is often possible to explain any decision based on either decision-making logic. Most states likely engage in a mix of both, most of the time. Regardless of whether the rationalist or boundedly rational logic of BITs has been the most prominent driver of the investment treaty regime, the examination of the current developments regarding BITs necessitates paying attention to both. I therefore remain agnostic as to the extent of states rationality regarding their decisions to join BITs initially, while considering both possibilities: neither logic is unresponsive to learning, especially from ISDS cases, which increase the salience and effectively inform states about the risks involved. Just as rational states can update their preferences as new information is learned, boundedly rational states can learn about the dangers of relying on the cognitive bias used to justify past decisions.

1.2 **Argument: Bargaining power and withdrawal from investment treaties**

I start my theory from the observation that international investment treaties are fundamentally shaped by the bargaining power relationship between the negotiating parties. Understanding how bargaining power underlies the design of the international economic agreements is vital for explaining why states might withdraw

68. Poulsen 2015.

from them in the future, and which factors enable them to do so. Because of the underlying bargaining power relations characterize BITs when they are signed, changes in the bargaining power dynamic between the signatory states are likely to enable change in the BIT regime.

I argue that regardless of the sources of dissatisfaction or political motivations, all states are limited by their outside options to BITs when deciding whether to terminate investment treaties, or to attempt renegotiating their terms. Furthermore, withdrawal from existing treaties can serve two distinct purposes: withdrawing from their commitments to the international regime, or a strategic tool to enable negotiation of more favorable terms in the future with the most important partners. I refer to the two signatory states as the *revisionist state*, who wants to change its investment treaty commitments, and the *status quo state*, who prefers to keep the treaty in place because it continues to benefit from it.

A revisionist state has three possible options to change its existing investment treaty commitments with the status quo state: *exit*, *renegotiation*, and *strategic exit*. The revisionist state might consider exiting the agreement completely in order to withdraw from its commitments under the treaty. However, it must assess whether it is truly better-off without the BIT in place, considering its outside options. Exit from a BIT is also costly, as it can send a hostile signal to foreign investors, the partner state, and financial markets. Furthermore, most BITs include a sunset clause, which upon unilateral termination keeps the terms of the treaty in place for another 10-15 years for all investments made prior to the exit. The revisionist state must therefore be confident that alternatives within its reach are stronger than the existing agreement, and that the costs of exit do not exceed its benefits.

To avoid the costs associated with exit, the revisionist state might want to renegotiate the agreement instead, for example, to limit the scope of ISDS provisions. However, the renegotiation of an agreement is difficult to achieve: the treaty favors the status quo state, who has no incentive to agree to reopen negotiations. In addition, renegotiation always involves time, technical efforts, and diplomatic resources. Renegotiation is most realistic in close economic partnerships, where

the states agree that mutual gains exist from keeping an agreement in place. Close partners are also likely to be more sensitive to each other's dissatisfaction under existing agreements and have effective channels of communication, due to cooperation often across multiple different issue areas. This makes signalling of a credible exit threat and changed preferences easier for the revisionist state.

The third option of strategic exit can allow the revisionist state to catalyze renegotiations also with partners who may not value the cooperative relationship as highly as some close partners. The status quo state would only ever agree to redistribute the benefits of the treaty through renegotiation if the collapse of the agreement was otherwise inevitable. Strategic exit enables costly signalling of improved alternatives and therefore demonstrates a credible exit threat: the revisionist state can exit the BIT in the hopes that abandoning the agreement will incentivize the status quo state to agree to new negotiations at a later stage. For strategic exit to be an attractive strategy, the revisionist state must, however, be able to bear the costs of abandoning the existing BIT, at least in the short term. Therefore, the pursuit of any of the three strategies available for a revisionist state - exit, renegotiation, and strategic exit - requires strong outside options.

Because states in the investment treaty regime do not operate in a setting of perfect information, learning occurring because of ISDS claims can incentivize states to initiate BIT reform efforts. Learning about BITs can occur through two mechanisms: *rational learning*, whereby states update their preferences considering new information received, or *breaking of bounded rationality*: after experiencing unexpected, negative outcomes, states abandon the boundedly rational logic which initially lead them to accept the risks of BITs. However, learning through ISDS does not automatically result in a preference to withdraw from or renegotiate BITs. States must still have strong outside options to the agreement; otherwise, they will not be better-off without the BIT in place, neither will they have a credible exit threat to convince the partner state to renegotiate the agreement.

BITs are most likely to get successfully renegotiated between partner states that consider each other vital economic partners, because the benefits from continued

cooperation as well as effective communication between them are more likely to be in place in such partnerships. On the contrary, a revisionist state is likely to unilaterally terminate BITs with partners that it does not consider important, regardless of whether the status quo state is willing to renegotiate the BIT. Strategic exit is most likely in asymmetric relations, where the revisionist state considers the status quo state important, but the status quo state does not reciprocate the same sentiment. If mutual benefits still exist for having a BIT in place, the revisionist state must terminate the old, unfavorable treaty to convince the partner to initiate new negotiations from a clean slate.

1.2.1 Bargaining Power as Alternatives

Bargaining power is best understood as the best alternative to the negotiated agreement, which is the most advantageous alternative that a negotiating party can choose if no agreement is reached.⁶⁹ In the context of BIT negotiations, stronger alternatives make a state less dependent on the treaty and enable it to more readily initiate reform through one of the three strategies. Alternatives to BITs have primarily come from two different sources. Firstly, they can include rules that facilitate foreign investment. For example, international agreements, such as free trade agreements with investment chapters, can replace the purpose of investment regulation and economic diplomacy with the partner state. Furthermore, domestic investment laws detailing the rights of investors or investor-state contracts can reassure foreign investors that their investments are protected. Such alternatives therefore improve bargaining power with regards to BITs.

Second, alternative sources of investment can improve a state's BATNA. Economic factors which make a state attractive for foreign investors, such as fast economic growth and an abundance of natural resources, can diversify the sources of FDI into a country, and therefore improve its alternatives to BITs. If a state becomes confident that foreign investors will want to come regardless of BIT in place, its dependency on the treaties decreases, and its outside options to BITs

69. Fisher and Ury 1981.

likewise improve. Generally, large economies have greater alternatives available to them in the world economy, as they provide ample opportunities for both potential investors and partner states through market access.

Changes in these two key sources of bargaining power have been instrumental in empowering states to take an active role in investment governance for the first time. Improvement of bargaining power through alternatives therefore gets states to a point of confidence to start considering their options regarding BITs. While other sources of bargaining power, such as those stemming from domestic political support of state leadership, can result in different kinds of changes that are eventually pursued by states, bargaining power improvement through key alternatives to BITs has been the main enabling factor for starting the reform process.

1.2.2 Learning from ISDS and incentives for BIT reform

Under perfect information, states react to improvements in their own and their partner state's alternatives and adjust international agreements accordingly, provided mutual benefits continue to exist. However, usually states do not have all possible information available to them. When initially signing BITs, they may also have been subject to boundedly rational decision-making. Facing ISDS claims is an important factor which can catalyze change in the regime by generating learning effects. Learning from ISDS can occur through two mechanisms: rational learning occurs when states update their preferences based on new information they learn. Breaking bounded rationality, on the other hand, occurs when the previously employed cognitive decision-making mechanism is proven unreliable through facing an unexpected, negative outcome that was a direct result of following the boundedly rational logic.

While ISDS experience can result in learning regarding BITs, it cannot explain states' decisions to initiate BIT reform. States only react to the learning effects if their alternatives or confidence to achieve them are stronger than the existing treaty. Improvement in outside options since the initial treaty signature raises the standards that must be met by the BIT for it to remain acceptable. However, if

a state learns about the true risks involved in keeping investment treaties, but its alternatives continue to be weak in comparison to the BIT, it will keep the treaty in place. If learning through ISDS informs the state that its alternatives have exceeded the benefits gained from BITs, only then will it either exit, or attempt to renegotiate the treaty.

Additional developments can also catalyze states to re-examine the desirability of their BITs. Changed perceptions about fairness of BITs considering new economic conditions, changes in government and their political ideology, and international efforts to create momentum for multilateral reform of investment governance have also motivated some governments to initiate a review of their investment treaties. However, like ISDS experience, such factors alone do not determine whether a state decides to act regarding specific BITs. Each state must make its own decisions regarding specific agreements, with reference to what their prospects for successful renegotiation or outcome in case of exit are.

1.2.3 Partner importance, renegotiation, and strategic exit

When a revisionist state has improved its alternatives or confidence that they can be achieved, it must decide how to best pursue changing its investment treaty commitments. Although bargaining power can help to explain when states get to a point where reform decisions can be made, whether BITs are ultimately terminated, successfully renegotiated, or strategic exit takes place is likely to depend on the perceived importance of the partnership between the states.

I define partner importance primarily in economic terms: a state which is home to many prospective investors and has attractive opportunities for market access is most likely to be considered important. On the contrary, countries with whom a partner has very little economic activity and with whom the prospects for future gains from a trade or an investment relationship are likely considered less important. Although various non-economic factors, such as foreign policy alliances, historical ties, and ideological considerations may also influence which partners are considered important, I assume that economic factors take priority when deciding

investment treaty partnerships. Because of the increasing perceived costs of keeping BITs in place due to threat of ISDS, other less risky agreements are likely to be considered for general diplomatic purposes.⁷⁰

First, a revisionist state is likely to unilaterally terminate BITs with unimportant partners: it does not have any interest in renegotiating BITs with states with whom few benefits result from having an agreement in place, even if the treaty is renegotiated with concessions from the partner state. Because renegotiation efforts are inherently costly, exit from treaties with unimportant partners is the best option for the revisionist state.

Second, if the signatory states to the treaty consider each other as vital economic partners, renegotiation of the BIT is likely. Close economic partners are usually sensitive to changes in each other's preferences: it is in the interests of a state to accommodate requests to adjust the treaty's terms by the partner, as both states have a lot to lose if the cooperative agreement collapses. There are usually also established channels of communication between states that interact a lot with regards to many economic issues, making strategic exit unnecessary for the purposes of communicating resolve to leave the agreement in the absence of renegotiation.

Finally, in the asymmetric case where the revisionist state considers the partner, status quo state important, but the partner does not consider it important in return, strategic exit becomes likely. This is because the revisionist state knows that any requests to renegotiate will not be met: the status quo state not only enjoys benefits from the unbalanced BIT in place, but it also does not value the partnership highly enough to give concessions to preserve the treaty. The revisionist state can effectively communicate its improved alternatives and resolve to walk away from the BIT through strategic exit. If cooperative benefits continue to exist from having an investment treaty in place between the partners, it is likely that the status quo state will be open to new negotiations in the future.

70. Some evidence from interviews also suggests that governments primarily assess the economic benefits of BITs after learning through ISDS has occurred, and at the point when deciding how to pursue their reform.

Withdrawal from BITs can therefore serve two purposes for revisionist states. They can accomplish an exit from the undesirable treaties, and eventually break the state free of its obligations in the regime. Withdrawal can also function as a costly signal to demonstrate to partner states that the revisionist state is prepared to unilaterally terminate BITs unless adjustment of the terms of cooperation take place. While learning through ISDS and other incentives can motivate states to reconsider their BITs, they can only result in change in BITs if the states also have stronger alternatives to their existing treaties – or the confidence that such alternatives can be achieved in the future.

The theory of bargaining power in the BIT regime has important limitations with regards to the kinds of outcomes it seeks to explain. While it outlines three possible strategies to BIT reform - exit, renegotiation, and strategic exit - there are different legal and political ways in which governments can pursue these strategies in practice. For example, the theory is not attempting to explain why a government might want to let its BIT expire over unilaterally terminating it, as both of these options are analytically similar to exit. The theorized strategies are the analytically most relevant options available for the revisionist state, while the exact choice over their pursuit is beyond the scope of the theory.

1.3 Data and methods

I employ a mixed-methods approach to investigate how bargaining power as alternatives influences BIT outcomes. The existing empirical political science work on BIT terminations and renegotiations has relied on either of two different approaches: IPE scholars have largely adopted either a large-n, cross-national approach,⁷¹ or a qualitative approach focusing on a small number of case studies.⁷² I leverage the advantages of both: the first component uses a panel dataset on over 2,600 unique BITs between over 2,400 unique country pairs. The large-n component

71. Haftel and Thompson 2018; Haftel and Levi 2019.

72. Calvert 2018; Haftel and Levi 2019.

enables examination of influential factors corresponding to BIT outcomes in the aggregate, assessing the wider applicability of the proposed theoretical framework.

The second component of my empirical work examines the experiences of two states in their efforts to withdraw from the investment treaty regime – Ecuador and Indonesia. Supplementing the cross-national analysis with qualitative examination of the specific withdrawal processes has several advantages: it enables the consideration of context-specific attributes of bargaining power, and additional factors influencing the withdrawal processes, which are necessarily only approximated in the analysis of the full universe of cases. The qualitative case studies are also vital in tracing the decision-making of reformist states, as well as illustrating the difference between unilateral withdrawal and strategic exit, which have the same observable outcome in the cross-national data.

1.3.1 Cross-national evidence

In Chapter 3, I conduct a cross-sectional analysis of data on BITs that have entered into force between 1963 and 2019. Specifically, I investigate which factors correspond to higher risk of existing BITs to get unilaterally terminated or renegotiated. Existing empirical work has largely explained the ongoing efforts by states to withdraw from or adjust existing BITs through their ISDS experience. I contribute to this literature by shifting focus on examining the impact of different measures of bargaining power on BIT reform, which are theorized to correspond to stronger alternatives to BITs as a means of FDI attraction and economic diplomacy. Furthermore, I investigate interaction effects between the bargaining power variables and ISDS to examine whether the ability of states to react to learning from international arbitration is constrained by their bargaining power position. Specifically, I employ economic power change as a proxy for improved alternatives, both in absolute terms for each signatory state as well as relatively between treaty partners since the year the BIT was signed. In addition, I investigate the impact of economic growth, law and order, investment profile, and free trade agreements in force for both parties, which likewise can approximate the alternatives available to states.

I find that states' stronger outside options to BITs, approximated by a set of measures, correspond to an increased risk of a BIT getting unilaterally terminated or renegotiated. The results support the theoretical expectation that as states develop their alternatives to existing agreements, they become able to initiate reform of their investment treaty commitments. I also show that bargaining power measures such as change in economic power *condition* the effects of learning from ISDS cases on BIT outcomes. Unilateral withdrawal from and renegotiation of a BIT becomes increasingly likely if the states have both the incentives to limit their ISDS exposure and the bargaining power to act on such incentives. I find support for my theory that bargaining power constrains the ability of states to react to changes in their incentives in response to ISDS experience.

1.3.2 Case study evidence

The second component of my research methodology consists of case studies of Ecuador and Indonesia. The two governments both decided to withdraw from their BITs between 2008-2017. Examination of the two cases enable me to investigate 1.) the varied sources of bargaining power that have shaped the BIT reform process, 2.) the unique processes and interfering factors that shape the incentives and constraints on the governments' decision-making, and 3.) the dynamic whereby unilateral withdrawal can help states achieve renegotiation success following exit from the regime.

The case selection leverages both between- and within-case variation to investigate the impact of shifting bargaining power dynamics on whether governments act to withdraw from BITs. While the governments of Ecuador and Indonesia differed in many influential factors, such as their motivations for investment treaty reform and the extent of their ISDS experience, they both made decisions to withdraw from BITs at times when their outside options to existing BITs were strong. Upward trajectories for the prices of commodities and economic growth increased interest from foreign investors at critical moments. Policymakers in both governments also intentionally waited for the establishment of domestic instruments and international

agreements to be enacted prior to the risky strategies to terminate BITs, constituting vital ways to incentivize and provide alternative protections for foreign investors. Furthermore, the cases show that a motivated state can be highly successful in pursuing negotiations of new investment agreements following withdrawal, although renegotiation is most likely between close partners.

To collect evidence for the analysis, I conducted 15 elite interviews with key politicians and advisors at the center of the events. I employed purposive sampling targeting specific individuals identified from news sources and reports, as well as snowball sampling whereby interviewees referred me to their colleagues. Three of the interviewees were high-level ministers in key positions within their respective governments and played an active role in making the decisions to withdraw from BITs. Due to the global health situation, all interviews were conducted via video calls between February and June 2021. All interviews were given confidentially, and the participants are treated anonymously with regards to the information they provided. In addition to the interview evidence, I also employ extensive secondary sources from policy and media publications to conduct an in-depth analysis of how the two governments became motivated to unilaterally terminate their investment treaties.

1.4 Outline of the thesis

The rest of the thesis is structured as follows. Chapter 2 makes the theoretical argument regarding the constraining effect of bargaining power as alternatives on states' choices regarding their investment treaties. It is followed by Chapter 3, which presents the cross-national evidence using a panel dataset of BITs and their outcomes. The results show that measures approximating bargaining power correspond to changes in BITs, and that they condition the effect ISDS experience has on catalyzing investment treaty reform.

Chapter 4 introduces the qualitative evidence and the case studies of Ecuador and Indonesia. It begins by detailing case selection and the interviews conducted for primary data collection. It then summarizes the insights derived from the qualitative evidence: strong economic conditions, alternative international agreements, and

domestic legal arrangements constituted stronger alternatives to BITs for Ecuador and Indonesia. While both had been on the respondent side in high-profile ISDS disputes, and experienced shifts in the national political sentiment, both governments reflected on the best strategic way and timing to pursue withdrawal from BITs. Eventually, it was the bargaining power position that enabled the two revisionist states to pursue their favorable paths to BIT reform.

In Chapter 5, I present the case study of Ecuador's nearly decade long process to exit from its BITs. Although the Latin American nation had plenty of incentives to move swiftly with regards to terminating its BITs, the government of Ecuador faced numerous obstacles to its reform efforts. President Rafael Correa was highly motivated to establish a hard line with regards to foreign investors, especially in the oil sector, which had resulted in some of the largest claims in the history of international investment arbitration. Ecuador however found itself waiting for the opportune moment to terminate BITs with important partner states, and only acted on its strong incentives to exit once improved alternatives were in place. Most importantly, Ecuador purposefully waited until the conclusion of the vital free trade agreement with the European Union. Ecuador unilaterally withdrew from its BITs in several waves between 2008 and 2017, with the most important treaties getting terminated last. The Ecuadorian experience illustrates the importance of the powerful constraints that even highly motivated revisionist states face in their efforts to withdraw from investment treaties.

Chapter 6, in turn, presents the case study of Indonesia, which had different motivations with regards to its investment treaties than Ecuador. Like Ecuador, the government of Indonesia was motivated by a series of ISDS cases to initiate a review of its BITs. However, Indonesia wanted to modernize, adjust, and make its treaty network more uniform, rather than withdraw from the regime completely. Indonesia initiated its BIT reform in 2014 by systematically terminating treaties as they approached expiry. However, it decided to change its approach in 2016 when it stopped the unilateral terminations. Instead of accepting the long sunset clauses that got triggered with every unilateral termination, Indonesia began to renegotiate

its investment treaties: it successfully negotiated a new BIT with Singapore in 2018 following the unilateral termination of the old one. Indonesia also managed to replace the BIT with Australia by negotiating a new Comprehensive Economic Partnership Agreement, notably managing to terminate the sunset clause of the old BIT. Indonesia's ability to successfully negotiate replacement agreement with favorable terms illustrates that it is possible for revisionist states to successfully reform investment treaty commitments as a result of strategic exit.

In Chapter 7, I summarize the key insights learned from the two case studies. I focus on the factors central to my theory, including sources of bargaining power, the role of ISDS and political ideology, as well as partner importance for the prospects of successful renegotiation. Finally, Chapter 8 concludes the thesis by summarizing its main argument, findings, future directions for research, and contributions.

The central contribution of this thesis is a theoretical framework for analysing states' decisions regarding their investment treaties through the lens of bargaining power. By defining bargaining power through states' outside options to BITs, it can explain why some states have withdrawn from the regime, while others have decided to keep their investment treaties despite learning about the risks of investment arbitration. Furthermore, the research shows that withdrawal from international regimes can serve two different purposes for dissatisfied states. It can enable *exit* from the obligations under the regime that the state no longer considers worth the risks. Alternatively, withdrawal can also work for the purposes of a *strategic exit*, providing a costly signal for communicating a credible exit threat, and therefore helping states to initiate new negotiations of their international legal commitments towards foreign investors.

2

Theory: Bargaining power and Withdrawal from the BIT Regime

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Why do some states withdraw from their investment treaties? And why do others keep them, despite learning they actively harm them? In this chapter, I argue that regardless of the sources of dissatisfaction or political motivations, all states are limited by their outside options to BITs when deciding whether to terminate investment treaties, or to attempt renegotiating their terms. Furthermore, withdrawal from existing treaties can serve two distinct purposes: withdrawing from their commitments to the international regime, or a strategic tool to enable

negotiation of more favorable terms in the future with the most important partners.

From the early phases of the investment treaty regime, the underlying negotiations were highly asymmetrical, with capital exporting states largely dictating the terms of cooperation.¹ Many states were neither in a strong position to push for their interests effectively in negotiations, nor fully aware of the true risks that BITs involve. As learning and shifts in the international sentiment regarding investment treaties have occurred, many governments have started to reconsider their treaty commitments: some have incentives to completely withdraw from the regime, while others merely wish to renegotiate their BITs to modernize and adjust the terms of cooperation. Despite the different motivations, both such states are *revisionist states*, as they wish to change the existing investment treaties. Their partner states, who do not have the incentives to change the terms of cooperation because they benefit from them, are *status quo states*.

A revisionist state has three possible options to change its existing investment treaty commitments with the status quo state: *exit*, *renegotiation*, and *strategic exit*. For any revisionist state, the option of renegotiation of a BIT is difficult to achieve. The treaty favors the status quo state, and hence it has no incentive to agree to reopen negotiations with regards to the agreement already in force. In addition, renegotiation always involves time, technical efforts, and diplomatic resources. Renegotiation is only a realistic goal in close economic partnerships, with mutual recognition of the partners importance and effective communication.

For a revisionist state to choose the option of exit, it will have to assess whether it is truly better-off without the old treaty in place. Even though the BIT may not correspond to its ideal agreement, or the gains from cooperation disproportionately favor the partner state, it may still be preferable to keep the treaty in place in comparison to the counterfactual. Furthermore, exiting a BIT is costly, as it can send a hostile signal to foreign investors, the partner state, and the financial markets. For exit to be the preferable strategy, the revisionist state must be confident that

1. Regardless of the extent of asymmetry, BITs always reflect the underlying bargaining power dynamic between negotiating partners. Even though most BITs were products of highly asymmetric negotiations, the outlined logic is also applicable to more symmetric negotiations.

the alternatives within its reach are stronger than the existing arrangement, so that the costs of exit are outweighed by the associated benefits.

The third strategy of strategic exit combines the options of exit and renegotiation. Strategic exit works as a costly signal: to effectively communicate improved alternatives, and demonstrate a credible exit threat, the revisionist state must exit the BIT in the hopes that new negotiations follow at a later stage. This however requires that the revisionist state is comfortable abandoning the existing agreement, at least in the short term. Any revisionist state therefore requires strong alternatives to the existing BIT, regardless of whether its intentions are to exit permanently or only strategically to catalyze new negotiations. Furthermore, because the status quo state would only ever agree to renegotiate a BIT if the collapse of the agreement was otherwise inevitable, the pursuit of all three strategies – exit, renegotiation, and strategic exit – require the revisionist state to have strong outside options.

Therefore, any state seeking BIT reform will need strong alternatives, which define its bargaining power in bilateral negotiations. The stronger the outcome for a revisionist state in the absence of the BIT, the more favorable its terms must be to prevent the collapse of the cooperative agreement. Withdrawal can therefore not only enable exit from an international regime, but also credibly demonstrate the ability of a revisionist state to walk away from cooperation unless its demands for renegotiation are met. If one plans to rock the boat, they must prepare to swim.

The theory of bargaining power of alternatives in the investment treaty regime makes several important contributions to the study of investment treaty reform in particular and withdrawals from international regimes in general. First, it specifies how bargaining power, defined as outside options to the existing treaties, constrains the choices available to states when seeking investment treaty reform. Existing literature on BIT terminations and renegotiations has identified ISDS as one of the main reasons why states become dissatisfied with their old treaties. I contribute to this literature by demonstrating why, despite learning about the risks of ISDS, states do not always act to change the rules that govern their relationships with

foreign investors. The theory can explain inaction and selective withdrawal, even when the risks of BITs have become widely known.

Furthermore, with reference to bargaining power as alternatives, the theory can explain why some states terminate their investment treaties even when their intention might be to renegotiate. I bring insights from literatures on inter-state bargaining and international cooperation to illustrate that withdrawal from international regimes does not necessarily imply a backlash against the regime in principle, but it can be a manifestation of a strategic element inherent to any international interaction. In a world of imperfect information, where some continue to enjoy greater benefits from existing institutionalized forms of cooperation than others, sometimes the only way to amplify voice is, first, to exit.

Finally, by theorizing about the role of bargaining power in BIT reform I explicitly examine the limits of the bargaining story in explaining withdrawals from international regimes. While improvement of alternatives for previously disadvantaged states has been a vital pre-requisite for change in the BIT regime, it cannot explain all the specific outcomes of the reform process. Once bargaining power takes states to a point of confidence where decisions can be made regarding existing international agreements, other factors are likely to influence how exactly the reform process unfolds - whether it is through successfully convincing partners about the benefits of mutual termination, or strategic initiatives to draft alternative agreements and arbitration institutions.

The rest of the chapter proceeds as follows. Section 2.1 explains how the underlying asymmetric negotiations between states came to shape the investment treaty regime, and how it is the access to alternatives that makes economically more developed states stronger at bargaining. In Section 2.2, I outline the logic of bargaining power as imposing important constraints on states when considering initiating reform of their investment treaties, and what their alternatives have looked like in practice. Section 2.3 outlines the factors that have caused learning effects and given emergence to states' incentives to reform their investment treaties. Finally, Section 2.4 outlines how the prospects of successful renegotiation largely depend on

how important the two partners consider each other, and how strategic exit from BITs may provide revisionist states a vital costly signal to enable renegotiation and reform of terms of cooperation at a later stage. Section 2.5 concludes.

2.1 BITs as products of asymmetric negotiations

I start my theory from the observation that international investment treaties are fundamentally shaped by the bargaining power relationship between the negotiating parties. Understanding how bargaining power underlies the design of the international economic agreements is vital for explaining why states might withdraw from them in the future, and which factors enable them to do so. Crucially, the state with stronger bargaining power in relation to the opponent shapes a treaty to more closely resemble its preferences. The weaker party, on the other hand, is largely a rule-taker. Because of the underlying bargaining power relations fundamentally characterize BITs when they are signed, changes in the bargaining power dynamic between the signatory states are likely to enable change in the BIT regime.

Support for the assumption can be found from two sources: historical knowledge of the conditions under which the early BITs were formed, as well as literature analyzing the content of the treaties as a function of the power relations of the signatory states. At the early onset of the BIT regime, the treaties in protection of foreign investments were designed by powerful states. European states and the United States were leading the way in designing legal protections for companies and investors with investments located abroad, often in regions of political instability. The governments of democratic states were motivated to promote protections for businesses investing abroad, because investors form powerful interest groups in these states. They took the lead in the promotion of a rules-based regime for the governance of foreign investing with their drafted model agreements. For countries mostly exporting capital, significant economies of scale also existed in signing the same model BIT with aspiring partners, which encouraged the powerful to insist new partners to adopt the already existing template treaty, instead of negotiating

new agreements with all potential partners.² As a result, the terms of investment governance were largely dictated by such countries and imposed on their treaty partners, especially in the developing world.³

This imposition did not necessarily constitute outright coercion. Instead, the asymmetry of bargaining power between the parties caused the weaker parties to not be able to negotiate effectively through two main mechanisms. The first was the need for especially developing countries to attract capital from the major capital exporting countries: the race-to-the-bottom theory of BITs proposes that states signed treaties out of competition against other capital importing states.⁴ While collectively it may have been better for especially developing countries to refuse treaties that expose them to international arbitration and ties their hands with regards to the treatment of investors, individually signing BITs was the best decision to make in order to not lose the competition over foreign investors.⁵ Developing countries were not in a position to bargain effectively because of their dire need for capital and lack of alternative sources for financing, which resulted in little bargaining power in the negotiations.⁶ Increased FDI was implicitly promised through signing of BITs as a mutually beneficial tool to facilitate cooperation between the participant states, resulting in treaty terms that closely correspond to the preferences of the more powerful actors.⁷

The second dynamic that limited effective bargaining by the weaker states, especially developing countries, is that they were more likely to fall prey to boundedly rational decision-making.⁸ Such states did not fully understand the costs involved with joining the regime: instead of seeking detailed information about provisions of BITs and carefully weighing costs and benefits of different possible treaty designs, many governments simply took the promise of the positive effects of BITs as a

2. Chilton 2016.

3. Salacuse 1990.

4. Guzman 1998.

5. Elkins, Guzman, and Simmons 2006.

6. The beginning of global diffusion of BITs took place during the late 1980s and early 1990s, which was also a time of stagnant international bank lending. Simmons 2014, 20–21.

7. Allee and Peinhardt 2014; Alschner and Skougarevskiy 2016.

8. Poulsen 2015.

given. Cognitive biases such as motivated reasoning, salience bias, and status quo bias were prominent in the initial decisions to join the regime. Developed countries, which constituted the stronger parties in most early BIT negotiations, were not as prone to such boundedly rational decision-making due to their privileged access to expertise.⁹ It is important to highlight that expertise does not necessarily shield a negotiator from biases of bounded rationality in negotiations.¹⁰ However, it increases the information available about the rules of the interaction, costs and benefits of different options, as well as probabilities of potential outcomes. Therefore, higher levels of expertise entail an advantage in negotiations.¹¹

Because of these two dynamics, the resulting investment treaty regime became to feature strong protections for foreign investors, especially the dispute settlement provision. Although in principle reciprocal, the investment treaties were never intended to be used by investors outside Western democratic states against their governments. As articulated by the then Government Deputy Chief Whip, Lord Davies,

Nothing could be more offensive. . . than the idea that someone based abroad would be able to take advantage of bilateral treaties that were designed to. . . safeguard, on the whole, British taxpayers regarding regimes that can act on occasion in an extremely arbitrary and unfair manner.¹²

The idea that BITs can also be used against European governments has not been a serious concern until recently precisely because of the strong prevailing sense that BITs are instruments protecting the interests of investors from the developed, capital exporting states.

These dominant narratives about the rise of BITs into prominence of global governance of investments have largely been framed as a story of asymmetric bargaining between economically developed and developing countries. However,

9. Ibid 26.

10. Even with the privileged amount of information available to actors with high levels of expertise, they may also fall prey to biases of bounded rationality. For example, a legal expert with plenty of experience may for example fall into the status quo bias of respecting old treaties as a good template for new ones.

11. On the role of expertise and bureaucratic capacity in shaping the architecture of the international investment regime, see Berge and Stiansen 2016; St John 2018.

12. Hansard Deb Vol 699, cols 1481-1482 2008.

economic power does not guarantee success in negotiations, and the narrow understanding of the bargaining power dynamics in early North-South BITs can be unnecessarily limiting when seeking to explain developments that do not relate directly to these early investment treaties: a large number of intra-EU BITs have been negotiated, and South-South BITs continue to be increasingly common since the early onset of the regime.¹³ In order to understand how *all* BITs are shaped by bargaining dynamics, it is important to highlight that the fundamental sources of asymmetry in negotiations do not come from economic power differences or expertise *per se*. Instead, bargaining power in any negotiation fundamentally stems from the alternatives each party has. In the global economy, economic power often comes hand in hand with a multitude of attractive options.

Economically stronger states usually enjoy greater opportunities in the global economy. Largest economies in the world are systematically also among the largest recipients of FDI, and strong economic performance can help to diversify the sources of capital flows.¹⁴ Because access to the domestic markets of large economies is valuable, such states are also more attractive as economic partners, especially in free trade agreements for businesses looking to produce for the purposes of exporting. To negotiate any economic agreement with a larger economy is therefore considered a great opportunity, all else equal. It is the access to such alternatives brought by a strong economy that can translate economic power into bargaining power. Therefore, the association between economic power and access to outside options in relation to BITs is strong, and one can get a good sense of the landscape of possibilities for a state based on the size of its economy. Weaker economy limits the strength of options available, and results in a weaker position when negotiating the terms of economic cooperation.

The next Section 2.2 outlines how bargaining power is best conceptualized as alternatives to the negotiated agreement in the context of investment treaties, and

13. For example, the United Arab Emirates has signed 12 new BITs since 2018.

14. In 2020, China surpassed the United States as the largest recipient of FDI in the world, the two being also the largest economies in the world. “China was largest recipient of FDI in 2020” 2021.

what kinds of factors improve states' alternatives to them in practice. I outline what governments have considered to be the most important benefits gained from keeping BITs, or negative effects resulting from their termination, and therefore what their outside options to BITs look like in practice.

2.2 Bargaining power Constraints and the Power of Alternatives

2.2.1 Conceptualizing bargaining power

I conceptualize bargaining power as the alternatives to the agreement under negotiation. The theory of best alternative to negotiated agreement (BATNA) suggests that an actor is only as strong at bargaining as is their best outside option to the agreement under negotiation.¹⁵ If a negotiator has a high no-agreement payoff, which can also be called a bottom line¹⁶ or a resistance point¹⁷ the better the payoff from the negotiated agreement must be to be preferable to status quo of no-agreement. A party to a negotiation improves their bargaining power by improving their alternative to the negotiated agreement. An example of the 1971 Maltese-British negotiations shows that Malta was able to obtain better rental rates of a naval base from Britain by approaching the Soviet Union and Arab states to induce offers from them: approaching the North American Treaty Organization's (NATO) geopolitical opponents improved Malta's alternatives while simultaneously making Britain's alternatives significantly worse, despite the clear inferiority of Malta's security and economic power.¹⁸

Thinking in terms of BATNA has several benefits over alternative conceptualizations of bargaining power. First, the broadest definition of the concept of bargaining power as an "act that is designed to cause another party to move in a desired direction"¹⁹ is problematic because it defines bargaining power of an actor

15. Fisher and Ury 1981.

16. Lax and Sebenius 1985.

17. Odell 2018.

18. Lax and Sebenius 1985, 168.

19. Zartman and Rubin 2002.

based on the outcome of bargaining.²⁰ Instead, BATNA avoids this circularity of linking bargaining power to outcomes, as it is possible to improve alternatives and hence bargaining power before knowing anything about the strategic setup or outcome of the negotiation. Second, BATNA has advantages over simply relying on attributes of negotiating parties, such as economic power or bureaucratic capacity, as it captures the context-specific nature of bargaining power: what makes one strong in a specific negotiation may not bring any bargaining power in an agreement over another issue. Finally, BATNA allows the consideration of factors beyond objective attributes of negotiators, as it is fundamentally a cognitive construct of the negotiator: although observable factors can be used as proxies, the true best alternative is what the negotiator perceives as such. By identifying what actors perceive as their alternatives, one can arrive at an operationalization of bargaining power regarding any specific agreement under negotiation.

In the context of BIT-negotiations, stronger alternatives make a state less dependent on the BIT, and hence make them able to act on newly learned information or emerged incentives to reform existing treaties, a mechanism detailed in Section 2.3.2. Stronger alternatives therefore give states the ability to act regarding agreements when learning occurs, while states who remain highly reliant on the BIT may not be able to initiate reform in the fear of losing the benefits provided by the treaty. Bargaining power therefore functions as a precondition that must be met in order for change to occur.

Closely related conceptualization of bargaining power in the context of BIT-negotiations is the characterization of power as “go-it-alone” power.²¹ It illustrates how some actors in economic negotiations have the power to push for their preferences with or without the cooperation from a specific partner. In the context of free trade agreements, weaker parties are left with the bad option to join the agreement with a high cost of opening their markets to international competition, or the

20. Odell 2018, 32; Schelling 1960, 22.

21. States may sometimes join and remain members of institutions and agreements even if they are worse-off by doing so in the absolute terms. This is because the alternative of non-inclusion is even worse than the costs of being included. Gruber 2000.

even worse option to be excluded from the trading bloc. If one party has multiple potential partners, a significance of any one of them will be less than it would be without them. While potential alternatives do not constitute BATNA for Fisher and Ury, they can constitute “go-it-alone” power: if a state perceives that there are potential, yet-unmaterialized opportunities outside the agreement at hand, this confidence of finding alternatives can translate into stronger bargaining power in negotiations. This has especially been the case with the decision-making processes of the governments of some emerging economies. States who have improved their economic power substantially in relation to other states have also gained more confidence about their ability to pursue more favorable agreements in the future, as well as develop ways to attract investment even if the existing BITs are abandoned.

What different governments consider to be the feasible alternatives or outside options to their investment treaties can be highly context specific and depend on the functions they were thought to fill in the first place. In some cases, new solutions for providing protections and attracting foreign investors have provided a feasible alternative to investment treaties. For political leadership in other states, it has been the growing confidence that their economic strength and natural resources are enough to attract investors regardless of the state of investor protections. To understand what constitutes the key alternatives to governments in relation to their investment treaties, the costs and benefits of keeping, terminating, or renegotiating BITs are mapped.

2.2.2 Keep, terminate, or renegotiate?

In the first instance, the options available for a revisionist state in pursuing BIT reform can be analyzed by adopting two assumptions. Before relaxing the assumption of perfect information, I assume that both parties know the payoffs of different outcomes, as well as each other’s outside options. In introducing the available strategies, I also assume that the benefits gained from BITs are strictly zero sum: any renegotiation of the agreement entails concessions from the status quo state to the benefit of the revisionist state. It will eventually become evident that

neither assumption is strictly necessary for the theory to show that the strength of outside options determines whether the revisionist state can renegotiate an existing BIT or unilaterally terminate it.

There are five different possible observable outcomes for BITs that have ceased to be in force: unilateral denouncement, expiry, renegotiation, amendment, and mutual termination (Figure 2.1). I group these strategies under overarching analytical categories, based on them having similar properties from the perspective of the bargaining dynamic. Unilateral denunciation is a clear case of exit, because a single signatory state has to take action to terminate the existing treaty. Furthermore, some states have decided unilaterally to let their BITs expire by serving notice to the partner that it will not allow the tacit renewal clause to take effect. Although legally the two actions utilize different treaty provisions, both of them can be analyzed under the strategic category of exit from the treaty.

Whether any single unilateral denunciation or decision to let a BIT expire constitutes strategic exit is difficult to determine empirically, as the observed outcome of a specific BIT is the same for both analytical categories. Strategic exit can therefore only be differentiated from exit based on the motives of the terminating government, as well as the approach it takes to its investment relations following unilateral termination. I explore these dynamics empirically through the two case studies.

Unlike exit, the renegotiation strategy can take three different forms: the replacement of the BIT with a new treaty, as well as the amendment of the existing BIT are both instances where the parties need to reach agreement to change the language in the existing BIT. In addition, I consider mutual termination as a subcategory of renegotiation, as it also requires reaching an agreement between the two partners. Furthermore, other ways to mutually change the commitments outlined in BITs, such as by issuing joint interpretative statements regarding how certain BIT features should be interpreted in any arbitration proceedings²², are also subtypes of renegotiation.

22. Poulsen and Gertz 2021.

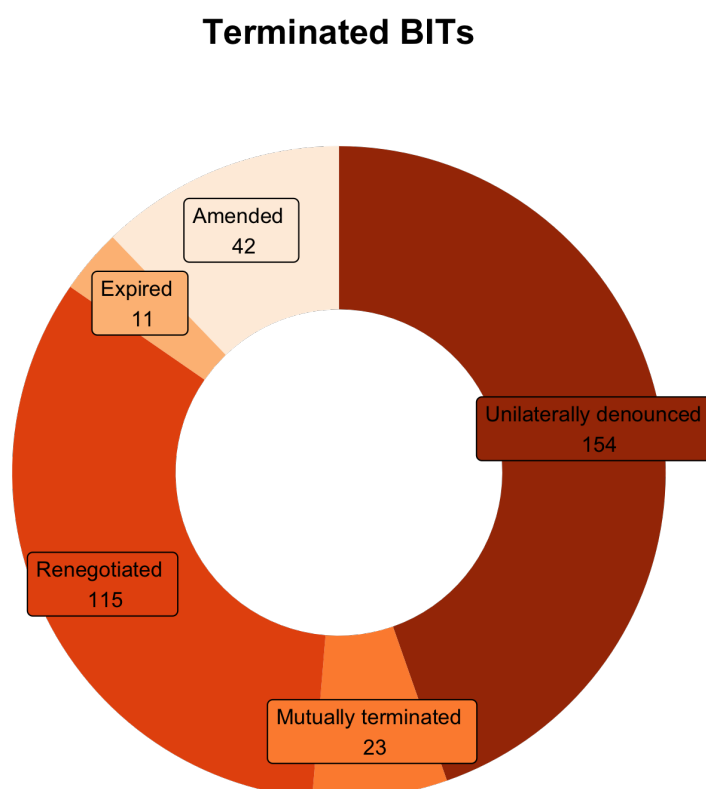


Figure 2.1: Terminated BITs by type of termination, 2019

Although the determinants of the exact way in which renegotiation is achieved will depend on various factors, such as preferences of the partner state, in all three cases the revisionist state must convince its partner to give concessions in comparison to the cooperative agreement already in place - whether the desired outcome is an amended BIT, new FTA with investment provisions to replace it, mutual termination, or a joint statement. The theory is not aiming to explain the exact way in which renegotiation is pursued, but to isolate the dynamic of reaching an agreement to change the status quo agreement.²³

Difficulty of mutual termination

Most BITs can be terminated by consent when both parties agree that the BIT is no longer serving its intended purpose. Mutual termination can be executed through

23. It is also possible for states to sign BITs but to never ratify them, leading the treaties to never actually enter into force, such as the approach by Brazil (Campello and Lemos 2015). As the theory only applies to BITs that have the power of international law with the associated costs, explaining the instance of nonratification is also beyond its scope.

an exchange of notes (*note verbal*) which constitute an agreement to terminate the agreement.²⁴ Such an agreement is the best solution for states wishing to withdraw from their investment treaties, as it lowers important costs of withdrawal. Because the termination of the BIT is consensual by both parties, the revisionist state does not have to worry that the partner state interprets the withdrawal as a negative statement with regards to their economic partnership. Mutual termination is also more neutral, as it is less likely to be interpreted as anti-investor sentiment of the revisionist state, and more likely viewed as a mutual effort to eliminate an outdated agreement by international markets. Mutual termination is a harmonious outcome, where both states' choices automatically facilitate the attainment of their partner's goals.²⁵ After mutual termination, the treaty ceases to be in force, and by agreement the sunset clause that keeps the treaty's features valid for up to 15 years can also be eliminated.

However, very few such instances have occurred to date: out of 2638 ratified treaties, only 23 have been terminated by consent (Figure 2.1). This is because the status quo state benefits from an existing BIT, and therefore it has little incentive to agree to terminate the agreement and abolish the protections for its investors that are in place. Most of the BITs terminated by consent are intra-EU treaties, suggesting that they are a special case of BIT reform. Mutual terminations between EU member states have started increasing since a ruling by the European Court of Justice (ECJ), which in March 2018 addressed the long-standing concern that the arbitration clauses included in investment agreements between two EU-member states are incompatible with EU law. The so-called *Achmea* ruling is likely to eventually result in denunciations of all intra-EU BITs.²⁶ Beyond this specific class of BITs, mutual termination remains rare.²⁷

The difficulty of achieving mutual termination is even larger for governments of small economies, especially from the global South, or states that do not otherwise

24. Voon and Mitchell 2016, 413–433.

25. Keohane 1984, 51.

26. Foucard and Krestin 2018.

27. The only non-intra-EU BITs that have been reportedly terminated by consent to date are the Australia - Chile (1996), Argentina - Indonesia (1995), and Austria -Cape Verde (1991) BITs.

have a close relationship with the status quo state. As an official at the Ecuadorian government noted, mutual termination of BITs with stronger partners was not a realistic option for them when considering how to proceed with BIT withdrawals:

[W]e do not have the possibility to push the other states to mutual termination. We cannot say to the US or to the French government “lets mutually terminate” when it’s a treaty that is established precisely in their benefit, and not our benefit. Then we don’t have the position in the international negotiation to make a mutual termination [sic]. Otherwise, we would surely have considered that possibility.²⁸

Despite being the least controversial approach to BIT reform, mutual termination of BITs therefore often remains an unrealistic approach for revisionist states. Instead, they may therefore attempt one of the other two routes to adjust their BIT commitments, renegotiation or unilateral termination.

Challenges of renegotiation

Absent the willingness for status quo partner to mutual terminate a BIT, a revisionist state can attempt to renegotiate the BIT. After conclusion of a new agreement the old treaty ceases to be in force.²⁹ Most BITs include provisions for amendments and renegotiation, which are intended to provide flexibility. For example, Article 13 of the 1994 Indonesia-Netherlands BIT outlines provisions for consultation and amendment:

1) Either Contracting Party may request that consultations be held on any matter concerning this Agreement. The other party shall accord sympathetic consideration to the proposal and shall afford adequate opportunity for such consultations. 2) This Agreement may be amended at any time, if deemed necessary, by mutual consent.³⁰

The benefit of renegotiating a BIT or negotiating a new replacement agreement with the partner is that the status quo state does not have to completely give up all protections its investors are enjoying under the existing treaty. For example, the partners may agree to keep ISDS provisions, but their scope can be narrowed, or definitions clarified. This can effectively limit how easily a host government

28. Interview E009.

29. Bernasconi-Osterwalder et al. 2020.

30. Ecuador - United Kingdom BIT 1994.

can be brought to international arbitration. Some revisionist states have been successful in defining more strictly what kinds of disputes qualify for international arbitration. In its Comprehensive Economic Partnership Agreement with Australia (IA-CEPA), Indonesia successfully negotiated an investment chapter where any claims that arise in relation to governmental measures for protecting public health are excluded.³¹ The renegotiation was therefore satisfactory for both parties: ISDS provisions stay in place for Australian investors in Indonesia bringing certainty for long-term investment projects, albeit being applicable to a narrower set of disputes, and Indonesia adjusted its previously broad ISDS obligations to better accommodate its new preferences for its investment treaty commitments.

However, it is challenging for the revisionist state to initiate renegotiations. As with mutual termination, the status quo state must agree to forego some of the existing benefits it enjoys from the agreement. Because the status quo state continues to benefit from the old BIT, it has no incentive to re-open negotiations. The only way for a revisionist state to convince the status quo state to redistribute the cooperative benefits is to have a credible exit threat: a believable threat that unless renegotiations take place, the dissatisfied party will exit from the agreement. This is because if the status quo declines to renegotiate, the result is the end of the cooperative agreement, abolishing any potential mutual benefits. Assuming that the threat is credible, and there is still a bargaining window for treaty terms that both parties would find acceptable, the status quo state will agree to renegotiate with the revisionist state.

Whether or not the revisionist state has a credible exit threat largely depends on its outside option to the old BIT. If the state's no-agreement payoff has improved, it has also become less dependent on the BIT. Under perfect information, the status quo state observes the improvement in the revisionist states alternatives and agrees to renegotiate to prevent the collapse of the cooperative agreement. Alternatives therefore define the bargaining power of the revisionist state and help it to open renegotiations with a status quo state. However, the realities of the

31. Australia-Indonesia CEPA 2019, Section B, Article 14.21, 1.b.

BIT regime do not closely match a world of perfect information. Perceptions are sticky, and a revisionist state may struggle to communicate its improved alternatives. Furthermore, future outcomes are always uncertain, and states must make decisions based on information available to them at a given time.

Renegotiation also carries important costs independent of convincing the status quo state to renegotiate. The legal and technical preparation required for carrying out negotiations are significant. When states wish to keep their investment commitments somewhat uniform across their often-numerous BITs, renegotiation of one BIT may imply a review of the entire national foreign investment policy. To this end, both developed and developing countries have drafted model BITs, which are meant to streamline the states' negotiating position, and preferably result in economies of scale in conducting investment treaty negotiations. However, the drafting of a model BIT is likewise costly: Ecuador's Citizens' Audit Committee tasked to review the existing stock of the country's BITs and propose a strategy for reform took almost two years to finish its report.

The only option of unilateral termination?

If both mutual termination and renegotiation are unattainable, the revisionist state can resort to unilaterally terminating the BIT. In fact, the largest proportion of BIT terminations have been unilateral denunciations. Exit from the treaty can indeed be the only – and therefore, the best – available route to reforming BIT commitments for a revisionist state. If the revisionist state fails to effectively communicate its improved alternatives to the status quo state and convince it to renegotiate via one of the possible mechanisms, it needs to consider whether exit is preferable to sticking with the existing BIT.

There are reasons to believe that exit from BITs might be the obvious strategy for revisionist states. At the onset of the regime, as well as through the increasing popularity of investment treaties between 1980 and 2000, signing BITs was associated with signaling to wealthy Western countries and investors about willingness to respect their property rights. However, as signing BITs became common place

globally and "boilerplate"³², the associated signal has also waned. Getting rid of BITs could therefore become an obvious choice for states that no longer see any benefit in keeping them, and who are also concerned with the risks of ISDS. In addition, for some governments exit from BITs can provide benefits from their domestic audiences that might reward their leaders for taking a stance against what is perceived as an unfair global governance regime.

The option of exit is however costly in many ways. Unilateral termination of a BIT triggers the sunset clause, which ensures that the terms of the treaty stay in force for investments made prior to termination usually between 10 to 15 years afterwards. Although the provisions cease to apply to any new investments, the exiting state locks itself to the BIT's provisions with regards to all existing investments. For a reasonably long time after, the legal effect of the unilateral termination therefore is the same as keeping the old BIT.

In addition, unilateral termination of BITs can send hostile signals to the partner state, investors, and the financial markets and lenders. From the perspective of the partner state, exiting from an international agreement can constitute defection from a cooperative equilibrium: terms of investment protection have been mutually agreed on, and unilateral withdrawal from the agreement can be interpreted as a signal that the partner exiting no longer wants to continue to cooperate. This can result in damage to the reputation of the revisionist state as an unreliable partner in economic cooperation.

Furthermore, choosing the radical approach of exit from international agreements can have reputational consequences though association with certain kinds of states. Because some of the first countries to unilaterally terminate BITs were Venezuela, Bolivia, and Ecuador, who likely enjoyed some additional domestic benefits from unilateral terminations, the strategy became associated with the left-wing populist governments in Latin America. For other revisionist states, the risk was to become associated with the strategy adopted by governments that took radical measures and used harsh rhetoric against the investment treaty regime, ISDS, and foreign

32. Peacock, Milewicz, and Snidal 2019.

companies.³³ The efforts of the Ecuadorian government to bring legitimacy for their BIT reform efforts through soliciting public advice from international experts, and attempts to announce the terminations together with South Africa, illustrate the concerns of revisionist states about how their actions may be perceived by international audiences, even when some of the costs might be offset by domestic political benefits.

In addition to signaling a certain profile as an economic partner for other states, unilateral termination of BITs can signal to foreign investors an unwillingness to guarantee protections for investors in the future. Investors often rely on cues regarding the conditions in target countries.³⁴ An investor can therefore interpret the exit from BITs as preparation to limit exposure to investment arbitration, increasing uncertainty over the government's intentions regarding regulation of investments, as well as general stability of the conditions in the country. Many international economic and legal observers have reported extensively on BIT terminations by governments, their prime audience being potentially concerned companies.³⁵ It has also been found that terminating BITs may exclude states from receiving financing from institutions such as IMF and the World Bank, which implicitly consider BITs a part of providing sufficient legal guarantees for the treatment of investors.³⁶ Some governments have additionally perceived that withdrawal could influence their credit ratings and interest rates on existing debt, for example through OECD rankings on countries' safety for investors.³⁷ Concerns over hostile signaling through unilateral BIT terminations are therefore a serious cost of pursuing exit from the regime.

Like renegotiation, the costs of exit from BITs therefore also require the revisionist state to have strong alternatives: the benefits of termination and opting for the best outside option must exceed the costs stemming from the hostile signal in order to be attractive. However, because exit is costly, it would only ever be pursued by

33. Gray 2013.

34. Shim *forthcoming*.

35. In addition to individual commercial law firms, media outlets such as Kluwer Arbitration Blog, Global Arbitration Review, and Lexology have been active in reporting on developments on government BIT policies.

36. Mossallam 2015.

37. Interview E005.

Table 2.1: Costs and benefits of keeping status quo BIT, unilaterally terminating, and attempting renegotiation for a revisionist state

	Keep status quo	Unilateral termination	Renegotiation
Benefits	No disturbance of FDI flows Reputation from adherence to treaty commitments (not "defecting")	Dissolve ISDS-obligations for new investors Potential domestic audience benefits Potential advantage of strategic exit	Strengthen cooperation Adjust terms
Costs	Continued exposure to ISDS	Hostile signal to foreign investors and financial institutions Political costs of renegeing from cooperation Sunset clause	Effort Time

a state with sufficiently strong alternatives. Therefore, unilateral termination can also work as a costly signal to the partner state that absent adjustment of the terms of cooperation it is no longer worried to make do without the old BIT. I detail how the costly signal enables revisionist states to leverage unilateral termination as strategic exit in Section 2.4.

Table 2.1 summarizes the costs and benefits of each strategy for a revisionist state. Next, I will elaborate how a revisionist state can expand its bargaining power.

2.2.3 Alternatives to BITs

To initiate the reform of investment treaties, a revisionist state will therefore consider its alternatives to the existing BITs because they define its payoff in the case of collapse of the treaty. In the most analytical definition of BATNA, the best alternative is simply the payoff the state receives in the absence of the agreement. In practice, these payoffs in the counterfactual scenarios are hard to foresee. There are therefore two kinds of categories of alternatives that influence government's decision-making when considering their prospects in case old BITs are removed: first, concrete arrangements that mitigate the costs of hostile signaling to partner

states and investors, and second, factors which make governments confident that such arrangements can be achieved in the near future.

First, alternatives to BITs can include different agreements or doctrines with the aim of reassuring foreign investors that their investments are protected: alternative international agreements that include investment provisions such as FTAs, domestic investment laws that detail the rights of investors, or investor-state contracts detailing the exact terms of under which a specific company may operate in a state are all alternative ways to address investor concerns. Although Ecuador had set out to terminate all of its BITs almost ten years prior, the government only took the last step to terminate the most important BITs with European partners, the US, and China in 2017, after finalizing an FTA with the European Union.³⁸ On the other hand, South Africa, being the pioneering state to terminate all of its investment treaties in response to a threat of ISDS claims arising from its Black Economic Empowerment (BEE) policies, proceeded to terminate BITs in tandem with proposing a new Promotion and Protection of Investment Bill (PPIB), which was intended to take over functions of investor protections previously guaranteed by BITs.³⁹ Such arrangements are likely to mitigate the costs of BIT termination and therefore improve the government's BATNA to existing investment treaties. Therefore, the first expectation stemming from the theory can be outlined as follows:

Expectation: A state wishing to withdraw from or attempt renegotiating BITs is likely to try developing both domestic and international alternative legal guarantees and incentives for foreign investors.

Furthermore, the government of a revisionist state can attempt to mitigate the costs of negative signaling by reassuring investors and partner states that their intentions are not hostile to investors nor partner states. Most governments who have resorted to unilaterally terminate their BITs have made public statements indicating their intentions to renegotiate their investment treaties later. For example, when India sent the notifications of termination for the 58 BIT partners starting from 2016, they were accompanied with expressions of intent to renegotiate all agreements based

38. Interview E008.

39. Mossallam 2015, 13.

on its new model BIT. Such promises do not improve the concrete alternatives for states, but they are an effort to mitigate the costs of hostile signaling. If successful in reassuring investors and partner states, they can improve the no-agreement payoff for a revisionist state. The observable implication of such strategic efforts is therefore:

Expectation: A state withdrawing from BITs is likely to make statements to signal that the intention is to renegotiate the treaties at a later date.

For some states, alternatives to investment treaties may not involve developing ways to provide replacement protections and incentives or calming down the international audiences. Instead, governments may be confident that none are needed: if the state believes that foreign investors will want to come regardless of BITs in place, their dependency on the treaties decreases. Several factors may result in such a situation. During the commodities boom of 2000s, many natural resource rich countries found that their fuel, oil, and metal resources were in high demand as the commodity prices soared. The strong demand especially in the extractive industries from foreign investors in Indonesia convinced the government at the time that despite the continued uncertainties and complicated domestic legal structures, companies would want to continue to get access to Indonesian natural resources.⁴⁰

Likewise, strong economic performance and growth can create perceptions in the government that the no-agreement outcome in relation to BITs is not as disastrous as once thought. It is no coincidence that emerging economies such as India, Indonesia, and South Africa are amongst the states who have taken strong action to withdraw from the investment treaty regime, especially at times of an upward trajectory of their economic development. Strong economy can bring confidence to pursue otherwise costly BIT termination.

Expectation: A state withdrawing from or attempting renegotiation of BITs is likely to do so at a time when the economic conditions in the country are favorable.

40. Interview I005.

Bargaining power of alternatives to existing BITs is therefore a vital background condition for decision-making regarding investment treaty reform. It determines the constraints on governments' decisions on whether and when to initiate reform of investment treaties. Given the underlying bargaining power structures embedded in BITs, one might logically deduce that when the constraints lift, and there are changes in the underlying bargaining power structures as a result, we should observe changes in investment treaties. Empirically, however, states rarely react to changes in alternatives in real-time. In Section 2.3, I explain why developments that have acted as catalysis driving states' actions for investment treaty reform are necessary for states to begin to assess their bargaining power position, and eventually take action to reform BITs.

2.3 Incentives driving BIT reform

In a world of perfect information, states would always be aware of any changes in the bargaining power relations with partners and their improved alternatives, and therefore react to them by adjusting their international agreements.⁴¹ Yet in practice, states do not adhere to the assumptions of perfect information. Furthermore, they do not react instantly to changes in bargaining dynamics, neither can they predict the future perfectly. Instead, states react to events which increase the salience of and teach them new information about the cooperative issues at stake. In this section, I outline how some developments have catalyzed action by states to react to their changed bargaining power positions.

First, I focus on the important effect that the increasing instance of ISDS claims has had on the respondent governments. These events teach states about the true risks of BITs and increase the salience of related issues. As a result, facing ISDS creates important incentives towards BIT reform. Second, I outline other possible developments that have in practice shifted states attitudes towards BITs, independent of their bargaining power in relation to specific partners. Third, I

41. Flexibility provisions such as renegotiation clauses are included in international legal agreements to enable the adjustment of treaty terms in the case of bargaining power changes, avoiding the collapse of treaty-based cooperation. Koremenos 2002.

illustrate why all states are constrained by their bargaining power when eventually deciding whether to withdraw from BITs or not - regardless of the reasons why they signed BITs in the first place, or the kinds of incentive-changes they experience.

Throughout the section, I employ a standard conceptual distinction between *incentives* and *preferences*. Actors have preferences over outcomes, and different incentives can shift their preference of one outcome to the other.⁴² Policymakers often attempt to create or adjust citizens incentives to shift their preferences by employing various kinds of sticks and carrots. Presence of new incentives may or may not tip the balance to prefer one course of action over another. In the context of BITs, likewise, strong incentives to withdraw from the regime do not automatically translate into a preference to do so. Governments, like individuals, often have to do things they do not really want to do. This is because governments are largely risk averse, and it is better to choose the safer course of action among bad options. It is therefore vital to separate analytically incentives from preferences to withdraw from international regimes, so-far overlooked in much of the analysis of withdrawals from BITs.

2.3.1 Learning One's Lesson: Impact of ISDS

It is clear that the increase of investor-state dispute settlement cases has initiated serious discussions about reform of the investment treaty regime. A majority of states explicitly announce the threat of ISDS as the main reason for their decisions to withdraw from the regime. From the rational design perspective, it may seem surprising that states become dissatisfied with their investment treaties when faced with the prospect of ISDS: if BITs were truly signed for the purposes of creating credible commitments, ISDS is a vital feature of investment treaties because they help to alleviate political risk for investors. Investment treaties are supposed to work precisely because they “bite”.⁴³

However, two different mechanisms of learning through ISDS within the rationalist framework can explain why the occurrence of disputes has resulted in the negative reaction by some governments. First, states may have experienced *rational learning*:

42. Osborne 2003.

43. Tobin and Rose-Ackerman 2011.

updating preferences based on learning new information about the strategic situation at hand. Even the most knowledgeable and careful government can be taken by surprise by some peculiar features of the ISDS regime that have emerged. As an Indonesian government official highlights, despite the fact that the government has won all its recent ISDS cases against investors, the sheer administrative costs of ISDS faced by defendant governments have taken them by surprise:

[T]he investment arbitration claims are not about just [whether we] win or lose the case, but also about the arbitration costs. According to the OECD survey, the arbitration costs could be 8million – up to 30 million – only for the administration costs, not including the compensation that the host has to pay, if the decision is in favor of the investor.⁴⁴

The majority of known ISDS cases have also been brought based on so-called indirect expropriation, where the investors bring claims in response to government actions that may affect the value of the investor's property.⁴⁵ Recently, the coal phase-out plan by Netherlands provoked an arbitration case in ICSID by a German energy company RWE.⁴⁶ In addition, Ecuador's citizens' audit commission into the country's BITs found that Ecuadorian investors had been able to access ISDS through BITs and sue their own government for compensation.⁴⁷ While the purpose of the regime has been thought to facilitate investment internationally, domestic investors had been able to use subsidiaries or partnerships in countries which have investment treaties in place to initiate legal action towards their own government. In the case of Ecuador, "a lot of FDI was, in fact, not international investment, but Ecuadorian investment."⁴⁸ Such unintended consequences of BITs could easily have been unforeseen even by the most rational and careful government when initially joining the regime.

The second mechanism through which facing ISDS can result in learning is *breaking bounded rationality*. Many states joined BITs because of their reliance on cognitive biases, and for many states BITs continue to serve the purpose of a

44. Interview I002.

45. OECD 2004.

46. Wehrmann 2021.

47. Interview E008.

48. Ibid.

diplomatic tool, rather than a direct means for investment facilitation. Because of the continued position of BITs as focal points in governance of international investment⁴⁹, many governments do not effectively bargain over their contents, but accept readily available templates and practices without much consideration. They also do not necessarily conduct a careful assessment of the costs and benefits of BITs in light of their outside options. However, when facing ISDS disputes, a learning shock about the true costs of BITs can awaken the government to re-evaluate their existing agreements.⁵⁰ They can also result in the government to spend more resources on training their personnel, participating in events and forums regarding ISDS and best strategies towards reform, as well as take a more active position in their BIT-decision making. Such shift from the previously dominant approach constitutes breaking bounded rationality.

In theory, states do not necessarily have to themselves face ISDS claims from investors in order for either of the two types of learning to occur. States may simply observe other states fall victims to arbitration, read about high profile ISDS cases in the news, or for example participate in workshops organized by NGOs such as the South Centre.⁵¹ However, while most states by now are well aware of the possibility that they may get hit by an ISDS claim, learning effects are most likely when the government itself is the defendant in international arbitration.⁵² Following learning from ISDS cases, the government is likely to reflect on their bargaining position more carefully, and approach existing BITs in a more rationalist fashion. Section 2.3.2. illustrates this dynamic graphically.

2.3.2 Interaction between learning and bargaining power

Despite the learning effects from ISDS cases, and the frequent change in states incentives towards investment treaties as a result, most states have not initiated

49. Poulsen 2019.

50. Poulsen and Aisbett 2013.

51. Montes and Timossi 2016.

52. States have been found to prefer larger state regulatory space in their investment treaties after themselves facing ISDS claims as defendants, and hence renegotiation of such agreements becomes more likely. Haftel and Thompson 2018.

reform of their BITs. This is because bargaining power, as defined by their alternatives (Section 2.2), imposes constraints on states and often prevents them from taking decisive action with regards to their BITs. To illustrate the interaction between learning through ISDS and bargaining power changes in explaining BIT reform, I adopt a simple spatial bargaining illustration for three hypothetical scenarios. In Scenario 1, two states know exactly the implications of ISDS at every point in time, but there is a change in one party's bargaining power, which makes the existing BIT unstable. The situation shows that bargaining power changes would result in changes in BITs in a world of perfect information. The other two scenarios relax the assumption of perfect information: one of the states experiences learning since the BIT is signed.⁵³ Scenario 2 shows how a BIT becomes unstable following learning by one of the parties as a result of ineffective bargaining initially. Finally, Scenario 3 illustrates a situation where despite learning, the limited bargaining power of a revisionist state does not enable it to withdraw or demand renegotiation of the BIT.

Key insights emerge from the illustration. First, in a world of perfect information, states only deviate from their investment treaties if their outside options to the BIT have improved since the initial treaty signature. Second, while states may experience learning because of facing ISDS, the learning effects alone do not enable them to walk away from existing agreements: for a change in a BIT to take place following learning effects, the revisionist state must have either improved its outside options since initial signature or have initially been in a strong bargaining power position, which continues to be reflected by the existing BIT.

Figure 2.2 presents a stylised two-axis diagram of a bargaining situation over a BIT in Scenario 1.⁵⁴ Any point in the diagram represents a potential agreement: points to the east entail gains for Party 1, and points to the north for Party 1. B1 and B2 represent the reservation points for the parties respectively, which are the worst terms they would be willing to accept before no-agreement becomes

53. While both parties to a BIT may experience learning, for the purposes of simplified illustration only one party is assumed to do so.

54. Illustration adapted from Odell 2018, 29–31.

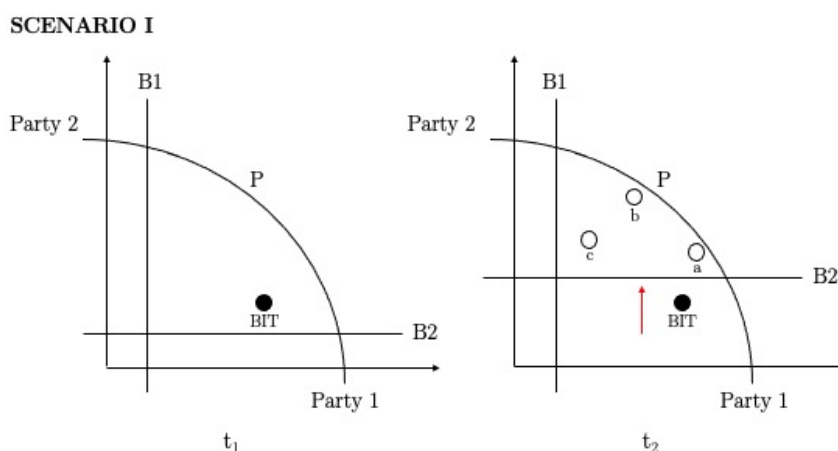


Figure 2.2: Scenario 1, Two-axis diagram with resistance points of negotiating parties under the assumption of perfect information and possibility frontier at two time points.

preferable. Because there is a limit to the extent to which a negotiated agreement can result in benefits for the parties, this limit is represented by a theoretical possibility frontier P . Any agreement northeast on the diagram implies absolute gains from the agreement; however, any point beyond P is unfeasible, perhaps for practical or technological reasons. A sustainable negotiated agreement must therefore lie in the space limited by $B1$, $B2$, and P . Assuming perfect information, the negotiated BIT falls within this space at time t_1 , because neither party would accept an agreement worse than their bottom line.

At t_2 , the bargaining power of Party 2 has improved, which is reflected by the shifting of $B2$ to north. This improved bargaining power through better alternatives to the existing BIT results in increased demands for the BIT in order for it to be preferable to a no-agreement outcome. The improvement has left the old BIT outside the space constrained by $B1$, $B2$, and P , making it unstable. Points a , b , and c represent new possible BITs that would be sustainable in light of the new $B2$, as well as $B1$ and P . The only option that would result in absolute gains for both Party 1 and Party 2 is a , while agreements b and c would benefit Party 2 but make Party 1 worse-off by redistributing some of the benefits it has enjoyed from the old BIT.

Assuming perfect information, improvement of at least one party's bargaining power can directly result in either withdrawal from or adjustment of the BIT.

When one of the parties improves their outside options substantively, abandoning the old treaty becomes favourable to keeping it, even if the other party continues benefitting from it. This logic of traditional bargaining models clearly illustrates how bargaining power changes upset the status quo of negotiated agreements.

Expectation: Under perfect information, a state is likely to withdraw or from or attempt to renegotiate its BITs following an improvement of its outside options to the BIT.

However, in the context of BITs where many states have been boundedly rational in their decision-making, or rational learning has taken place since the initial joining to the regime, it is important to relax the assumption of perfect information. Figures 2.3 and 2.4 show Scenarios 2 and 3, where one of the parties to the agreement experiences learning between the time points t_1 and t_2 .⁵⁵ The dashed B2 line at t_1 in both scenarios indicates Party 2's reservation point that it is not fully aware of: due to either imperfect information or boundedly rational reasoning, Party 2 cannot assess the strength of its outside options in relation to the BIT at t_1 . It does not have all the information available required to assess whether the BIT is preferable to its alternatives, and it is forced to decide based on the limited information available at the time. Alternatively, a boundedly rational state relies on mental short cuts, such as motivated reasoning when deciding to sign the BIT. For example, it might wishfully convince itself by observing other states signing BITs that the treaties are an excellent instrument for investment attraction or enhancing relations with the partner state. As result, it does not actively assess whether the related risks of ISDS are likely to outweigh the expected benefits. By t_2 , Party 2 has however learned about the dangers of ISDS. It updates its expectations in light of the new information or engages in assessment of its alternatives in relation to the agreement for the first time. This is indicated by the solid B2 line at t_2 .

Scenario 3 illustrates that states do not always prefer to terminate or renegotiate their BITs following rational learning or breaking of bounded rationality as a result

55. While learning can result from various different kinds of processes, here the focus is on the implications of learning which enable the state to more accurately assess its bargaining power position in relation to the existing agreement and its outside options.

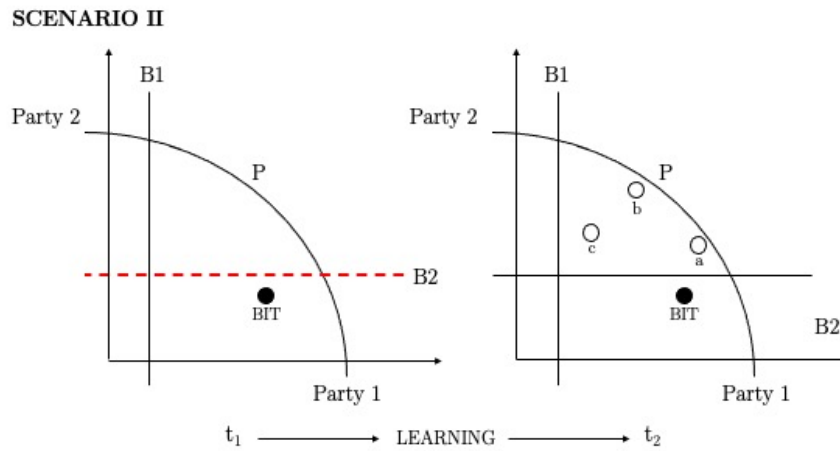


Figure 2.3: Scenario 2, Two-axis diagram with learning occurring between two time points and BIT outside the bargaining range

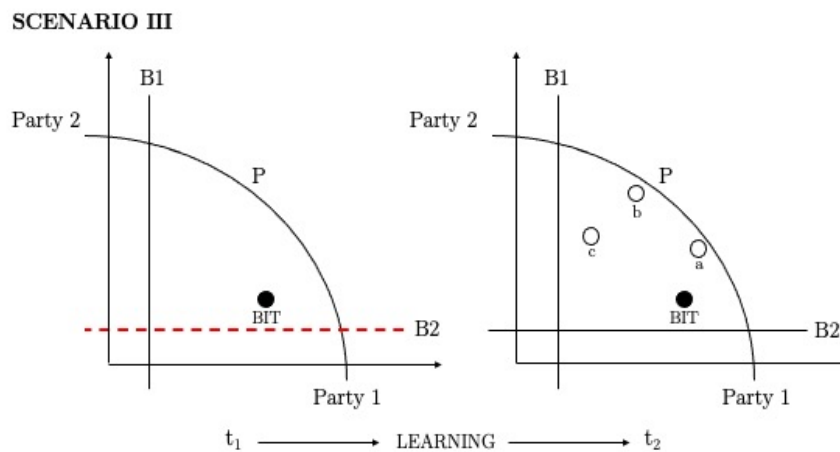


Figure 2.4: Scenario 3, Two-axis diagram with learning occurring between two time points and BIT inside the bargaining range

of facing ISDS. While learning effects may teach states about the true risks of BITs and break boundedly rational decision-making, whether learning is sufficient in explaining change in the agreement depends on the strength of their outside options at t_2 . In Scenario 2, after Party 2 experiences learning, it realizes that the BIT was always a bad deal: because the old BIT was and continues to be outside the acceptable space between $B1$, $B2$, and P , the BIT becomes unsustainable, and Party 2 will demand renegotiation of the agreement – or else withdraw from it completely.

In contrast, in Scenario 3, Party 2 realizes that the BIT has always been preferable to its outside options. Party 2 is still better-off by sticking with the specific agreement despite learning new information about the intricacies of BITs and the risks they entail. It is possible that states have signed BITs that would have been initially preferable even if they had perfect information at the time of first signing them.

Expectation: When learning occurs since initial BIT signature, a state is only likely to withdraw from or renegotiate its BITs if its outside options are stronger than the existing BIT.

Learning through ISDS experience therefore cannot explain why some states terminate or renegotiate their BIT without reference to the bargaining power of the treaty partner states. This is because after the incentives of the parties' change, the state enters the same bargaining dynamic as states under the assumption of perfect information: the decision to push back on existing BITs will depend on its alternatives to the BIT, and therefore its bargaining power.

2.3.3 Additional incentives

While ISDS experience and the resulting learning effects have been one of the most important events catalyzing change in the investment treaty regime, other developments may also have changed some states' attitudes towards their investment treaties. Changed perceptions about fairness in light of new economic realities, changes in governments and their ideological positions, and the emergence of civil society mobilization against especially ISDS have contributed to changing sentiments in some countries. Furthermore, reform efforts by different governments do not occur in isolation, but the ongoing international legal and political debates at international forums such as UNCTAD have been shaping the relevant narratives. Yet, every state needs to make its own decisions in light of its bargaining power position within the regime. This is why, despite the various different incentives for investment treaty reform, we observe various levels of action – as well as inaction – by members in the regime.

The world economy and the range of active participants in it looks very different today than even some decades ago. In 2007, developing economies attracted a record of nearly \$600 billion in foreign direct investment. However, much of this investment was concentrated in projects that could ensure adequate returns of investment for commensurate risks, raising doubts about FDI helping with the achievement of Millennium Development Goals.⁵⁶ There has also been a shift of attention from the economies in the West toward seeking growth potential in the East: as the Indian Prime Minister Narendra Modi noted at the Asian Infrastructure Investment Bank conference of 2018, “[n]ow the continent finds itself at the centre of global economic activity. . . It has become the main growth engine of the world. In fact, we are now living through what many have termed the Asian century.”⁵⁷ The sense of empowerment through the boost of economic status especially for many emerging economies has come hand-in-hand with perceptions of injustice and frustration over inadequate solutions for development challenges. As issues regarding investment treaties and ISDS have become increasingly salient, BITs and their reform has become part of a larger agenda to take control over economic development and actively shape these states’ position in the global economy.

Improved economic conditions in relation to traditional economic partners, or rapid economic growth, can result in greater resolve to pursue reform objectives, and also perceptions that better alternatives to old, outdated investment treaties are achievable. As a legal advisor to the Indonesian government regarding the change in perceptions towards international investment protections notes,

And why has [Indonesia] changed its position? . . . [B]ecause it has convinced itself that foreign investors need Indonesia more than Indonesia needs foreign investors. And so, it believes that it does not have to offer protections, in particular international arbitration, to foreign investors. . . ⁵⁸

Improved economic position in relation to other economies can influence not only a government’s perceptions over the fairness of the existing terms of economic

56. World Investment Report 2008.

57. Wang 2021.

58. Interview I005.

cooperation, but also about dependency on the existing arrangements. In turn, these perceptions translate to bargaining power when a government believes better alternatives are realistically achievable. Like the concrete improvement of alternatives, change in relative economic position does not automatically translate into action regarding BITs. However, when combined with learning effects or emergence of other pressing developments, improved relative economic position can motivate such states to take firm action to withdraw or demand renegotiation of their investment treaties.

Expectation: A state that has improved its economic conditions in relation to BIT partners is likely to withdraw from or renegotiate its BITs when also facing changes in its incentives towards existing BITs.

Non-economic developments in the domestic politics of states are also likely to influence the economic relations agenda. Shifts in ideology of the ruling coalition have had an impact in attitudes especially in Latin America, where the so-called pink tide resulted in several governments to take a turn towards a leftist foreign economic policy agenda in the early 21st century. A state with newly emerged leftist leadership may consider BITs as inherently opposing their political ideals and are likely to view unilateral termination as inherently valuable in pursuit of their political goals. However, as the approach of the Kirchner governments in Argentina to not terminate any BITs despite some of the enormous ISDS cases shows, simple leftist ideology of a ruling coalition does not necessarily determine BIT-policy.⁵⁹ The role played by civil society movements and activism together with the ideological lenses worn by decisionmakers at critical junctures are more likely to explain some of the specific choices made by such governments.⁶⁰

There have also been multilateral efforts to unify the fragmented investment treaty regime. The European Union has initiated efforts to bring consistency and transparency in the arbitral process: their proposals range from establishing codes of conduct and advisory bodies for smaller economies to complement the system, to the more ambitious initiative to establish a Multilateral Investment Court.⁶¹

59. Calvert 2018.

60. Montal 2019.

61. Hallak 2020.

Many individual member states have now begun to refer their investment treaty policies back to these multilateral efforts, simply stating that they back up the EU's common efforts towards reform. Interestingly, these efforts are yet to have resulted in member states from terminating their BITs with non-EU countries. Even in the case of member states that themselves have become concerned with the implications of ISDS, the prospects of mutual termination or renegotiation with equally concerned partners have not been promising. This is because in relation to certain non-EU partners, EU states and their investors continue to benefit from having the asymmetric BITs in place. This suggests that despite the broader ambitions towards multilateral comprehensive reform, bilateral bargaining power relations continue to influence the decisions taken with individual partners.

The next section outlines how the importance of specific bilateral partnerships is vital for assessing whether or not renegotiation of BITs is likely to take place. Furthermore, it can help to assess which BITs are most likely to simply get terminated, and which lend themselves to strategic exit.

2.4 Partner importance, renegotiation, and strategic exit

Both withdrawal from and renegotiation of BITs are manifestations of a situation where at least one signatory state has become dissatisfied with the existing terms. For either one to take place, the state desiring change in its investment treaty commitments – the revisionist state – must have sufficiently strong alternatives to the BIT or confidence that they can be achieved. However, revisionist states can either exit from BITs, or successfully renegotiate their terms. Whether or not renegotiation is possible will depend on the bilateral relationship between the revisionist state and a status quo state, who in turn does not have incentives to adjust the existing agreement. The likely outcome, exit from or renegotiation of the BIT, will depend on how important these states consider their economic partnership.

Partner importance in BIT negotiations is largely determined by how profitable an economic partnership is likely to be in the future. A state which hosts many

existing or prospective investors is likely to be more attractive as a BIT partner than a state with whom there is little economic activity. Because governments do not consider their investment treaties in isolation from other commercial arrangements, attractive opportunities for market access also factor into the perceived importance of partner states.

However, the diplomatic elements of investment treaty politics cannot be underestimated when analyzing their survival or withdrawals from them. As the origins of the BIT regime show, rather than considering the detailed functions of investment treaties and conducting a cost-benefit analysis on each of them, economic agreements are often formed with some states for the purposes of general diplomacy. As a negotiator noted, “the main problem is which country we decide to be treaty partners with. . . the investment treaty [itself] is neutral.”⁶² The impression that multiple, sometimes even overlapping agreements with investment provisions with politically important partners are desirable continues to influence decisions in relation to BITs. As the states have learned about the true risks of ISDS, they have however become more careful in assessing the likely benefits of each treaty. Because it is one thing to sign a BIT, but another to exit one, I assume that the importance of an existing BIT partner is primarily determined in economic terms.

Once a revisionist state with improved alternatives is in the sufficient bargaining position and has developed the incentives to initiate BIT reform, whether or not attempting renegotiation of the treaty terms is feasible or even desirable will depend on how important the partner states view each other. Historically, states often signed BITs with as many partners as possible, in the hopes that cooperative benefits would emerge at little cost. As some of these promises have never materialized, BITs continue to exist between partners that have very little commercial activity between them.⁶³ Termination of such investment agreements is relatively uncontroversial for a state intending to limit its ISDS exposure, and renegotiation of such BIT is

62. Interview I002.

63. For example, there are currently no plans to replace the Indonesia-Argentina BIT that got terminated in 2016, due to the insignificant levels of investment between the two countries. Interview I001.

very unlikely due to the inevitable costs renegotiation entails (Section 2.1) Both partners that do not consider each other important have very little to lose from the collapse of the agreement, and the costs of negative signaling at least to the partner are likewise small.⁶⁴ Revisionist state is therefore likely to exit from BITs with unimportant partners.

Equally intuitive is the instance of renegotiation of an agreement between two very close economic partners when one of the states is dissatisfied with the existing treaty. Close economic partners are usually sensitive to changes in each other's preferences: if a close partner expresses dissatisfaction with the terms of a cooperative arrangement, it is in the interests of the partner to reciprocate any calls to adjust these terms. This is because both parties have a lot to lose if the agreement were to get terminated: if the calls for renegotiation by a revisionist state are not met by the partner, exit from the agreement becomes the dominant strategy for the dissatisfied party, leading to the collapse of the mutually beneficial agreement. The barriers to communication are also likely to be lower in the case of close partnerships. Due to the long-term cooperative relationship, both parties have incentives to maintain cooperative strategies,⁶⁵ and interactions tend to be frequent also outside of the specific issue area. There are also additional diplomatic benefits of successful renegotiations, as they can strengthen the cooperative partnership even further.

The revisionist party will therefore assess the importance of the partner as well as the likely success of an attempt to renegotiate before deciding to adopt such an approach. When the partnership is not symmetric, and one of the partners values the partnership more than the other, strategic elements become more obvious in the interaction. If a revisionist state does not consider a BIT partner very important, but the partner does value partnership with the revisionist state, there would certainly be room for renegotiation. However, from the perspective of the revisionist state, BITs with unimportant partners carry the costs of keeping old

64. Analytically, such agreements may never have had a feasible bargaining range to begin with. Hence, there are no cooperative benefits to be gained from renegotiation, independent of possible costs of ISDS and limited state regulatory freedom.

65. Friedman 1971; Wagner 1983.

treaties in place but result in little benefits. Even if the partner may consider the revisionist state important and might therefore be willing to give large concessions in renegotiations, there are few benefits for the revisionist state from doing so. Given the inevitable renegotiation costs, the revisionist state is likely to exit from BITs with unimportant partners.

In the case where the revisionist state would like to renegotiate an agreement with an important partner, but the relationship is asymmetric because the partner does not consider the revisionist state important in return, a different strategy may become attractive – a *strategic exit*. Because of the improved alternatives, the revisionist state is in a better position to cope with the costs of exit. However, cooperative benefits still exist, but they favor the status quo state that continues to enjoy the benefits from the unbalanced old agreement. Because the status quo state does not value the partnership as highly as the revisionist state, it is less sensitive to attempts to communicate any change in preferences of the partner, leaving the revisionist state to struggle to signal credibly its exit threat from the BIT. Even though it would be in the interest of the status quo state to give concessions to preserve the cooperative agreement, it will not believe that the partner will walk away from the agreement absent renegotiation.⁶⁶ Therefore, the status quo state has little incentive to spend resources on communicating and attempting to renegotiate with an unimportant partner.

The asymmetric situation therefore leads the revisionist state to believe that appeals to renegotiate will not be met, unless it can successfully signal a credible exit threat. Strategic exit from the BIT with the intention to negotiate a new agreement at a later stage may work as a costly signal for the revisionist state. The strategy provides a way to credibly signal its improved bargaining power position, and force the partner to give concessions in fresh negotiations if it wishes to preserve the agreement. Therefore, if some cooperative benefits continue to exist from having

66. The dynamic of strategic exit emerges due to incomplete information that characterizes interactions in the BIT regime. Especially the initially stronger states are most of the time not aware of the exact bargaining power position of the initially weaker states, resulting in the information problem.

Table 2.2: Expected outcomes of BITs between a revisionist and a status quo state by how important each considers the partner state

		Status quo state		
		Partner importance		
Revisionist state	Partner importance	<u>Low</u>	<u>High</u>	
		<u>Low</u>	Exit	Exit
		<u>High</u>	Strategic exit	Renegotiation

the agreement in place, even the status quo state will be better off by negotiating a new agreement following strategic exit.

Strategic exit therefore has two advantages for a revisionist state: first, it gets rid of the unbalanced existing agreement, and while sunset clauses are likely to apply following exit through unilateral termination, new investors are excluded from access to ISDS. Second, strategic exit works as a costly signal, effectively communicating both the determination to do away with the unsatisfactory agreement as well as the improved bargaining position of the revisionist state. A state would not be expected to exit from a BIT if it wasn't confident that it is no longer dependent on the agreement, and not afraid to go-it-alone. Table 2.2 summarizes these expected outcomes of the existing BIT between a revisionist and a status quo state based on how important each perceives the partner.

In practice, exit can be mixed with motives of strategic exit, and the two are difficult to distinguish between the two empirically. This is because existing agreements are sticky and adjusting their terms is difficult, especially for countries that traditionally have been in the weaker position in economic negotiations. Often, the only realistic opportunity for developing countries to initiate reform in the investment treaty regime is to withdraw even if the preference would be to renegotiate. In the position of a country such as “Indonesia or India... you terminate, you get rid of it. And then you start negotiating a different model.”⁶⁷ But before strategic exit becomes a realistic option, by definition the state must also be able to withstand the costs associated with exit. The clearest distinction between the

67. Interview E003.

two stems from whether or not bargaining power comes from alternatives already in place, or merely confidence that they can be achieved.

2.5 Conclusion

The argument of this thesis is that all states' decision-making in relation to whether to withdraw or attempt renegotiating their existing BITs is constrained by their bargaining power, as defined by their alternatives to existing BITs. Bargaining power influences all governments regardless of the reasons for joining the international investment treaty regime in the first place; the kind of learning that may have occurred since signing BITs; and the kinds of incentives that may be driving the desire to adjust the terms of international economic cooperation. Bargaining power is best understood as outside options to BITs, as they determine how costly or attractive efforts to abandon the existing agreement are likely to be. Efforts such as alternative legal protections for foreign investors and additional ways to attract FDI mitigate the costs associated with unilateral termination, and economic power can work as a useful proxy for such alternatives. Improved alternatives therefore result in lifting of bargaining power constraints on states decision-making to take action to withdraw from the regime, or successfully renegotiate with close partners.

Experience of facing ISDS claims can play a crucial role in generating learning effects in the BIT regime and catalyze states to react to their improved bargaining power. Rational learning can result when states realize some of the unexpected consequences BITs have had, such as the scope of indirect expropriation and treaty shopping by domestic investors through foreign partners. Boundedly rational learning can also occur when an ISDS claim forces states to carefully assess the costs and benefits of BITs for the first time, rather than relying on the previously dominant cognitive biases of decision-making. However, learning effects alone cannot explain the action – and inaction – regarding BITs, because every state will consider its alternatives to the existing agreement at the time reform is considered. The same is true for other developments which can change states incentives in relation to BITs. While domestic political developments or multilateral efforts may

encourage investment treaty reform and the abandonment of existing practices, the concrete steps to change treaty commitments are not well explained by the emergence of such incentives alone.

The role of economic power relations between BIT partner states is not only important for explaining the likely sources of dissatisfaction with existing agreements, but also how revisionist states perceive their potential to develop their alternatives to BITs. States which have grown stronger economically are more likely not only perceive existing agreements, negotiated in a weaker position, as unjust, but also their own capabilities to seek better alternatives outside the regime. When combined with ISDS claims or other events that provide incentives for BIT reform, such perceptions of economic empowerment make revisionist states more likely to withdraw from BITs or press for their renegotiation.

Whether or not exit from or renegotiation of specific BITs takes place is also likely to depend on the specific bilateral relationship in question. While termination of BITs between states who do not perceive each other as important are largely costless and inconsequential, BITs are likely to get renegotiated in mutually important partnerships. If a revisionist state does not feel that the partnership is important enough, there are few incentives to spend resources on renegotiation efforts, even if the BIT partner might be willing to give concessions. However, strategic exit may become an attractive strategy for a revisionist state even if it considers the partner important: this is because in asymmetric partnerships where the status quo state does not consider the revisionist state particularly important, any renegotiation efforts are unlikely to be met productively. In such a scenario, strategic exit can enable the revisionist state to signal improved alternatives and potentially push for a new agreement at a later stage.

This theoretical framework makes two important contributions. First, bargaining power as alternatives can explain why some states do not take action to withdraw from or renegotiate investment treaties, despite seemingly obvious incentives to do so. Second, the framework explains why sometimes withdrawals from international regimes occur even when states might have a preference to merely adjust the

relevant terms of cooperation. Impact of bilateral bargaining power relations, which previously have only been considered a background factor to be controlled-for in any examination of BITs, can help to explain states decisions of when and how to initiate change in the investment treaty regime.

3

Cross-national evidence

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This chapter examines the cross-national data on BITs and the signatory states' characteristics. The goal is to test the expectations stemming from the theory on how changes in bargaining power impact the likelihood of investment treaties being terminated or renegotiated. I provide evidence that improvement in signatory states' alternatives to BITs, approximated by a set of measures, corresponds to increased risk of BITs getting terminated or renegotiated. The results support the expectation that states that have developed stronger alternatives for investment attraction and governance become able to reform investment treaties. Furthermore, I illustrate that bargaining power measures, such as changes in economic power, condition the effects of ISDS cases on BIT outcomes. States are increasingly likely to act to terminate or renegotiate BITs when incentives to push for change coincide with a favorable bargaining power position in relation to the partner state.

My empirical analysis contributes to the existing line of inquiry into the systematic study of BIT formation, design, and recently, their outcomes. Past research has examined how characteristics of signatory states influence design features and preference attainment in their BITs.¹ In contrast, I examine the simple instance of treaty terminations and renegotiations, while remaining largely agnostic to the features included in BITs. Past research and interview evidence suggests that many decisions regarding investment treaties are highly political and have little to do with their specific features.² Even when governments have actively inspected if it could be possible to only terminate some BITs and keep others, for example those without the notorious ISDS clauses, they have generally concluded that selective withdrawal is simply not possible for legal and political reasons.³

Furthermore, while there are differences in the exact contents of different BITs, the most favored nation (MFN) clauses included in some BITs have enabled extension of the terms of some agreements into arbitration cases initiated based on other investment instruments.⁴ Examination of political and economic attributes that influence changes in the regime structures specifically can therefore provide valuable insights into how governments engage in treaty-politics. Past research has also accounted for bargaining power between states when examining renegotiation of BITs by including the economic gap between treaty partners into empirical models as a control variable.⁵ What remains unexplored is whether the bargaining power of signatory states can condition the learning effects from ISDS and other events turning states against the regime. The examination of the interaction effects between ISDS experience and bargaining power constrains provide a novel contribution to the study of BIT reform, bringing more nuance to the ISDS-centric empirical literature on the investment treaty regime. I find that multiple interaction effects between bargaining power and ISDS experience exist when predicting BIT outcomes.

1. Allee and Peinhardt 2010, 2014 (for a critical review, see Yackee 2013); Berge and Stiansen 2016.

2. Interview I002; Interview I005.

3. Interview E004; Interview E008; Interview E010.

4. Greenwood 2015.

5. Haftel and Thompson 2018.

I first introduce the data employed from the UNCTAD Investment Agreements Navigator, as well as my coding of the two state parties that are signatories to each BIT. I systematically rank the signatory states according to their relative bargaining power strength in the bilateral negotiations. I do this by leveraging data on their capital exports, membership in international organizations, and economic power the year of BIT signature. The ordering of signatory states enables the examination of the bargaining dynamics within the state-dyads, and whether there are systematic differences between the effects relating to the stronger and weaker parties. It also allows the investigation of whether changes in the bilateral economic power dynamic between partners has heterogeneous effects by levels of incentives for reform of each party. I find that the variables that capture characteristics of the weaker party correspond more systematically to different BIT outcomes than those of the stronger party. This suggests that the states that did not have the upper hand in negotiations initially are likely to be the ones driving change in the BIT regime.

Second, I introduce the key measures employed to capture bargaining power and learning. Bargaining power is first approximated through economic power as an over-time and relational change between the treaty partners. In the first instance, improvement in economic conditions since BIT signature for each state can approximate the improvement of their outside options. Furthermore, the change in the gross domestic product (GDP) ratio between the states can install greater confidence to reformist states about their capabilities to develop alternatives. Both types of economic power change since initial treaty signature therefore approximate the development of higher demands of states for their bilateral agreements. The two GDP-based measures are employed as proxies for capturing bargaining power in relation to BITs overtime, in the absence of comprehensive bilateral FDI flows data. In addition, I employ national-level measures such as economic growth rates, law and order, investment risk profile of the state in the eyes of foreign investors, and FTAs the state has with the BIT partner to capture other kinds of alternatives to their investment treaties. To capture states learning effects driving BIT reform, I employ data on ISDS experience the states have accumulated, as well as global instances of

ISDS cases. I also account for the possibility that states learn from other states that have withdrawn from the regime, and hence are more likely to imitate their approach.

I test the extent to which BITs are in a higher risk to get terminated or renegotiated as a response to changes in states bargaining power and learning. I show that changes in signatory states' economic power, both over time and in relation to the treaty partner, correspond to increased risk of BIT termination or renegotiation. I also show that other non-economic characteristics systematically influence outcomes of investment treaties. Furthermore, different bargaining power measures amplify the effects of ISDS experience, as states become more likely to terminate and renegotiate their BITs following ISDS suits when they also have strong alternatives. It is specifically the weaker states in each bilateral partnership that find their reform efforts constrained by their bargaining power. The analysis contributes to the literature exploring the effects of investor-state arbitration on the investment treaty regime by highlighting that the effects of ISDS depend on economic and strategic considerations, that characterize the bilateral partnership.

The rest of the chapter is structured as follows. In Section 3.1, I describe the employed data and how I order the two signatory states in each BIT based on their underlying bargaining power relationship. Section 3.2 outlines the measures employed for BIT outcomes, bargaining power, learning effects, as well as controls, and Section 3.3 introduces the empirical design used for the analysis. In Section 3.4, I report results of the analysis, first focusing on independent effects of different variables on BIT outcomes before turning to examine interaction effects between bargaining power variables and learning from ISDS experience. Section 3.5 concludes.

3.1 Data and coding

I employ data on BITs from the UNCTAD Investment Agreements Navigator, which reports publicly known BITs that have been recorded on government websites.⁶ The database reports which BITs are in the process of being negotiated, or have been signed, entered into force, or terminated. Because UNCTAD conducts continuous

6. UNCTAD International Investment Agreements Navigator 2020.

updating of the database, the collected data on the status of BITs represents a snapshot in time. Additional coding is conducted with regards to the outcome of BITs and the timing of the changes. A BIT is reported as terminated by UNCTAD if it has been replaced by a new agreement, unilaterally denounced, terminated by consent, or expired. In addition to these outcomes, I code when a BIT is amended, as reported in the database by inclusion of Amendment Protocols.⁷ Although the same BIT technically continues to be in force, an amendment of the agreement constitutes an important instance of renegotiation of its terms and should be considered as an outcome of interest. In addition, sometimes BITs get replaced by, or continue to co-exist with, a different type of investment agreement, such as a free trade agreement with an investment chapter. I code such instances as renegotiations because, like amendments, they require the parties to agree on new rules regarding investment governance.

With regards to dates of termination and renegotiation, I also make some adjustments to the publicly available data. For the purposes of examining the effect of changes in incentives and bargaining power on treaty outcomes, it is important to capture the year at which these changes take place. UNCTAD reports the termination date as the date at which the old BIT was no longer in force. Instead, for renegotiated and amended agreements, I code the date when the new agreement or amendment was signed as the date of renegotiation, as this measure better captures when the renegotiation between the parties took place. The exact timing of a decision to unilaterally terminate is harder to determine: most BITs include termination provisions with a notice period, commonly 6-12 months, after which the effective termination takes force.⁸ Furthermore, sometimes the states themselves are unsure how to exactly execute the termination of BITs, possibly resulting in delays in when the termination decision translates into the act of

7. These protocols usually involve an exchange of letters of transmittal and submittal, such as for the amendment of the US-Panama BIT (1982) in 2000, or a joint amendment agreement, such as the amendment of the Israel-Poland BIT (1991) in 1997.

8. Bernasconi-Osterwalder et al. 2020.

termination.⁹ While the exact timing of specific decisions to terminate are better traced in specific cases through qualitative evidence, the effective termination date falls within the same year as the publicized announcement to terminate for a majority of the terminations of BITs that were reported in the media. Therefore, the timing of unilateral denunciation is coded as the date at which the BIT ceased to be in force as reported by UNCTAD.

For the specifications that examine the decisions to keep or change existing BITs, I restrict the dataset to those BITs that have entered into force. This is because the theory under testing specifically addresses the decisions in relation to treaties that have the power of international law, with the associated costs (Table 2.1). I also exclude 11 BITs that have expired from the analysis. While allowing the expiration of BITs can be a conscious choice by participants to withdraw from the regime, the exact timing of expiration of a BIT is likely to be largely unrelated to events that cause changes in most BITs, due to many agreements having typically been negotiated many decades earlier. Furthermore, I exclude 23 BITs which have been terminated by consent from the sample. These mutual terminations are akin to renegotiation of BITs in that agreement between the parties must be reached for it to take place; however, these few instances are likely to have different determinants than successful renegotiations, which are largely unaddressed by the theory. However, I also include expired and mutually terminated BITs as a robustness check.¹⁰ The results remain largely unchanged.

To leverage over-time changes in BITs' status, I convert the data into panel format, where the unit of analysis is the treaty-year, embedded in the country-dyad of signatory states. This means that different BITs may belong to the same dyad-cluster.¹¹ Each treaty is observed from the year it entered into force either

9. For example, according to an interviewee, despite having announced the termination of a set of BITs publicly, the Ecuadorian government failed to deliver formal notification to the partner states of this decision, delaying the effective termination date. Interview E001.

10. Results from analysis including expired and mutually terminated BITs can be found in the Appendix A.1 and A.2.

11. For example, both the Indonesia-Netherlands BIT (1968) and the succeeding Indonesia-Netherlands BIT (1994) are included in the dataset as separate agreements, clustered in the Indonesia-Netherlands dyad.

until 2019, or the year it was unilaterally terminated or renegotiated, whichever came earlier. The BIT years included therefore range from 1963, when the first BIT between Cameroon and Germany entered into force, to the newest ones in 2019. The final dataset includes 51,409 treaty-years, associated to 2,604 unique BITs across 2,463 country-dyads. I obtain several covariates from other cross-national datasets. Data on investment disputes is from the UNCTAD Investment Dispute Navigator; the economic covariates come from the World Development Indicators; and the variables capturing domestic conditions relevant for foreign investors are from the PRS Group's International Country Risk Guide.¹² Some additional variables are acquired from World Economics and Politics (WEP) Dataverse, Variates of Democracy (V-Dem) Project, Quality of Government Dataset (QOG), and Database on Political Institutions (DPI).¹³

Stronger and weaker party

To obtain insights from the bilateral bargaining power dynamics between the partner states, I identify which of the BIT signatory parties was likely to be in a stronger bargaining power position when the agreement was negotiated.¹⁴ Because initial power asymmetries between states were likely to shape bilateral negotiations, changes in these power relations are of interest when estimating their durability. Dyadic FDI data would give an appropriate indication of dependence in capital flows between the two parties; unfortunately, the data is not available for most early BIT-years and most dyads.¹⁵ Therefore, I rely on a set of alternative coding rules based on the available data to define the initially stronger and weaker party in the initial bargaining process.

12. UNCTAD Investment Dispute Settlement Navigator 2020; World Development Indicators 2020; PRS Group Methodology 2020.

13. Graham et al. 2018; Coppedge et al. 2019; Theorell et al. 2020; Cruz, Keefer, and Scartascini 2018.

14. Ordering of BIT partners based on bargaining strength was first conducted by Allee and Peinhardt 2010

15. While data on bilateral FDI flows are available from the OECD and the IMF World Investment survey, even when combined, the resulting dataset results in over 90% non-random missingness. Cross-national reporting standards are also notoriously inconsistent, and the best data is available for OECD members only. This special subset of members in the BIT regime however misses out on the most important dynamics between major capital exporters and importers.

The primary coding rule identifies the party with the larger net outflows of FDI in the year of BIT signature as stronger, while the country with smaller exports is weaker.¹⁶ The rule captures a dynamic whereby on average, the larger exporters of capital in the dyad are attractive partners for a relatively larger pools of states. Therefore, they have more opportunities for alternative investment treaties and are less dependent on the BIT under negotiation.¹⁷ In addition, to account for the fact that some states had privileged access to institutional and technical knowledge regarding international negotiations and economic issues, I adopt an additional coding rule: when one of the parties in a dyad is a member of the OECD on the year the BIT was signed while the other one is not, they are coded as the stronger party. By virtue of their membership in the organization, these states were likely to have the upper hand in BIT negotiations. 90% of the dyads in the dataset can be ordered according to these two coding rules. To include additional dyads where both states are or are not OECD members and FDI export data is not available, the party with higher GDP per capita is coded as the stronger party. Finally, if none of the rules are sufficient in ordering the dyad, if one of the states was a member state of the EU in the year of BIT signature while the other was not, the former is coded as the stronger party.

3.2 Variables and measures

Outcome

The primary outcome of interest in the analysis is whether and when states act to reform their investment treaties. According to the theory, bargaining power through strong alternatives is required for a change in BITs to occur, whether it be unilateral termination or successful renegotiation. To test the determinants of reform initiation, these outcomes are therefore combined into one main variable: the

16. Data reported by the World Bank measures FDI net outflows as the Balance of Payments, in current US dollars.

17. While certain capital importers can obtain bargaining power because of their position as attractive destination for investors, their alternatives are likely to have been fewer due to the larger number of states desiring to attract capital for the purposes of development in comparison to those looking to invest.

outcome variable *Deviation* is binary, capturing whether the BIT is renegotiated, amended, or unilaterally terminated in the year of observation. The outcome therefore captures when an existing BIT deviates from the status quo of remaining in force. Out of 51,409 treaty-years in the data, there are a total of 367 instances of deviation, of which 152 are unilateral terminations and 215 are renegotiations. Because it is possible that the reasons for termination might differ from those for renegotiation, I also test whether the same set of predictors can explain the instance of *Unilateral termination* and *Renegotiation* separately, which are binary variables capturing each type of event in the year of observation. Due to the rarity of the instances of different types of deviation in the data, the results where outcome is split by event type are however interpreted with caution.

Bargaining Power

To capture the impact of bargaining power on BIT outcomes, I employ a set of variables that proxy states' bargaining power across time. First, I use over-time and relative changes in states' economic power. The larger the improvement in the economy of a signatory state since the initial treaty was negotiated, the stronger its alternatives to old BITs have become. *Power change* captures the change in log GDP experienced by a signatory state since the year the BIT was signed, measured separately for both parties.¹⁸

In addition, I explore the impact of the relative change in power dynamics between treaty partners. As the relative economic power relations between partner states change, so do the likely alternatives and confidence to pursue them for the state that catches up with the partner. On the contrary, the state that has experienced a relative decline in its economic power has a strong incentive to keep the existing agreement, because it negotiated it in a stronger position. I would therefore expect narrowing economic power gap to be associated with increased risk of BIT getting terminated or renegotiated. *Relative power change* therefore captures the difference in the signatory states' log GDP compared to what it was

18. Where variables are included separately for the two states, numbers 1 and 2 after variable name indicate the stronger state and weaker state respectively.

in the year of BIT signature. Declining values of the measure indicate a reduction in the economic gap between the parties, either due to the initially weaker party having caught up, or the stronger party having declined in relative terms.¹⁹ I also include *Economic growth* of each state to capture the annual GDP percent growth rates. Since higher economic growth rates are likely to instill the government with confidence about the country's economic prospects, and potentially even attract further inward investment, growth rates are a good proxy for alternatives to BITs. Higher economic growth rates can therefore be expected to correspond to increased risk of BIT deviation.

In addition to the economic measures approximating stronger alternatives, I also investigate the association between measures of institutional guarantees for foreign investors that can provide alternatives to BITs in each signatory state, and BIT outcomes. If BITs are considered as additional legal guarantees for foreign investors in regimes where they do not trust domestic legal institutions to protect their rights, states with stronger legal institutions might naturally rely less on BITs for such purposes. The *Law and order* variable comes from the PRS Group's researcher dataset, and it is measured on a six-point scale where higher values indicate stronger rule of law in a given signatory country.

To investigate the possibility that states that are otherwise attractive to foreign investors may be less dependent on their BITs for attracting FDI, I also include the variable *Investment profile*, which captures investment conditions for foreign investors on a 12-point scale.²⁰ Finally, I also consider *FTAs in force*, a count variable indicating how many preferential trade agreements states in the dyad have in force in a given year. FTAs can provide an alternative means to foster treaty-based economic partnerships, and therefore provide an alternative for fulfilling some of the purposes of BITs.

19. Substantively, one unit decrease in relative power change is equivalent to the stronger party having had 10 times the GDP of the weaker party on the year of BIT signature and ending with equal economic power in the year of observation.

20. Construction of the variables and their individual components are described in the International Country Risk Guide (ICRG methodology). PRS Group Methodology 2020.

Learning

Other variables included in the models aim to capture changes in states incentives towards the investment regime. To investigate the impact of learning through ISDS experience, I include a *ISDS respondent* variable for each state, which captures the number of cumulative ISDS cases brought against them. I include ISDS cases that were based on BITs as well as other instruments with ISDS provisions, as legal challenges by foreign investors are likely to result in the hypothesized learning effects regarding the investment treaty regime, regardless of which instrument was used to bring the suit.²¹ It is also possible that states already experience learning effects regarding their existing BITs after facing just one claim by foreign investors. Therefore, I also include a *ISDS respondent any* variable, which takes the value of 1 if the state has been a respondent in at least one dispute settlement case.

It is also possible that states learn from other countries ISDS experiences as well as their own, for example from media reporting or directly interacting with affected governments. Therefore, I also examine the association between BIT outcomes and *ISDS total*, a variable that captures the total number of ISDS cases reported by UNCTAD each year. Finally, governments communicate closely with each other regarding approaches to investment treaty reform. When worldwide unilateral terminations accumulate, states may learn from others' experience of withdrawing from the regime, and hence become more likely to imitate. Therefore, I include *Uni. termination total*, a measure of the total number of unilaterally terminated BITs globally in the year of observation.

Controls

I account for various domestic political factors which may influence investment treaty politics. Many governments especially in Latin America have taken action to withdraw from their BITs for ideological reasons following transition from center-right governments to more leftist and social-democratic ruling coalitions. *Left*

21. For example, some of the common non-BIT instruments evoked in ISDS cases are NAFTA and the Energy Charter Treaty.

executive is a binary variable capturing whether the executive of the country is labelled as communist, socialist, social democratic or left-wing in the Database of Political Institutions.²² It is also possible that some countries are more sensitive to the negative effects that have resulted from the rights granted to foreign investors under BITs: democratic states, for instance, are likely to be more sensitive to concerns across their electorate regarding for example public health or environmental protection. This possibility is accounted for by the inclusion of the variable *Democracy*, which is a combined average of Freedom House and Polity 2 democracy measures, with imputed missing values from the Quality of Government dataset.²³

Likewise, governments in regimes which are sensitive to citizen activism are more likely to initiate reform of BITs, as various civil society movements and NGOs have been the most vocal opponents to the current ISDS practice. I therefore account for *Democratic accountability*, which is a variable provided in the PRS dataset on a six-point scale, with higher values corresponding to greater accountability. Finally, I include a variable on *Socioeconomic conditions*: it is possible that overall living conditions in a country are associated with more vocal opposition to ISDS practices, and hence to increased chances of BIT reform.

Furthermore, I control for *Bureaucratic quality* in each signatory state, as states with more efficient bureaucracies may find it easier to execute reform of international legal commitments. Likewise, I control for the level of *Corruption* in each state, as it can influence how tolerant governments are toward legal challenges brought by foreign investors. I also include a variable for Government stability to account for the possibility that governments may engage in short-term planning if their political survival is uncertain, and hence make decisions without regard for wider medium and long-term societal consequences of their investment treaty engagements.

Finally, a recent ruling by the Court of Justice of the European Union on the Slovak Republic v. Achmea B.V. case concluded that the provisions in the Netherlands – Slovakia BIT (1991) had an adverse effect on the autonomy of EU law,

22. Cruz, Keefer, and Scartascini 2018.

23. Theorell et al. 2020.

and hence the treaty was to be considered incompatible with European legislation. Since many BITs include similar provisions, it is likely that all intra-EU BITs will eventually get terminated. While the Achmea ruling is a relatively recent development, it is possible that some of the latest terminations in the dataset may have been a result of this decision. I therefore control for the variable *Intra-EU*, which is coded as 1 if both parties are EU members. Because it is likely that governments react with a delay to changes in their conditions, and to address concerns of endogeneity in estimation, I include a two-year lag of all independent variables. Table 3.2 presents the summary statistics of all included variables.

3.3 Design

I study the relationship between bargaining power and BIT outcomes in two steps. First, I investigate the independent effects of different state- and dyad-level variables on BIT outcomes. Second, I examine the interaction effects between the bargaining power variables and states' ISDS experience: according to the theory, states are more likely to terminate or renegotiate their investment treaties after facing ISDS cases with foreign investors if they also have strong alternatives to the existing BITs. I therefore expect variables that capture such alternatives to amplify the effect ISDS experience on BIT termination and renegotiation.

Since the primary interest of the analysis is to examine explicitly the time it takes for an event to occur – in this case BIT termination or renegotiation – I estimate a Cox Proportional Hazard model. The Cox PH model is also suitable for coping with the rare instance of deviations from BITs, as most investment treaties continue to remain in force unchanged. The model enables the estimation of hazard ratios, which show the difference made by an increase in the predictor variables to the underlying base-line hazard for a BIT to deviate. To help the interpretation of interaction effects in the second step models, I also estimate a linear probability model (LPM) with fixed effects for each year. Because the linear estimation is sensitive to extreme values of the predictor variables, and the introduction of fixed effects reduces the overall variance leveraged for estimation, the results of the

Table 3.1: Variables and measures

Variable	Description	Source
Outcome		
Deviation	Binary: BIT uni. term. or renegotiated	UNCTAD
Unilateral termination	Binary: BIT uni. term.	UNCTAD
Renegotiation	Binary: BIT renegotiated	UNCTAD
Bargaining power		
Power change 1/2	Change in GDP since BIT sign.	WDI
Relative power change	Change in GDP gap between parties since BIT sign.	WDI
Economic growth 1/2	GDP % growth	WDI
Law and order 1/2	Score 0-6, higher values corresp. stronger performance	PRS
Investment profile 1/2	Score 0-12, higher values corresp. stronger performance	PRS
FTAs in force	No. FTAs in force between parties	WEP
Learning		
ISDS respondent 1/2	Cumulative no. of ISDS cases as respondent	UNCTAD
ISDS respondent any 1/2	Binary: state has been ISDS respondent >0 times	UNCTAD
ISDS total	No. of ISDS cases globally	UNCTAD
Uni. termination total	No. of uni. terminations globally	UNCTAD
Controls		
Left executive 1/2	Binary: leftist government in power	PRS
Democracy 1/2	Level of democracy (Freedom House/Imputed Polity)	QoG
Democratic accountability 1/2	Score 0-6, higher values corresp. stronger performance	PRS
Socioeconomic conditions 1/2	Score 0-12, higher values corresp. stronger performance	PRS
Bureaucratic quality 1/2	Score 0-4, higher values corresp. stronger performance	PRS
Corruption 1/2	Score 0-6, higher values corresp. stronger performance	PRS
Government stability 1/2	Score 0-12, higher values corresp. stronger performance	PRS
Intra-EU	Binary: both parties members of the EU	EU

Table 3.2: Summary Statistics

Statistic	N	Mean	St. Dev.	Min	Max
Deviation	51,409	0.01	0.08	0	1
Unilateral termination	51,409	0.003	0.05	0	1
Renegotiation	51,409	0.004	0.06	0	1
Power change 1_{t-2}	43,661	0.15	0.15	-1.06	1.26
Power change 2_{t-2}	41,710	0.22	0.20	-0.56	2.02
Relative power change $_{t-2}$	38,906	-0.06	0.18	-1.78	1.12
Economic growth 1_{t-2}	45,879	2.86	3.93	-62.08	123.14
Economic growth 2_{t-2}	45,091	4.23	5.32	-62.08	149.97
Law and order 1_{t-2}	43,862	4.82	1.03	1.00	6.00
Law and order 2_{t-2}	37,699	3.65	1.08	0.00	6.00
Investment profile 1_{t-2}	43,862	9.35	2.17	0.08	12.00
Investment profile 2_{t-2}	37,699	7.87	2.08	0.00	12.00
FTAs in force $_{t-2}$	46,152	0.19	0.65	0.00	7.00
ISDS respondent any 1_{t-2}	46,207	0.44	0.50	0.00	1.00
ISDS respondent any 2_{t-2}	46,207	0.57	0.50	0.00	1.00
ISDS respondent 1_{t-2}	46,207	3.02	7.51	0.00	60.00
ISDS respondent 2_{t-2}	46,207	3.09	6.49	0.00	60.00
ISDS total $_{t-2}$	46,207	39.17	25.74	0.00	86.00
Uni. termination total	46,207	5.40	9.66	0.00	43.00
Left executive 1_{t-2}	33,462	0.44	0.50	0.00	1.00
Left executive 2_{t-2}	22,524	0.57	0.49	0.00	1.00
Democracy 1_{t-2}	44,615	8.30	2.80	0.00	10.00
Democracy 2_{t-2}	43,839	5.78	3.19	0.00	10.00
Democratic accountability 1_{t-2}	43,862	5.06	1.47	0.00	6.00
Democratic accountability 2_{t-2}	37,699	3.76	1.61	0.00	6.00
Socioeconomic conditions 1_{t-2}	43,862	7.60	1.92	0.54	11.00
Socioeconomic conditions 2_{t-2}	37,699	5.39	1.88	0.00	11.00
Bureaucratic quality 1_{t-2}	43,862	3.19	0.92	0.00	4.00
Bureaucratic quality 2_{t-2}	37,699	2.01	0.80	0.00	4.00
Corruption 1_{t-2}	43,862	3.78	1.38	0.00	6.00
Corruption 2_{t-2}	37,699	2.44	0.87	0.00	6.00
Government stability 1_{t-2}	43,862	8.06	1.56	2.17	12.00
Government stability 2_{t-2}	37,699	7.96	1.76	0.67	12.00
Intra-EU $_{t-2}$	46,207	0.05	0.22	0.00	1.00

LPM must be interpreted with caution. However, the linear model is helpful for providing a graphical representation of the interaction effects, and for illustrating the intuition behind the interaction terms. The results of LPM are also very close to the results of the more suitable Cox PH model.

The unit of analysis is treaty-year, embedded in country dyads. There is a concern that outcomes of BIT-years that share the same country dyad are likely dependent, which may be a cause for concern for the consistency of the standard errors. Hence, I cluster the standard errors at the dyad-level.²⁴ To address concerns of confounding factors, I include a set of control variables related to the domestic political characteristics of each signatory state and other events that may influence the timing of BIT reform in my analysis. To account for concerns of endogeneity between the BIT outcomes and predictor variables, as well as the fact that governments are likely to react to any developments with a delay, I lag all independent variables by two years.²⁵

The first model examining independent effects of different bargaining power variables can be written as follows,

$$h(t) = h_0(t) * \exp(\beta_1 \Delta BP_{it-2} + \beta_2 \Delta BP_{jt-2} + \beta_3 X_{it-2} + \beta_4 X_{jt-2} + \beta_5 X_{ijt-2} + \varepsilon_{ijt}) \quad (3.1)$$

where $h(t)$ is the hazard function, and $h_0(t)$ is the baseline hazard for any BIT to get terminated or renegotiated, which may vary over time. ΔBP_{it-2} and ΔBP_{jt-2} are bargaining power change variables measured at the state-year level, specific to the stronger party i and weaker party j in the dyad, with a two-year lag. X_{it-2} and X_{jt-2} are sets of time-varying measures likewise specific to each signatory state, and X_{ijt-2} is a set of time-varying covariates measured at the dyad-year level. I also investigate the effects of a relative over-time change in bargaining power on BIT outcomes, which can be written as

24. The number of clusters, or unique dyads, in the data is 2,463.

25. Bellemare, Masaki, and Pepinsky 2017.

$$h(t) = h_0(t) * \exp(\beta_1 \Delta BP_{ijt-2} + \beta_2 X_{it-2} + \beta_3 X_{jt-2} + \beta_4 X_{ijt-2} + \varepsilon_{ijt}) \quad (3.2)$$

where ΔBP_{ijt-2} is the relative bargaining power change since the initial year of treaty signature, measured at the dyad-year level.

The main goal in the second step of the estimation is to investigate whether bargaining power conditions the learning effects resulting from states' ISDS experience. I therefore include interaction terms between the bargaining power variables and each signatory states' ISDS experience, which can be written as

$$h(t) = h_0(t) * \exp(\beta_1 \Delta BP_{ijt-2} + \beta_2 ISDS_{it-2} + \beta_3 ISDS_{jt-2} + \beta_4 X_{it-2} + \beta_5 X_{jt-2} + \beta_6 \Delta BP_{ijt-2} * ISDS_{it-2} + \beta_7 \Delta BP_{ijt-2} * ISDS_{jt-2} + \dots + \varepsilon_{ijt}). \quad (3.3)$$

3.4 Results

3.4.1 Independent effects

I first present the results from models examining the independent effects of different bargaining power and learning measures on whether a BIT gets terminated or renegotiated in Tables 3.3-3.5. The results show a statistically significant association between some of the bargaining power variables, such as those based on the economic measures, and the outcome. There are notable differences between stronger and weaker states: only for the weaker state are the improvement of economic power and law and order associated with higher risk of BIT deviation, suggesting that stronger bargaining power empowers the weaker states in particular. The measures that capture relative and over-time changes in economic power do not have an independent effect on deviation from BITs when the global ISDS case count is included in the models, which provide evidence that states also learn from other states' ISDS experiences. I therefore confirm the findings of previous research that ISDS experience has played a major role in driving states' BIT reform efforts. However, the results from models including interaction effects show that the effect

of ISDS experience is conditioned by bargaining power, the latter amplifying the effects of the former for the weaker states. While the results are largely consistent for both unilateral terminations and renegotiations, some differences are detectable: for example, the total number of unilateral terminations globally only increases the risk of unilateral terminations, and higher bureaucratic capacity the chances of renegotiation.

Table 3.3 reports the results from Cox PH models with different variables approximating bargaining power. In models 1-6 in Table 3.3, ISDS respondent is included to capture the learning effects from ISDS experience. The reported coefficients are the betas of the hazard model, where positive values correspond to an increased hazard of BIT deviation.

Effects of bargaining power

The models in Table 3.3 capture various independent effects between BIT outcomes and bargaining power variables. The results imply that it is the initially weaker parties that are empowered by improvements in their absolute and relative economic power to change their BITs. While power change 1, capturing economic improvement of the initially stronger party, does not increase the risk of BIT deviation, the opposite is true for economic improvement of the weaker party. In all three models where included (M1, M3, and M5), there is a statistically significant and positive association between an improvement in economic power of the weaker state since BIT signature year and the risk of BIT deviation. The power change 2 coefficient of 1.53 in Model 5 corresponds to a hazard ratio of 4.58 for one unit change. These figures imply, all else equal, that a median increase of 50% (0.18 units) in the weaker party's GDP increases the risk of BIT deviation by 82% in the fully restricted model. The improvement of economic power of the weaker states therefore has a large substantive effect on the risk of BIT reform.

The effect of relative power change also becomes significant when all the controls are included. The negative values of relative power change correspond to the economic gap between the parties having grown smaller, either by the initially

Table 3.3: Bargaining power measures, Cox PH models with dyad-clustered SEs

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Power change 1_{t-2}	0.4714 (0.3846)		0.1374 (0.3973)		-1.2662 (0.7640)	
Power change 2_{t-2}	1.1719*** (0.2930)		1.0482*** (0.3004)		1.5323** (0.5032)	
Relative power change t_{t-2}		-0.6164 (0.3701)		-0.5587 (0.3559)		-1.4059** (0.5045)
Economic growth 1_{t-2}	0.0295*** (0.0035)	0.0302*** (0.0033)	0.0279*** (0.0034)	0.0276*** (0.0033)	0.0352*** (0.0085)	0.0377*** (0.0080)
Economic growth 2_{t-2}	0.0197** (0.0074)	0.0202** (0.0066)	0.0214*** (0.0055)	0.0215*** (0.0052)	0.0223*** (0.0059)	0.0218*** (0.0063)
Law and order 1_{t-2}	-0.1521* (0.0628)	-0.1716** (0.0595)	0.0631 (0.0804)	0.0713 (0.0796)	-0.0533 (0.1690)	-0.0558 (0.1763)
Law and order 2_{t-2}	0.0644 (0.0610)	0.0320 (0.0579)	0.1244 (0.0655)	0.0987 (0.0638)	0.4407*** (0.0937)	0.4169*** (0.0945)
Investment profile 1_{t-2}	0.0356 (0.0300)	0.0325 (0.0294)	-0.0060 (0.0319)	-0.0174 (0.0319)	-0.0412 (0.0720)	-0.0625 (0.0751)
Investment profile 2_{t-2}	-0.0078 (0.0334)	0.0075 (0.0326)	-0.0356 (0.0352)	-0.0294 (0.0352)	-0.0614 (0.0772)	-0.0584 (0.0802)
FTAs in force t_{t-2}	0.1327 (0.1039)	0.1601 (0.0995)	0.0946 (0.1044)	0.1095 (0.1015)	0.0288 (0.1906)	0.0321 (0.1875)
ISDS respondent any 1_{t-2}			0.6689*** (0.1499)	0.7607*** (0.1539)	0.4117 (0.2280)	0.4910* (0.2368)
ISDS respondent any 2_{t-2}			0.7596*** (0.1587)	0.8560*** (0.1630)	0.7217** (0.2660)	0.8454** (0.2862)
Uni. termination total t_{t-2}					0.0415*** (0.0071)	0.0415*** (0.0073)
Leftist executive 1_{t-2}					-0.1081 (0.1918)	-0.1346 (0.1968)
Leftist executive 2_{t-2}					0.5078* (0.2223)	0.5313* (0.2304)
Democracy 1_{t-2}					-0.1266 (0.1251)	-0.1113 (0.1299)
Democracy 1_{t-2}					-0.1266 (0.1251)	-0.1113 (0.1299)
Socioeconomic conditions 1_{t-2}					0.1736 (0.1049)	0.1978 (0.1079)
Socioeconomic conditions 2_{t-2}					-0.1823* (0.0828)	-0.1859* (0.0860)
Democratic accountability 1_{t-2}					0.3475 (0.2258)	0.3006 (0.2346)
Democratic accountability 2_{t-2}					-0.0053 (0.1136)	-0.0162 (0.1134)
Bureaucratic quality 1_{t-2}					0.0228 (0.2316)	0.1373 (0.2433)
Bureaucratic quality 2_{t-2}					0.6878*** (0.1599)	0.7206*** (0.1651)
Corruption 1_{t-2}					-0.1805 (0.1575)	-0.2257 (0.1666)
Corruption 2_{t-2}					-0.3473* (0.1564)	-0.2876 (0.1592)
Government stability 1_{t-2}					0.0137 (0.0861)	-0.0159 (0.0883)
Government stability 2_{t-2}					-0.1366* (0.0693)	-0.1287 (0.0703)
Intra-EU t_{t-2}					-0.4588 (0.3952)	-0.3749 (0.3978)
AIC	5783.1632	5492.7865	5730.1538	5426.3572	2115.4585	1975.1853
R ²	0.0017	0.0010	0.0035	0.0032	0.0128	0.0128
Max. R ²	0.1636	0.1590	0.1636	0.1590	0.1656	0.1585
Num. events	291	275	291	275	123	115
Num. obs.	32590	31817	32590	31817	12262	12043
Missings	18819	19592	18819	19592	39147	39366

*** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$; $\cdot p < 0.1$

weaker party having caught up, or the stronger party having declined. Therefore, the negative coefficient indicates that as the signatory states become more equal in terms of their economic power, the risk of the BIT being terminated or renegotiated increases. Substantively, a one unit decrease in relative power change is equivalent to the stronger party having had 10 times the GDP of the other party in the year of BIT signature and ending up with equal economic power in the year of observation. A median change of relative economic power of some -0.04 corresponds to 1% increase in the risk of BIT deviation. While the effect size of relative economic power change is relatively small, it does appear to have a systematic effect on the complex strategic outcomes of BITs. More importantly, the results lend support to the theory: a narrowing economic gap empowers the weaker party in the bilateral relationship, and, therefore, enable it to act regarding agreements it negotiated in a previously worse bargaining position.

The rest of the measures capturing bargaining power reveal that economic growth of both parties is systematically associated with greater risk of BIT deviation. States appear to become more likely to engage in BIT reform during times of high growth rates. The effects of law and order again differ between the stronger and weaker party, higher scores of Law and order for the weaker party increasing the chances of BIT deviation, while there is no statistically significant effect detected for the same measure for the stronger party in models where controls are included. The results are consistent with the theory that BITs are more likely to have been substitutes for domestic legal structures initially in the weaker states, and improvement in these alternative legal guarantees can render standing BITs obsolete. However, as data availability does not allow the use of an overtime-change measure for law and order, the interpretation must be limited to the level of law and order in the year of observation, higher values corresponding to higher chance of BIT deviation. The measures of investment profile or FTAs in force do not have a detectable impact on the outcome in models M1-M6.

Learning effects

Table 3.4 investigates further the possible learning effects stemming from ISDS experience and global unilateral BIT terminations. In fact, in Table 3.4, it is evident that the different measures of ISDS experience are systematically associated with the risk of BIT termination. The measures capturing any experience as an ISDS respondent have statistically and substantively significant effects: the risk of BIT termination or renegotiation increases by 63% if the stronger party has been a respondent in at least one dispute, while the same experience faced by the weaker party increases the chance of BIT reform by some 133% (Table 3.4 M1). On the other hand, one additional case where a state has been on the defendant side of the investment dispute increases the risk of BIT deviation by 2.3% and 2.7% for the initially stronger and weaker respectively (M2 Table 3.4). The results also indicate that states observe the globally occurring ISDS cases as well as decisions to unilaterally terminate BITs by other states and learn from these worldwide developments. On the aggregate, each additional global ISDS case increases the chances of any single BIT getting terminated or renegotiated by about 4.4% (Table 3.4 M3-M4). Finally, the total unilateral terminations of BITs worldwide are consistently associated with BIT terminations, each unilateral termination having an effect size of around 2-4% across the models.

Notably, when the global measures of ISDS and termination occurrence are added in Models 3 and 4, the absolute and relative economic power change variables no longer have an independent effect on the risk of BIT deviation. The high-level, economic change measures cease to independently influence the occurrence of reform when accounting for the broader trends in the investment treaty regime.²⁶ However, when examining the interaction effects in further models, these economic bargaining power indicators systematically condition some of the effects of learning through ISDS. The measures of economic growth in both partner states, and the

26. Interestingly, when the mutually terminated and expired BITs are included in the data as a robustness check, both absolute and relative economic power change variables have a statistically significant, independent effect on overall deviations (see Appendix, Tables A.1 and A.2.) It is possible that this more diverse set of BIT deviations is not as well accounted for by the other theorized covariates, and hence economic power changes explain more of its overall variation.

Table 3.4: Comparing learning effects, Cox PH models with dyad-clustered SEs

	Model 1	Model 2	Model 3	Model 4
Relative power change $_{t-2}$	-1.4059** (0.5045)	-1.8322*** (0.5016)	-0.8514 (0.4888)	-0.8514 (0.4888)
Economic growth 1_{t-2}	0.0377*** (0.0080)	0.0380*** (0.0082)	0.0410*** (0.0080)	0.0410*** (0.0080)
Economic growth 2_{t-2}	0.0218*** (0.0063)	0.0217** (0.0068)	0.0258*** (0.0058)	0.0258*** (0.0058)
Law and order 1_{t-2}	-0.0558 (0.1763)	-0.0128 (0.1621)	0.0301 (0.1812)	0.0301 (0.1812)
Law and order 2_{t-2}	0.4169*** (0.0945)	0.4698*** (0.1024)	0.4446*** (0.1004)	0.4446*** (0.1004)
Investment profile 1_{t-2}	-0.0625 (0.0751)	-0.0037 (0.0730)	-0.0789 (0.0786)	-0.0789 (0.0786)
Investment profile 2_{t-2}	-0.0584 (0.0802)	0.0535 (0.0901)	-0.0629 (0.0856)	-0.0629 (0.0856)
FTAs in force $_{t-2}$	0.0321 (0.1875)	0.0214 (0.2258)	0.0556 (0.1860)	0.0556 (0.1860)
ISDS respondent any 1_{t-2}	0.4910* (0.2368)			
ISDS respondent any 2_{t-2}	0.8454** (0.2862)			
ISDS respondent 1_{t-2}		0.0231* (0.0090)		
ISDS respondent 2_{t-2}		0.0269** (0.0084)		
ISDS total $_{t-2}$			0.0432*** (0.0073)	0.0432*** (0.0073)
Uni. termination total $_{t-2}$	0.0415*** (0.0073)	0.0424*** (0.0067)	0.0213** (0.0078)	0.0213** (0.0078)
Controls	yes	yes	yes	yes
AIC	1975.1853	1974.0412	1942.4894	1942.4894
R ²	0.0128	0.0129	0.0153	0.0153
Max. R ²	0.1585	0.1585	0.1585	0.1585
Num. events	115	115	115	115
Num. obs.	12043	12043	12043	12043
Missings	39366	39366	39366	39366

*** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$; · $p < 0.1$

weaker state's Law and order also remain consistently statistically significant in all models, indicating robust association between these bargaining power variables and BIT reform.

Unilateral termination vs. renegotiation

Interestingly, the investment profile variable for the weaker state shows heterogeneous effects on the two subsets of BIT deviation. Stronger investment profile increases the risk of the BIT getting unilaterally terminated, but it decreases the risk of renegotiation of the agreement. Higher scores of investment profile indicate stronger attractiveness of the state for foreign investors by capturing factors, such as contract viability and expropriation, profits repatriation, and payment delays.²⁷ The opposing effects can explain the statistical insignificance of the variable in the earlier models, as the opposing effects cancel each other out in the aggregate. The improvement of the investment profile can boost bargaining power by generating realistic alternative opportunities for FDI attraction independent of the BIT, hence enabling states to unilaterally walk away from the existing BITs. The fact that an improved investment profile makes renegotiation less likely could be explained by the fact that states simply find it easier to unilaterally terminate rather than attempting renegotiation when in a strong position. It is also possible that the stronger state in the dyad faces increased resistance to renegotiate existing agreements with a dissatisfied partner if it anticipates larger demand for additional protections from its investors.

Other differences between prospects of unilateral termination and renegotiation relate to the learning effects and some of the control variables. Expectedly, the total number of global unilateral terminations only increases the risk of a BIT getting unilaterally terminated, whereas they have no effect on the prospects of renegotiation. Substantively, each additional unilateral termination worldwide almost exactly doubles the risk of any specific BIT getting unilaterally terminated. It is highly probable that states learn about the possibility of unilateral termination when they observe other states adopting the approach, and governments openly

27. PRS Group Methodology 2020.

declare that they have communicated and even attempted to coordinate unilateral termination with other states.²⁸ Interestingly, while the global ISDS cases have a statistically significant and positive net effect on BIT deviations (M3 and M4 in Table 3.4), they do not have a similar effect on unilateral terminations alone. The positive association with the instance of renegotiation on the other hand manifests that states have started to redefine the provisions in existing BITs in response to the global dispute settlement trends.

Although having a leftist executive in power in the initially weaker state is statistically significant and positively associated with BIT deviation in all presented models, the effect loses its statistical significance when the outcome is divided into unilateral terminations and renegotiations. It is possible that the rarity of events in the subcategories of the outcome prevents the effect being picked up in the cross-national setting. The same is true for the coefficient of the Socioeconomic conditions indicator for the weaker party, which loses statistical significance in models using uni. termination and renegotiation as outcome variables (Table 3.5). Furthermore, the Intra-EU variable has an extraordinarily large coefficient for an exponential model: while the exact substantive effect size may be very unstable when the estimated beta is large and the covariate skewed, as is the case with Intra-EU indicator, it should not influence the main diagnostics or the interpretation of the other betas in the model.²⁹ It is safe to conclude that BITs where both members are part of the EU rarely get unilaterally terminated, whereas possible effects on BIT renegotiations are not identified using the present dataset.

The results also show that higher bureaucratic quality in the initially weaker state increases the chances of successful renegotiation of the BIT, which adheres to the results from previous research.³⁰ Finally, government stability in the stronger and weaker state show the opposite effect on the risk of unilateral termination: while a one-score increase in stability in the stronger state increases the chances of termination by some 55%, equivalent improvement in the weaker state decreases

28. Interview E008; Interview E010.

29. Therneau 2008.

30. Berge and Stiansen 2016.

Table 3.5: Comparing BIT outcomes, Cox PH models with dyad-clustered SEs

	Deviation	Uni. termination	Renegotiation
Relative power change _{t-2}	-0.8514 (0.4888)	-1.1887 (0.6902)	-0.9460 (0.7210)
Economic growth 1 _{t-2}	0.0410 *** (0.0080)	0.0633 *** (0.0094)	0.0362 ** (0.0129)
Economic growth 2 _{t-2}	0.0258 *** (0.0058)	0.0226 * (0.0095)	0.0392 *** (0.0081)
Law and order 1 _{t-2}	0.0301 (0.1812)	0.2323 (0.3189)	-0.2077 (0.1674)
Law and order 2 _{t-2}	0.4446 *** (0.1004)	0.5488 ** (0.1837)	0.3454 ** (0.1283)
Investment profile 1 _{t-2}	-0.0789 (0.0786)	0.1361 (0.1186)	-0.0522 (0.1047)
Investment profile 2 _{t-2}	-0.0629 (0.0856)	0.5379 *** (0.1379)	-0.4614 *** (0.1289)
FTAs in force _{t-2}	0.0556 (0.1860)	0.2607 (0.5828)	-0.0561 (0.1834)
ISDS total _{t-2}	0.0432 *** (0.0073)	-0.0026 (0.0127)	0.0664 *** (0.0093)
Uni. termination total _{t-2}	0.0213 ** (0.0078)	0.0696 *** (0.0152)	0.0044 (0.0106)
Leftist executive 1 _{t-2}	0.0047 (0.1964)	-0.3596 (0.3417)	0.1412 (0.2603)
Leftist executive 2 _{t-2}	0.4916 * (0.2191)	0.4976 (0.4165)	0.2890 (0.2488)
Democracy 1 _{t-2}	-0.0246 (0.1473)	-0.0787 (0.2562)	-0.2003 (0.1611)
Democracy 2 _{t-2}	-0.0246 (0.1473)	-0.0787 (0.2562)	-0.2003 (0.1611)
Socioeconomic conditions 1 _{t-2}	0.0924 (0.1142)	0.3253 (0.1670)	-0.1285 (0.1651)
Socioeconomic conditions 2 _{t-2}	-0.2403 ** (0.0805)	-0.1864 (0.1299)	-0.1959 (0.1019)
Democratic accountability 1 _{t-2}	0.3042 (0.2638)	0.3271 (0.4689)	0.5227 (0.2879)
Democratic accountability 2 _{t-2}	0.0557 (0.1297)	-0.1647 (0.1642)	0.3442 (0.1838)
Bureaucratic quality 1 _{t-2}	0.1779 (0.2582)	-0.1389 (0.3914)	0.5031 (0.3264)
Bureaucratic quality 2 _{t-2}	0.7624 *** (0.1722)	0.3787 (0.2876)	0.7491 *** (0.2020)
Corruption 1 _{t-2}	-0.2949 (0.1875)	-0.4756 (0.2897)	-0.1449 (0.2184)
Corruption 2 _{t-2}	-0.1863 (0.1773)	0.0019 (0.2192)	-0.2383 (0.2670)
Government stability 1 _{t-2}	0.1812 (0.1142)	0.4357 ** (0.1626)	-0.0913 (0.1544)
Government stability 2 _{t-2}	-0.0583 (0.0835)	-0.4013 *** (0.1032)	0.0522 (0.1153)
Intra-EU _{t-2}	-0.7724 (0.4066)	-16.8828 *** (0.5175)	-0.7863 (0.4664)
AIC	1942.4894	761.1411	1078.8968
R ²	0.0153	0.0116	0.0163
Max. R ²	0.1585	0.0683	0.0968
Num. events	115	47	68
Num. obs.	12043	12043	12043
Missings	39366	39366	39366

****p* < 0.001; ***p* < 0.01; **p* < 0.05; *p* < 0.1

the risk by 44%. It is probable that the government already in a stronger position benefits from stability for its reform efforts, whereas the weaker party is likely unwilling to withdraw if the same government has to deal with the costs of a risky negotiation strategy.

The investigation into the potentially different additional determinants of unilateral termination and renegotiation can benefit from further data collection as both types of instances of BIT reform accumulate overtime. At present, rarity of both instances, and missing data for key variables, make a more detailed investigation into cross-national covariates challenging. However, the described results are largely in line with the theoretical expectations, as well as with previous research on BIT renegotiations.

3.4.2 Interaction effects

Next, I turn to investigate conditional effects in additional models predicting BIT deviation. According to the theory outlined in Chapter 2, I would expect learning effects that change states attitudes towards their existing BITs to depend on bargaining power attributes of the states. I focus on the learning effects that states are likely to experience from facing ISDS cases: I would expect the positive association between ISDS experience and BIT deviation to be amplified by increases in variables that approximate bargaining power. As per the theory, states are likely to act on the learning effects more readily when they also have strong alternatives in place. The following results contribute important nuance to the current empirical literature on the relationship between ISDS experience and BIT outcomes.

Table 3.6 presents a set of models exploring such conditional effects by including interaction terms between cases as ISDS respondent and bargaining power measures for each signatory state. Models 1-6 include one possible interaction term at the time, while Models 7-8 include all hypothesized interaction terms in the same model. Positive coefficients for the interaction terms should be interpreted as the two variables amplifying each other's effect on the outcome of BIT deviation.

Across the models, there are systematic differences in interaction effects for the initially stronger and weaker states. Generally, bargaining power measures condition the learning experienced by the weaker state, while it appears to have no impact on the association between ISDS cases faced by the stronger states and BIT deviation. This is consistent with the expectations from theory on the impact of bargaining power on BIT reform: because the stronger states had the upper hand when the treaty was initially negotiated, their preferences are likely already reflected in the existing agreement. There is therefore no further need for the stronger party to experience boosts in their bargaining power position, as they are already in a stronger position in the bilateral partnership. The stronger parties are therefore likely able to act in response to learning effects from ISDS directly. Model 8 in Table 3.6 provides evidence for this, as the independent effect of ISDS respondent 1 increases the risk of BIT deviation, but none of the interaction effects for the stronger party have statistically significant effects.

For the weaker party, on the other hand, the effects of their bargaining position are more constraining. In the aggregate, weaker parties are more likely to undertake the costly reform of BITs if they have also either 1.) improved their economic position since BIT signature, or 2.) otherwise perform strongly with regards to the alternatives to investment agreements. Economic power changes amplify the effects the weaker state's ISDS experience has on BIT deviation: the larger the improvement in economic power since BIT signature has been, the larger the risk created by ISDS cases faced by the weaker party (Models 1 and 7 in Table 3.6). Changes in the relative economic power between the states likewise condition the effects of ISDS. The interaction effect between relative power change and ISDS respondent 2 is negative, which means that the more the economic power gap between the states has narrowed since the BIT was signed, the higher the risk of BIT deviation when the weaker state faces ISDS cases (Models 2 and 8 in Table 3.6). Because a narrowing economic gap improves the bargaining power of the weaker state in relation to the stronger state, the results are consistent with the expectations that such relative changes enable the weaker parties to act according to the learning effects from ISDS.

Table 3.6: Interaction effects, Cox PH models with dyad-clustered SEs

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
Interaction effects								
Power change 1_{t-2} *ISDS respondent 1_{t-2}	-0.0587 (0.1012)						-0.0601 (0.1132)	
Power change 2_{t-2} *ISDS respondent 2_{t-2}	0.4417*** (0.0880)						0.3326*** (0.0797)	
Relative power change e_{t-2} *ISDS respondent 1_{t-2}		0.0779 (0.0476)						0.0482 (0.0453)
Relative power change e_{t-2} *ISDS respondent 2_{t-2}		-0.2223*** (0.0624)						-0.1810** (0.0627)
Economic growth 1_{t-2} *ISDS respondent 1_{t-2}			-0.0006 (0.0026)				-0.0006 (0.0020)	-0.0005 (0.0019)
Economic growth 2_{t-2} *ISDS respondent 2_{t-2}			0.0019* (0.0009)				-0.0003 (0.0011)	-0.0010 (0.0008)
Law and order 1_{t-2} 1*ISDS respondent 1_{t-2}				-0.0099 (0.0071)			-0.0019 (0.0102)	-0.0015 (0.0102)
Law and order 2_{t-2} *ISDS respondent 2_{t-2}				0.0695*** (0.0098)			0.0707*** (0.0141)	0.0761*** (0.0141)
Investment profile 1_{t-2} *ISDS respondent 1_{t-2}					-0.0059 (0.0044)		-0.0047 (0.0070)	-0.0061 (0.0067)
Investment profile 2_{t-2} *ISDS respondent 2_{t-2}					0.0166*** (0.0046)		-0.0214* (0.0089)	-0.0099 (0.0089)
FTAs in force e_{t-2} *ISDS respondent 1_{t-2}						-0.0344 (0.0237)	-0.0120 (0.0132)	-0.0199 (0.0138)
FTAs in force e_{t-2} *ISDS respondent 2_{t-2}						0.0127 (0.0098)	0.0170* (0.0082)	0.0143 (0.0078)
Independent effects								
Power change 1_{t-2}	-1.4459 (0.8330)						-1.2661 (0.8420)	
Power change 2_{t-2}	-0.4010 (0.7287)						-0.1620 (0.7611)	
Relative power change e_{t-2}		0.0084 (0.6257)	-1.0886* (0.4932)	-1.1362* (0.5082)	-1.0669* (0.5028)	-1.0696* (0.4994)		-0.0291 (0.6900)
Economic growth 1_{t-2}	0.0397*** (0.0082)	0.0391*** (0.0085)	0.0416*** (0.0115)	0.0396*** (0.0087)	0.0408*** (0.0084)	0.0405*** (0.0081)	0.0419*** (0.0107)	0.0417*** (0.0110)
Economic growth 2_{t-2}	0.0245*** (0.0050)	0.0272*** (0.0054)	0.0163* (0.0070)	0.0177* (0.0074)	0.0254*** (0.0058)	0.0255*** (0.0058)	0.0221*** (0.0061)	0.0258*** (0.0062)
Law and order 1_{t-2}	0.1412 (0.1742)	0.1151 (0.1801)	0.0869 (0.1825)	0.2638 (0.1915)	0.1644 (0.1908)	0.0831 (0.1883)	0.2605 (0.1905)	0.2226 (0.1877)
Law and order 2_{t-2}	0.4674*** (0.1054)	0.4825*** (0.1046)	0.4796*** (0.1062)	0.1610 (0.1154)	0.4955*** (0.1079)	0.4912*** (0.1072)	0.2102 (0.1105)	0.1670 (0.1169)
Investment profile 1_{t-2}	-0.0396 (0.0755)	-0.0535 (0.0781)	-0.0887 (0.0796)	-0.0833 (0.0835)	-0.0292 (0.0867)	-0.0914 (0.0778)	-0.0204 (0.0844)	-0.0483 (0.0861)
Investment profile 2_{t-2}	-0.0688 (0.0912)	-0.0377 (0.0956)	0.0046 (0.0968)	-0.0534 (0.0952)	-0.1141 (0.0999)	-0.0176 (0.0963)	-0.0205 (0.1002)	-0.0454 (0.1037)
FTAs in force e_{t-2}	0.0950 (0.2132)	0.1022 (0.2022)	0.0644 (0.2052)	0.0621 (0.2024)	0.0464 (0.2130)	0.1697 (0.2414)	0.0077 (0.2852)	0.1052 (0.2523)
ISDS respondent 1_{t-2}	0.0256 (0.0238)	0.0231* (0.0103)	0.0129 (0.0127)	0.0482 (0.0283)	0.0620 (0.0390)	0.0168 (0.0098)	0.0774 (0.0430)	0.0817* (0.0398)
ISDS respondent 2_{t-2}	-0.1172*** (0.0304)	-0.0029 (0.0116)	0.0144 (0.0085)	-0.1699*** (0.0292)	-0.0956** (0.0335)	0.0181* (0.0084)	-0.1355*** (0.0394)	-0.1399*** (0.0406)
ISDS total 1_{t-2}	0.0367*** (0.0070)	0.0393*** (0.0070)	0.0403*** (0.0073)	0.0338*** (0.0072)	0.0397*** (0.0073)	0.0404*** (0.0074)	0.0328*** (0.0072)	0.0335*** (0.0071)
Uni. termination total 1_{t-2}	0.0156* (0.0075)	0.0195* (0.0076)	0.0190* (0.0078)	0.0192* (0.0079)	0.0178* (0.0080)	0.0197* (0.0079)	0.0202** (0.0076)	0.0210** (0.0078)
Controls	yes	yes	yes	yes	yes	yes	yes	yes
AIC	2052.2570	1923.8656	1942.2340	1898.5087	1935.0446	1939.2406	2034.8734	1898.1247
R ²	0.0184	0.0175	0.0160	0.0195	0.0166	0.0162	0.0210	0.0209
Max. R ²	0.1656	0.1585	0.1585	0.1585	0.1585	0.1585	0.1656	0.1585
Num. events	123	115	115	115	115	115	123	115
Num. obs.	12262	12043	12043	12043	12043	12043	12262	12043
Missings	39147	39366	39366	39366	39366	39366	39147	39366

***p < 0.001; **p < 0.01; *p < 0.05; †p < 0.1

The effects of the Law and order -variable in the weaker party return interesting results. The measure captures the strength and impartiality of the legal system, as well as the popular observance of the law in the country.³¹ While stronger conditions in the weaker party are systematically associated with higher risk of BIT deviation in all models reported in Section 3.4.1, these independent effects disappear once an interaction term is included between the Law and order 2 and ISDS respondent 2 variables (Models 4, 7, and 8 in Table 3.6). This suggests that it is unlikely that weaker states initiate BIT reform as their domestic rule of law improves; rather, Law and order 2 captures an element of bargaining power, which amplifies the effect of ISDS experience on BIT outcomes for the initially weaker states.

Economic growth in the signatory states, on the other hand, does not seem to condition the effects of ISDS on deviation from BITs. Both states' growth rates however maintain their statistically significant, independent effect on unilateral terminations and renegotiations in all models: it appears that GDP growth is associated with increased likelihood of BIT reform on its own right, in contrast to the overtime-change variables of economic power. Furthermore, the independent effect of ISDS respondent 2 falls below the cutoff of statistical significance in Model 3, where the interaction term between economic growth of the weaker party and its ISDS experience is included. For the weaker parties, economic growth therefore seems to provide an important enabling factor for reform, even stronger than their ISDS experience in some models.

The investment profile of the weaker state returns mixed results when interacted with ISDS experience. When included as the sole interaction effect in Model 5, stronger investment profile of the weaker state amplifies the positive effect faced ISDS cases have on the risk of BIT deviation. However, when the other interactions are included in Model 7, the interaction term becomes negative, and the interaction effect loses its statistical significance in the final Model 8 accounting for relative power changes. As the results of models examining differences between unilateral termination and renegotiation indicate (Table 3.5), it could be that the investment

31. PRS Group Methodology 2020.

profile results in different dynamics depending on whether the outcome of interest is unilateral termination or renegotiation also in conditioning the impact of ISDS experience. The rarity of events and the low number of degrees of freedom in the full model however prevent the examination of these dynamics in the cross-national analysis. Based on the available evidence, it does not seem that investment profile conditions the effects of ISDS on BIT reform in any systematic way.

Finally, the only statistically significant impact of the number of FTAs in force are detected in Model 7, where it appears to condition the effect of ISDS experience for the weaker state. It is therefore possible that the more FTAs are in place between the partner states, the more confident the weaker party is to react to the ISDS cases it has faced. Since the effects are not robust to the alternative specifications (Models 6 and 8), I however interpret the effect with caution in the cross-national setting.

I illustrate two key conditional effects of ISDS respondent 2 on BIT deviation based on a linear probability model (LPM), which is better suited for intuitive graphical presentation of interaction effects. The LPM uses the same specification as Model 8 in Table 3.6, apart from replacing the global ISDS cases and unilateral terminations with year fixed effects. In addition to capturing variation in these two variables, year fixed effects also account for any time trends which may influence the outcome of all BITs in the dataset. Figures 3.1 and 3.2 present the effects of ISDS respondent 2 on BIT deviation, interacted with Relative power change and Law and order 2 respectively.

Figure 3.1 shows that as the economic power gap between the parties increases, the ISDS cases faced by the weaker party have a decreasing impact on BIT deviation. Weakening bargaining power position for the weaker state can therefore prevent the learning effects from ISDS from translating from actual BIT outcomes. However, as there are few extreme values of relative power change in the data, I do not extrapolate the findings for very high or low values of the variable. While the detected substantive effect sizes are small, such a high-level, economic bargaining power measure seems to capture a part of variation in BIT outcomes, and systematically conditions the more direct learning effects resulting from ISDS experience. Likewise, Figure 3.2

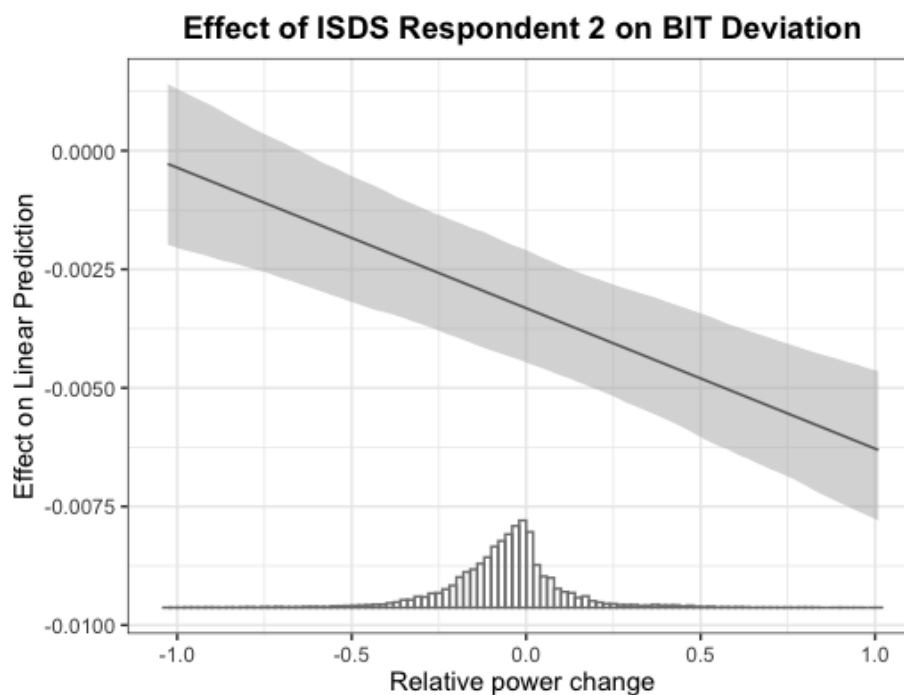


Figure 3.1: Effect of ISDS respondent experience of the weaker party on BIT deviation, conditional on relative power change; linear probability model with year-FEs, outcome: BIT deviation.

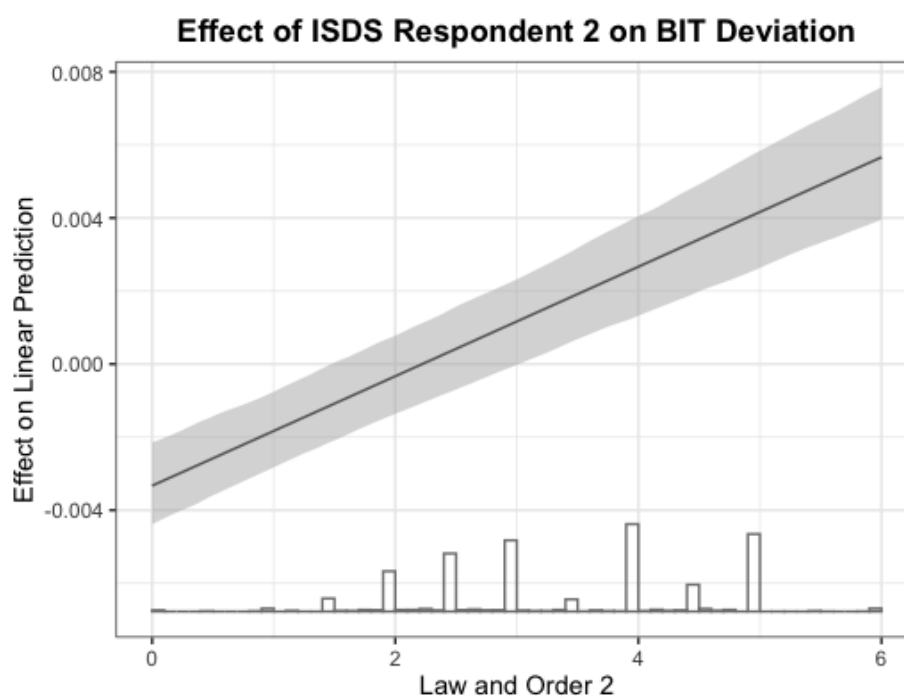


Figure 3.2: Effect of ISDS respondent experience of the weaker party on BIT deviation, conditional on Law and order 2; linear probability model with year FEs, outcome: BIT deviation.

illustrates how the effect of ISDS experience on the linear prediction of BIT deviation changes for states that score differently on their law and order -ranking. While ISDS experience increases the likelihood of BIT getting terminated or renegotiated for weaker states with high levels of law and order, the effect becomes negative for states with a law-and-order score lower than 2.

3.5 Conclusion

In this chapter, I have provided evidence that different measures of bargaining power have statistically significant effects on the occurrence of unilateral terminations and renegotiations of BITs. In particular, economic power changes, economic growth, and law and order have systematic effects on the risk of BIT deviation. I also show that there are differences in how state-level changes impact BIT outcomes when they relate to the initially weaker and stronger state in the bilateral relationship. Variables capturing developments in the weaker party more systematically have an effect on the risk of BIT termination and renegotiation, while only some effects are found for the same measures in relation to the stronger state. Stronger law and order in the country, as well as left-leaning leadership, only correspond to changes in BITs when improvements occur in the weaker state. However, economic growth has a positive and statistically significant impact on BIT deviation for both signatory states, suggesting that governments are increasingly likely to initiate risky BIT reform when their economies are strong.

I also confirm the findings of past research that ISDS, as experienced by the signatory states and globally, are strongly associated with changes in existing BIT architecture. However, I present a more nuanced empirical story about the association between instance of ISDS and BIT changes by showing that different bargaining power variables can amplify or reduce the effects ISDS has on BIT reform. These conditional effects are systematically present for the weaker party in the cooperative arrangement, suggesting that the strength of a government's response to ISDS cases will depend on factors such as economic power change since joining the BIT, and law and order in the country. The effects of ISDS cases faced

by the stronger party, on the other hand, do not depend on the employed measures of bargaining power, suggesting that the parties already in stronger position are able to act on potential learning effects by virtue of already having been in a strong position since the onset of the investment treaty regime.

I also investigate whether unilateral terminations have systematically different determinants than renegotiations. More nuance is presented for the association between accumulation of ISDS cases and BIT outcomes, as increasing numbers of investment disputes are only associated with renegotiation of the agreements, while having no impact on unilateral termination. While most effects stay constant across the different types of BIT deviations, stronger investment profile of the weaker state is associated with increasing risk of unilateral termination, supporting the theory that such states are more likely to walk away from their existing BITs, while at the same time making renegotiation of the agreement less likely. While worldwide unilateral terminations are only associated with increased risk of unilateral termination of BITs, higher bureaucratic quality of the weaker state is only associated with increased chances of successful renegotiation of the BIT.

These results provide the first empirical evidence about the role of bargaining power in the BIT regime. Since only general determinants, which are likely to be common across a large number of instances of BIT reform can be detected cross-nationally, the next chapter investigates the dynamics of BIT reform in detail in two case studies: Ecuador and Indonesia. Through the two cases, it is possible to assess in detail how the different motivations for reform in the two governments were conditioned by access to different alternatives, and eventually enabled the governments to take action to withdraw from their BITs.

4

Introducing case studies

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In Chapter 3, I have examined factors which are associated with changes in most BITs up to date. In addition to the cross-national evidence, I conduct case studies of two states, Ecuador and Indonesia, which both decided to pursue withdrawal from their investment treaties following large ISDS claims by foreign investors. While the circumstances, motivations, and the process of withdrawal were different for the two governments, bargaining power can explain the approaches of both. The states enjoyed improving economic conditions building up to the terminations. Both governments were also confident about their ability to attract investment and pursue alternative domestic and international legal arrangements after BIT terminations. In addition, both differentiated between specific BITs in deciding their approach to reforming them, depending on their leverage and importance of the relations with specific partner states. The qualitative evidence can uncover commonalities between the constraining effects of bargaining power, otherwise overlooked by the abundance of other influential factors.

This component of my research design complements the empirical evidence in support of my theory in various ways. First, the case studies enable the examination of more specific attributes of bargaining power. For example, while economic power is a common determinant of concrete alternatives, different factors influence the available outside options to different states. The timing of Indonesia's decision to withdraw from all its BITs followed the commodities boom of the 2000s, which drove up the prizes of commodities and raw materials worldwide and increased the interest of foreign investors especially in the Indonesian mining sector. Indonesia's leverage in investment-related negotiations at the time stemmed from the confidence that key investors would want to come regardless of BIT terminations. The continued demand convinced the Indonesian government that key partners would be willing to negotiate alternative contracts and even new investment agreements, and withdrawal from old BITs would be the best way to begin to modernize its investment governance. In contrast, prior to withdrawing from BITs, Ecuador developed concrete alternative arrangements that were meant to facilitate an investor-friendly environment and reassure those factions of the government who were more concerned about the economic and political impacts of BIT terminations, including the Domestic Production Code (2010), Public-Private Partnerships Act (2015), and finally, the FTA with the European Union (2017). In general, the alternatives that boost states' bargaining power can be highly context-specific to a particular cooperative arrangement, and qualitative evidence enables the investigation of such factors in detail.

Second, inclusion of detailed case studies enables the consideration of more factors which can interfere with the BIT reform process. While the cross-national evidence focuses on factors that are most likely to be common across different treaties as well as time, focus on individual cases allows detailed investigation into the relevant events and decision-making processes. In Indonesia, the political blanket decision to withdraw from all BITs was announced in 2014, but it was succeeded by a bureaucratic effort to examine individual treaties to determine the best way to withdraw from them. The interplay between political leadership with nationalistic

tendencies, and the technocratic government bodies that were tasked to execute the political orders shaped the withdrawal process. Eventually, the technocrats brought the withdrawal process to a halt before all the BITs had been terminated. On the other hand, Ecuador faced unique constitutional and parliamentary hurdles that needed to be cleared before certain BIT terminations could go ahead, and the direct lobbying and even threats from especially European partners delayed the process at several stages. Although in both cases alternatives enabled the eventual withdrawal from BITs, each process of withdrawal is unique, and case studies can uncover influential factors not picked up by the quantitative evidence.

Finally, the cases enable empirical investigation into the thus far unexamined difference between *exit* and *strategic exit*, theorized in Section 2.4. The two strategies by a reformist state have the same observable outcomes in the large-n data. However, it is possible to investigate the motivations of the withdrawing government qualitatively through elite interviews. While the motivation behind Ecuador's withdrawal from BITs was the fundamental rejection of the practice of ISDS, Indonesia was less opposed to investor arbitration in principle. Despite the concern over recent large ISDS claims, the government in Indonesia took a nuanced approach to its BIT reform. The Southeast Asian nation began by withdrawing from investment treaties, and thus demonstrated its determination to modernize the stock of old investment treaties. However, eventually Indonesia changed its approach: it successfully pursued negotiations of new investment instruments which replaced the old BITs with the most important regional partners – Singapore and Australia – thus avoiding the survival clauses of old BITs. The initial withdrawals from BITs therefore assisted Indonesia in catalyzing renegotiations. Despite the different motivations, both Ecuadorian and Indonesian governments unilaterally terminated their BITs after sufficient alternatives were expected to be in place. Withdrawal can therefore serve different purposes: clean exit and desire to do without the regime, and strategic exit to facilitate new negotiations within the regime.

I will first describe the case selection strategy in Section 4.1, before introducing the collection of primary source data through elite interviews in Section 4.2. Section 4.3 presents a preview of evidence from the two cases.

4.1 Case selection

The case selection strategy aims to leverage both between and within-case variation to investigate the effects of bargaining power on BIT outcomes. Indonesia and Ecuador represent cases from different parts of the world, with different geopolitical realities as well as their general economic characteristics. Indonesia, an emerging market economy, reacted to large ISDS claims by announcing the termination of its investment agreements in 2014. It commenced to unilaterally denounce BITs systematically, according to their specific termination provisions. Ecuador, on the other hand, started to push for withdrawal from BITs by first denouncing the ICSID Convention in 2009, and then terminating BITs in waves, spanning over almost a decade.

Both states took decisive steps at times when their outside options to existing BITs were strong: prices of oil (Ecuador) and commodities (Indonesia) drove up the interest of foreign investors as well as the anticipated profits from related production. Both also pursued investment treaty reform in the context of improved alternatives through other international economic agreements: Ecuador intentionally waited for the free trade agreement with the European Union to be concluded before taking the final step to terminate BITs with important European partners, as well as the US and China. For Indonesia, likewise, The ASEAN Comprehensive Investment Agreement (ACIA) came to force a few years prior to Indonesia's BIT terminations, and the negotiations for a new Regional Comprehensive Economic Partnership (RCEP) agreement were in full swing. Indonesia also made a declaration of its intent to join the Transpacific Partnership Agreement (TPP) at the height of its investment treaty withdrawal in 2015. BIT terminations by Ecuador and Indonesia have in common their timing, which coincided not only with ISDS-induced incentives to withdraw, but also the enabling factors of strong alternatives to BITs.

Focusing on two cases which manifest the same outcome can be problematic because selection on the dependent variable inevitably results in only half the information required for making causal claims between an explanatory variable and the outcome of interest.¹ To address the concern, I intentionally choose cases which also provide within-case temporal variation in the outcome of interest. Ecuador withdrew from its BITs in “waves of termination”, whereby some BITs were terminated nearly ten years apart from each other. The timing of terminations coincides with conditions of strong economy and improvement of alternative legal and investment facilitation arrangements. On the contrary, the most convincing alternative explanations of the threat of ISDS, political ideology and motivation of leadership, civil society mobilization, and pressure from foreign states were largely present throughout the ten-year period of interest, and therefore cannot explain the timing of BIT terminations. I illustrate that the delays in terminating BITs were not only parliamentary or bureaucratic, but there were executive decisions taken to delay withdrawals until stronger alternatives were in place.

The cases are also intentionally chosen to give serious consideration for alternative explanations. Both cases have a strong presence of powerful alternative factors, making them hard cases to show the effects of bargaining power constraints on policy-choices. First, negative ISDS experience by host states constitutes the single most important explanation for BIT withdrawals both in policy, legal, and political economy analysis to date. While both Indonesia and Ecuador were motivated to reform their investment treaties at least partly in response to large ISDS claims, ISDS cannot explain the exact timing of termination decisions in Ecuador. Furthermore, Indonesia proceeded to renegotiate new BITs with ISDS provisions, suggesting that their motivations were focused on modernizing and redefining the scope of international arbitration provisions, rather than eliminating them completely. I show that Indonesia leveraged terminations as a strategy to open fresh negotiations from

1. Geddes 1990. However, in social science research, the interest is often on the outliers, as is the case when studying the rare instance of states withdrawing from international regime. Investigation into the commonalities of circumstances in two cases where decision-makers resort to the same approach can provide valuable insight into what enables states to terminate their BITs.

a clean slate, and it successfully imposed important limitations on key provisions in the new agreements. Since initiating BIT terminations, the government of Indonesia has successfully negotiated new agreements with investment provisions, such as the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), notably negotiating down the sunset clause of the old BIT with Australia. The examination of the two cases engages seriously with investment arbitration as a catalyst for reform but illustrates that it cannot alone explain the outcomes in the BIT regime.

Second alternative explanation suggests that BIT terminations are driven by political ideology of governments and the wider population: leftist or populist leadership, and general anti-globalization backlash can arguably explain why states withdraw from international agreements.² However, ideology does not fully explain the variation and timing in the reform approaches taken in the two cases. Ecuador and Indonesia both had reputations for leftist ideology and resource nationalism respectively at the time of BIT withdrawals, and foreign investors in extractive industries have often been the targets of anti-capitalist and anti-neocolonial sentiments. However, political ideology and the possible general backlash especially against Western capitalism does not explain the timing of withdrawals from the regime in the cases of Ecuador and Indonesia, as such motivations remained largely constant over the study period when decisions were made.

Finally, the two cases provide an opportunity to study the different purposes served by withdrawals from the international regimes. While the BIT terminations by Ecuador were motivated by the desire for a clean exit from the customary practice in the investment regime, Indonesia intended to modernize, recalibrate the bulk of its investment regulation, and negotiate itself more state regulatory space. The two cases therefore illustrate the outcomes of unilateral termination and strategic exit, both of which were made possible by bargaining power through improved alternatives. I will show that while Ecuador was truly confident that

2. Calvert 2018; Walter 2021.

it would be better-off outside the regime, Indonesia leveraged strategic exit to initiate new negotiations with important partners.

4.2 Interviews

In addition to extensive secondary material from press releases, media reports, and legal and policy analyses, I collect evidence through elite interviews with individuals at the center of BIT reform efforts in Ecuador and Indonesia. I conducted 15 interviews with 16 individuals who can be defined as elites: individuals with privileged access to power or decision-making regarding the events of interest. The interviewees had important insight into the events building up to BIT terminations, the actual decisions taken, and the aftermath following the withdrawals. The persons interviewed include three senior ministers who made decisions and engaged in investment agreement negotiations at the time. Furthermore, I interviewed three government officials at relevant bodies of the governments, and five private sector individuals, including two arbitration lawyers who had represented the governments in investment arbitration. In addition, because of the crucial role played by non-governmental actors in BIT terminations, six interviewees are representatives of academia and civil society organizations who advised the governments of Ecuador and Indonesia regarding investment treaty reform.

Due to the nature of specific events of interest, I conducted purposive sampling targeting specific individuals identified from news sources, opinion blogs, and reports related to investment agreements. I also relied on snowball sampling, whereby interviewees helped contacting their colleagues who might be willing to participate in the study. Referrals from participants were instrumental especially with regards to reaching out to the higher-level governmental officials. All contacts were approached either directly via email or via email introduction through other interviewees. Once an appropriate email address was obtained or introduction made, the acceptance rate to the request for an interview was 71% for Ecuadorian and 66% for Indonesian individuals. Due to the global health situation, interviews were conducted through video-call platforms such as Zoom and Skype between the 2nd

Table 4.1: Interviews by participant category

Category	Number of interviewees	
	<u>Ecuador</u>	<u>Indonesia</u>
Government	3	3
Private sector	1	2
NGO and academic	6	1

of February and the 28th of June 2021. The interviews were conducted in English, which provided no difficulty for communication as the participants were largely immersed into the international policy-debates regarding the investment regime.

The interviews were semi-structured, with pre-prepared list of questions tailored to each participant, but with flexibility to divert the conversation to direction guided by the interviewee. Because interviewees had insights into different aspects of the withdrawal processes, different sets of questions were employed depending on the category of elite: politicians and negotiators (government), investment and legal experts (private or third sector), and activists (third sector). Saturation in qualitative research refers to a point at which no new information is gained by continuing sampling from a specific category.³ For triangulation of information, I asked the same questions within each category or interviewees unless a saturation point was successfully reached, as was the case with government and NGO/academic categories for Ecuador, and government category for Indonesia. All participants were offered the possibility to contribute anonymously due to the potentially sensitive nature of information provided, and every interview was recorded and transcribed afterwards.⁴

4.3 Summary of case study evidence

Case study evidence of Ecuador's withdrawal is presented in Chapter 5 and that of the Indonesian case in Chapter 6. The structure of the case studies is similar. They begin with a description of the political and economic context in both states, with a special focus on their relationships and disputes with foreign investors. The

3. Glaser and Strauss 2017.

4. The example interview questionnaires are provided in the Appendix B.1.

chapters proceed to present a loosely chronological description of unfolding events, focusing on the most important stages in the governments' individual withdrawal processes. In the case of Ecuador, I describe the three distinct stages in the government's efforts to initiate BIT reform: the first terminations in 2008, the period of preparing to terminate 2008-2016, and the final terminations in 2017. Likewise, in the case of Indonesia, the focus is on the first terminations in 2014, the period of systematic terminations 2014-2016, and the change in reform strategy in 2016 examining the three routes to renegotiation. Following the case study chapters, Chapter 7 discusses the key insights derived from the cases. It examines the presented evidence considering the most important factors to the theoretical framework, including the different attributes of bargaining power of economic conditions and alternative agreements, as well as the alternative explanations of ISDS experience and political ideology.

The Ecuadorian case is the clearest example of a dynamic where the bargaining power of a state limits its ability to withdraw from investment treaties. Ecuador had all the possible enabling factors in place to conduct a decisive exit from the regime: high-profile ISDS cases with multinational oil companies; politically motivated and determined executive and majority government; increased salience and support of the wider population and civil society movements; and legitimacy brought by a new constitution banning international arbitration outside Latin America, and the Citizens' Audit Commission with internationally recognized experts recommending withdrawal. Yet, Ecuador could not promptly pursue BIT terminations. It had to be selective which BITs it could terminate, as it remained highly dependent on the relationships with key partners and investors. Ecuador only moved to terminate when sufficient alternatives brought confidence that withdrawal would not result in disastrous backlash from investors and partner states: the most important BITs were terminated after the economic conditions in the country had improved, and the vital free trade agreement with the EU was concluded.

The case of Indonesia, in turn, illustrates the dynamic of strategic exit, whereby withdrawal from BITs can demonstrate the improved bargaining position and cat-

alyze new negotiations with important partners. Indonesia first began to unilaterally withdraw from BITs in 2014, and systematically sent notices to partner states with whom their investment treaties were approaching expiry. In 2016, it shifted its approach to avoid the sunset clauses, which were triggered by every unilateral termination. It adopted three different routes to reform: mutual termination with Argentina, mutual termination with renegotiation with Australia, and unilateral termination followed by negotiation with Singapore. For Indonesia, the unilateral terminations proved vital for signaling a credible exit threat to the closest regional partners, helping Indonesia to initiate new negotiations. Indonesia successfully negotiated a new BIT with Singapore and a CEPA with Australia, which both more closely match Indonesia's new preferences for its investment governance.

The cases of Ecuador and Indonesia illustrate the two different ways in which bargaining power enables states to leverage withdrawal in shaping their international commitments regarding investment governance. When sufficient alternatives are in place, states can either exit the undesirable treaties like Ecuador, or conduct strategic exit by attempting new negotiations following exit like Indonesia.

5

Power to Terminate: Ecuador

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Ecuador provides a case of withdrawal from BITs where despite various enabling factors and strong motivations it took the government a decade to complete the termination process. While the so-called “easy BITs” got terminated already in 2008, the final bulk of BITs with the most important economic partners such as China, the Netherlands, Canada, the US, and Spain had to wait for termination until 2017. I will show that while there were multiple different events unfolding simultaneously, the critical steps towards withdrawal were taken at times when important enabling factors related to Ecuador’s bargaining power fell into place.

Ecuador’s contradictory policies through President Correa’s two governments to withdraw from BITs on the one hand, and to establish various incentives to attract investment on the other, were sending mixed messages to foreign investors. These opposing policies have been explained though the constant power struggle within

Correa's governments between the so-called moderate and radical-leftist factions.¹ It is however possible to reconcile these seeming policy-contradictions through the lens of bargaining power of alternatives: in order to be able to withdraw from what were perceived as unjust neo-colonial investment instruments, only serving the interests of Western capital, alternative arrangements were actively pursued by the Ecuadorian government. Despite BIT terminations, Ecuador aimed to strengthen the prospects for attracting FDI and cooperation with important partner states. Furthermore, the final step to terminate the most important investment agreements was only taken after the most important economic agreement, the free trade agreement with the European Union, was finally in place.

5.1 Correa and mission against capitalism

Ecuador, like most of Latin America, has a long and controversial history of foreign direct investment especially from Europe and the United States. The oil-rich Ecuador has continued to attract the largest proportion of FDI inflows towards its petrochemicals sector, with almost 80% of FDI targeting oil in 2019.² Oil exploration was under the control of the state-owned Petroecuador from 1970s until the 1990s, when Ecuador privatized the hydrocarbons sector to attract foreign investment. Because the disastrous economic performance of Latin America in the 1980s and the early 1990s, hard-hit by the international debt crisis, Ecuador was also more receptive to the structural economic reforms broadly referred to as the Washington Consensus.³ The liberalization efforts resulted in almost a ten-fold increase in FDI, largely into oil, between 1970 and 1999.⁴ Within the same period, Ecuador also signed over 20 BITs with both regional and Western partner states in the spirit of liberalization, and with hopes of boosting the reputation of the country as friendly to foreign investors.

1. Montal 2019.

2. World Investment Report 2020.

3. Fraga 2004.

4. UNCTAD 2001.

The difficulties with foreign investors and ISDS in Ecuador have their roots in the late-1990s economic crisis, which simultaneously consisted of a currency crisis, a banking crisis, and a sovereign debt crisis.⁵ The crisis led masses of Ecuadorians to move abroad in search of work and resulted in deep resentment towards politicians who were blamed for the disastrous implementation of the neoliberal reforms. After the renegotiation of Ecuador's debt burden and the adaptation of new measures to improve tax collection by President Gustavo Noboa in the early 2000s, the Ecuadorian tax authority announced that oil companies operating in Ecuador would no longer receive VAT reimbursements, which had been used to incentivize investors. The government of Ecuador (GoE) faced the fury of the oil companies, as the withheld reimbursement amounted to some US\$ 200mil. Some of the oil companies were also demanded to repay already received reimbursements.⁶

One of these companies was Occidental Petroleum, a US oil and gas company, which filed its first investor-state dispute settlement claim based on the Ecuador-US BIT under the United Nations Commission On International Trade Law (UNCITRAL) rules in 2002. The tribunal ordered Ecuador to pay US\$ 71.5mil. in compensation to Occidental. They found that GoE had engaged in discriminatory practices, because VAT benefits continued to be provided for investors in other sectors.⁷ In retaliation, the Attorney General's office of Ecuador began to audit Occidental's operations and found significant breaches in its contracts. On the 15th of May 2006, the GoE issued the *Caducidad* Decree to terminate Occidental's contract, and the company's assets were expropriated.⁸ In response, Occidental filed its second ISDS claim against Ecuador, this time at ICSID, which is part of the World Bank Group.

When the ICSID tribunal ruled on the dispute, Occidental was awarded an unprecedented amount in compensation: GoE was ordered to pay US\$ 1.71bn, as

5. Montiel 2013.

6. Calvert 2018, 87.

7. *Occidental Exploration and Production Company v. The Republic of Ecuador* 2004.

8. Jones and Thomas 2015.

well as interest at the rate of 4.2% per annum since the filing of the claim.⁹ Although the size of the award was later reduced, the conflict between Occidental and GoE escalated, which increased the salience of ISDS and BITs amongst the wider public and catalyzed further civil society activism. Especially ICSID (known as CIADI in Spanish) became “literally a bad word. . . CIADI was the devil, because that’s where Occidental had initiated the humongous arbitration against Ecuador.”¹⁰ At the time, the price of oil was also surging, prompting increasing demands that the population in Ecuador should be able to reap more of the benefits from the exports. As the general sentiment in the country grew increasingly anti-investors, the Congress amended the Hydrocarbons Law to impose a 50% tax on oil exports.

Rafael Correa was elected president in November 2006. He represented the most ideologically radical left, and he fully identified himself with what was discussed as the “left turn” in Latin American politics at the time.¹¹ The 44-year-old, US-trained economist openly embraced Venezuela’s president Hugo Chávez and Bolivia’s Evo Morales, and vigorously opposed neoliberalism: in his inauguration, he announced his intentions to lead Ecuador on the path to “socialism of the twenty-first century”.¹² Despite the populist rhetoric, Correa’s government was formed with largely Western-educated individuals, self-identifying as “the technocrats of the left.”¹³ With his 73% approval rating, and a rare majority in government, Correa set to deliver on his promise of radical change and a clean break from neoliberal economics. Within his first years in office, he raised the already 50% tax on oil exports to 99%; doubled the welfare benefits for the poor from US\$ 15 to US\$ 30 per month; and pushed through a new constitution in 2008 banning investor-state dispute settlement outside Latin America. With regards to foreign investors, Correa’s tone was characteristically anti-American, and he was active in reaching out to potential new investment partners

9. *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador* 2012.

10. Interview E010.

11. Schamis 2006.

12. Conaghan 2008.

13. Interview E008.

in Venezuela, Iran, and China. He also developed cooperation with the Middle East by re-joining the Organization of Petroleum Exporting Countries (OPEC).¹⁴

The disputes with oil companies continued to intensify in the first years of Correa's presidency. A long-standing dispute with a US oil company Chevron relating to the Lago Agrio oil field in the Amazon rainforest escalated when the company first filed claims under UNCITRAL rules in 2006. Chevron proceeded to file another claim in 2009, where the company was demanding relief of an award granted to residents of Lago Agrio in a class-action lawsuit in US courts due to environmental and health damage caused by the company.¹⁵ When the tribunal ruled that Ecuador was to stop the enforcement of the compensation to the residents, Correa refused to comply with the ruling. Distrust on investment arbitral institutions became increasingly widespread, especially towards the World Bank institution ICSID, considered under the influence of the US.

In December 2007, Correa notified ICSID that it would no longer recognize the institution's authority ruling on disputes related to natural resources. However, it soon became obvious to policymakers in GoE that such announcement did not have any effect given Ecuador's multiple investment agreements delegating ISDS authority to ICSID. As a result, in 2009, Ecuador sent written notice to withdraw from the ICSID convention following the lead of Bolivia, which had denounced the institution in May 2007. Ecuador's withdrawal took effect six months later in January 2010.

The denunciation of the ICSID convention by Ecuador was a dramatic change in the country's economic policies and relations with the Bretton Woods institutions, and extremely controversial even when the general opinion was turning against the large foreign oil companies:

It was a scandal in Ecuador. The media were all over Correa. It was seen as a very symbolic break with international governance, obviously linked to the World Bank. But Correa by this time had already expelled the IMF representative and the World Bank representative from Ecuador. We were already in a major conflict with World Bank and IMF. This was the next chapter.¹⁶

14. Conaghan 2008, 56.

15. López 2019.

16. Interview Eoo8.

Despite the radical decision by the government to withdraw from the ICSID convention, the move was somewhat of a compromise between the different factions within Correa's government. In contrast to the overtly reformist stance by Correa with regards to investment treaties and ISDS, there were some in the government who were more cautious regarding the hard line driven by the so-called radicals. These divisions between the more moderate and radical factions within the government persisted throughout the two terms of Correa's presidency: the ministries relating to the economy were concerned that escalating disputes with investors and arbitration institutions was unwise and unnecessary, and that more nuanced approach to reform would be less disruptive to economic relations with partner states:

There was always the tension between those of us who are more on the economic sovereignty side: the Planning Ministry, Ministry of Finance, and the Foreign Ministry versus the Production and Trade Ministries. This was the main tension that was occurring at the time.¹⁷

These political power struggles within GoE can explain why Ecuador failed to achieve a credible exit threat and initiate renegotiation of BITs with partner states at a later stage, despite withdrawal from ICSID. Withdrawal from ICSID was instrumental for the radicals in GoE to advance their ISDS-critical stance and use it to send a message to the arbitration institution. However, investors could still access ISDS through BITs in other arbitration tribunals despite the withdrawal from the World Bank arbitration center.¹⁸ Some critics at the time complained that withdrawal from ICSID was merely symbolic and did not do much to reduce Ecuador's exposure to new claims: the anticipated legal effects from denouncing ICSID did not materialize in the short term, as the sunset clauses of various BITs delegating ISDS to the World Bank institution continued to apply.¹⁹ ICSID withdrawal was therefore an early compromise for the reformists in the Ecuadorian government with the more liberal, pro-business factions. Domestic negotiations

17. Interview E010.

18. There were also legal uncertainties regarding what Ecuador's withdrawal from ICSID meant exactly for the jurisdiction on BIT-based disputes. For details, see Alschner, Berdajs, and Lanovoy 2010

19. Interview E002.

limited the options available for the executive in Ecuador in the international sphere in the first years of Correa's presidency.²⁰ Because there were those deeply concerned with the negative consequences of what withdrawal from the investment treaty regime would mean for the Ecuadorian economy, its partner states never truly believed that Ecuador would terminate its BITs.

5.2 First BIT terminations, 2008

Despite the determination of reformists in Correa's government, GoE demonstrated careful balancing regarding its investment treaty reform agenda. Correa only terminated the nine least important BITs in the first wave of terminations, illustrating critical evaluation between the different treaty partnerships. The withdrawal from BITs was initiated in 2008, when Ecuador terminated BITs with Cuba, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Romania, Uruguay, and Paraguay.²¹ These first terminations were the so-called "easy BITs", as they were considered by GoE inconsequential with regards to bringing in any significant FDI.²²

If Correa's ideological disposition and majority government, backlash against ISDS, or momentum for reform alone were the determining factors of BIT policies, he would have been expected to terminate all BITs at the same time. When inquired why Correa adopted a selective approach to the BIT termination process initially, the interviewees agree that the reasons were highly political. The bargaining power position of Ecuador was strong with regards to the partner states whose BITs got terminated first: Ecuador's alternatives to the easy BITs were good, because it had more important BITs in place, such as those with the US, China, and its European partners. There was very limited amount of investment or other economic activity between Ecuador and the nine partner states, and therefore these BITs unnecessarily exposed GoE to ISDS claims. Therefore, any backlash from the governments of

20. Putnam 1988.

21. Of the first terminated BITs, only the Nicaraguan and Romanian BITs delegated ISDS authority to ICSID.

22. Interview E003; Interview E008.

the partner states would not have any significant economic impact, and the costs of hostile signalling from unilateral termination were negligible.

The first terminations were also easy in terms of the process required to terminate them. At the time, an executive order from the president was enough. However, following a constitutional referendum on the 28th of September 2008, a new constitution came into force. The constitution of 2008 includes Article 422, according to which “treaties or international instruments where the Ecuadorian State yields its sovereign jurisdiction to international arbitration. . . cannot be entered into.”²³ Although Correa intended the new constitution to provide a clear mandate for banning investment arbitration outside Latin America, it also made the termination of the remaining BITs more complicated. It outlined a process whereby any terminations of international agreements had to be approved by a vote in the National Assembly.²⁴ The National Assembly began to insist on clearance of the terminations by the Constitutional Court of Ecuador prior to any vote taking place due to the disagreements over the illegality of BITs under the new constitution. As a critical observer pointed out, “they [GoE] did everything wrong. If they wanted to do this [terminate BITs], they could have done this on year one!”²⁵ After the first “easy” BITs, the rest of the BITs had to be later terminated through the longer process outlined by the new constitution. Correa’s initially selective withdrawal therefore destined the rest of the BITs for a long and tedious route to termination: instead of a simple executive order, now constitutional and legislative approval were required for terminating investment treaties.

The initial, selective BIT terminations however enabled Correa to use the first wave of terminations for his political messaging. The first terminations served two distinct purposes: increasing the salience of issues relating to investment treaties domestically, and signalling to the international audiences about the intentions of Ecuador to terminate. While the disputes with companies such as Chevron had caught the attention of the wider public, there was little broader awareness over

23. Constitution of the Republic of Ecuador 2008 at Title VIII Chapter 2, Article 422.

24. *ibid.*, at Title VIII, Chapter 2, Article 419.

25. Interview E001

BITs at the time. A soft start to terminations could serve the purpose of raising further awareness and support for Correa's cause:

The least problematic [BITs] sent a strong signal. They created a nationwide debate around it. It gave the government an opportunity to talk about these things and why they're a problem, and to also embolden its bases to start talking about it... This was a way of putting it on the agenda...and obviously, you'll try starting with the least conflicted ones."²⁶

More importantly, the first terminations were used as an attempt to signal credible exit threat to international investors and partner states, and hence to boost Ecuador's bargaining power. The first terminations were a way of "pre-warning capital and states in the international system that you're starting a process of denouncing these bilateral investment treaties."²⁷ The early terminations, together with the earlier withdrawal from ICSID, were therefore a warning sign that the Ecuadorian BIT reform was underway. While GoE received lot of international attention in the beginning of its withdrawal process, it did not manage to convince the powerful partners about its determination to exit unless renegotiations would take place. This was largely due to the internal divisions in Correa's government, the well-known dependence of Ecuador on foreign investment for oil extraction, and the willingness of powerful states to instead focus on pressuring the Ecuadorian National Assembly to not approve Correa's BIT terminations.²⁸

The economy of Ecuador at the time of the first terminations was strong. Ecuador's GDP had near doubled between 1999 and 2007, and it had maintained an average annual growth rate of 4.5%. Most notably, the global crude oil prices increased dramatically from US\$50 in early 2007 and hit an all-time high in July 2008, peaking at US\$ 142 per barrel. At this peak, oil rents amounted to 18.5% of Ecuador's GDP.²⁹ The expansion of oil extraction activities with new partners were also expanding, with China National Petroleum Corp. (CNPC) having established a joint venture Andes Petroleum Ecuador with Chemical Corp. (Sinopec) in 2005.³⁰

26. Interview E008.

27. Ibid.

28. See Section 5.3.

29. World Development Indicators 2020.

30. Bourne 2013.

In this context, Ecuador was highly confident about their economic prospects, and it was a good time to begin to pursue BIT reform. GoE felt reassured that its alternatives to the nine BITs that got terminated first were strong, hence improving the strength of its bargaining position in relation to them. Because the alternatives to the BITs were considered very good, there was no interest to even consider renegotiating the easy BITs.

However, the same was not true for the rest of Ecuador's BITs. Profits from oil extraction were in key role in funding Correa's numerous social development programs, and there was a significant reliance on foreign investors in extractive efforts at the time. This dependency explains the reluctance of Correa's government to terminate the BITs with major investment partners.³¹ While the alternatives to the easy BIT were strong, and hence they could be terminated swiftly, the rest of the treaties had to wait for further improvement in alternatives and confidence that such alternatives could be achieved.

5.3 Preparing to terminate, 2008-2016

International audiences in partner states and the private sector got increasingly alarmed by Ecuador's reform efforts following the withdrawal from ICSID and the first set of BIT terminations. What followed was a period increasing international pressure on Ecuador to not terminate any further investment agreements, economic downturn after the height of 2007-2008, as well as parliamentary and legal battles over the faith of the remaining investment treaties. It is evident that during the entire period, the GoE was engaging in efforts to pursue alternative arrangements for appeasing investment incentives and partner states, and hence develop its bargaining power. GoE waited for such arrangements to be in place before decisive action to terminate further BITs.

31. Calvert 2018, 90.

Parliamentary delays

The 2008 financial crisis hit Ecuador hard, with the oil prices also dropping to US\$34 per barrel. In December 2008, Correa defaulted on the country's debt, claiming it illegitimate and the bondholders as "real monsters".³² While concerns over the economy were pressing especially for some factions in the government at the time, Correa pushed forward with the investment treaty reform efforts: on the 28th of September 2009, he requested the approval of the National Assembly to terminate additional BITs which granted ICSID jurisdiction, and therefore were alleged contrary to the new constitution. The National Assembly was however divided on the issue, and business groups in Ecuador protested that terminations would scare away investors that were now needed more than ever. The National Assembly therefore returned Correa's request saying that before a vote, it requires a prior ruling from the Constitutional Court about their anti-constitutionality.³³ However, when the Constitutional Court finally issued the requested judgements in June 2010, confirming that they violate the Article 422, the National Assembly only approved the terminations of BITs with Finland, the UK, and Germany. Of the three approved treaties, only the BIT with Finland was terminated in 2010.

This selectiveness of the National Assembly as well as the executive manifests of the profound concerns over the implications of BIT terminations. It was obvious that the BITs with stronger economic partners were risky to terminate, as "it was not the same thing terminating the Finnish treaty than the US treaty, for sure."³⁴ As was the case with the easy BITs, the treaty with Finland was not particularly important economically, but its elimination would likewise be a step towards limiting ISDS exposure. The executive initially hesitated to terminate the BITs with the UK and Germany, as terminating the treaties with larger economies would have potentially generated a stronger negative backlash.

Furthermore, lobbying efforts by some foreign states in the National Assembly also ramped up to stop the BIT terminations from getting approved, with pressure

32. "Ecuador defaults on sovereign bonds" 2008.

33. Gómez and Katia 2011.

34. Interview E001.

especially from the UK, the Netherlands, Germany, and Spain.³⁵ Furthermore, when Foreign Minister Fander Falconi informed the US Ambassador in 2009 in a meeting in Quito about GoE's plans to terminate and replace BITs with a new model to promote investment and social justice, his proposals were met by the Ambassador stating that GoE would have "hard time explaining this to Washington."³⁶ It was made clear that terminating the BIT with the US would have consequences, as US was also in a position to block a loan Ecuador had been negotiating with the IMF.³⁷

Eventually, the Swedish and French BITs also made it through the Ecuadorian legislative process in March, 2011. However, the executive did not pursue the immediate denunciation of these treaties. Ideology and determination of the leadership cannot explain the selectiveness of BIT terminations, as there was clear hesitation regarding the agreements with the European states, with the exception of the Finnish BIT.³⁸ There was also some confusion regarding how the agreements were to be terminated exactly: even though the decisions regarding terminations of BITs with the UK, Germany, Sweden and France were eventually taken by the end of 2011, it appeared that no formal notifications were sent to the affected partner states or their embassies at the time.³⁹ These BITs stayed in force for several years afterwards, with further extension provided in their sunset clauses. In April 2013, Correa filed a further petition to declare unconstitutional additional BITs with Argentina, Bolivia, Italy, Peru, and Spain. While the court agreed later in the same year, no immediate action was taken regarding these BITs either.

Developing alternatives

Amid pressure at the diplomatic level and delays in the National Assembly, the GoE was also hesitant to terminate further BITs while waiting for a new production law to take force in late-2010. The Congress enacted the Organic Production, Commerce and Investment Code, which was designed to provide a legal framework

35. Interview E010.

36. WikiLeaks Document 09QUITO905a 2009, 7.c.

37. Interview E003.

38. Montal 2019, 269.

39. Interview E001.

for formulating investor-state contracts with specific companies willing to invest in Ecuador.⁴⁰ For the reformists in the government, these contracts were preferable to international investment treaties in principle, as GoE was more in control of their content and dispute settlement provisions than they were of those in BITs. The expectation of the Ecuadorian government was that the most important investors would be willing to negotiate such contracts to provide the legal certainty previously provided by BITs, and therefore mitigate the inevitable backlash from investors that would follow any further terminations.

These contracts proved decisive in appeasing then-Chinese investors, who were more accustomed to the contract-based model of investment protection than their Western counterparts. China was investing heavily in Ecuador at the time through large infrastructure projects, and the plans for the over US\$ 10mil. Pacific refinery were in motion. There were fears that terminating the BIT with China would have severely endangered these investments.⁴¹ GoE resolved the issue by arranging state-investor contracts with the Chinese, which still allowed contract-based access to ISDS: any proceedings would take place in the Latin American region, in institutions such as the Santiago de Chile Chamber of Commerce or the Sao Paulo Chamber of Commerce, hence making them compatible with the Ecuadorian constitution. For the Chinese, these contracts were acceptable replacements for protections provided in BITs. By the time of the eventual termination of the Chinese BIT, most of the Chinese-funded infrastructure projects therefore had contract-based arbitration coverage in place, providing a vital alternative to protections under BITs. Establishment of the new framework and negotiating state-investor contracts therefore boosted Ecuador's alternatives to the BIT with China, and its bargaining power by minimizing the costs of withdrawal.

Correa also initiated the establishment of an alternative investment arbitration centre within the Union of South American Nations (UNASUR).⁴² Recognizing that if the government were to continue negotiating investor contracts with dispute

40. Organic Code of Production, Commerce, and Investment 2010.

41. Interview E010.

42. Páez-Salgado and Pérez-Lozada 2016.

settlement provisions, as well as keep providing access to ISDS based on the existing investment agreements, a new institution within Latin America would be both preferable to the Western arbitration institutions, and in line with Article 422 of the constitution. The possibility was attractive for both the reformists as well as the more business-oriented policymakers in the Ecuadorian government, as it would establish a clean break from the World Bank institutions, but also maintain access to ISDS for investors.⁴³ It also provided an opportunity for Correa to build a domestic coalition in support of continuing BIT reform: if a new arbitration tribunal was established, it could be a compromise between ICSID and completely abolishing ISDS provisions for foreign investors.

However, the negotiations for an UNASUR arbitration center were slow and hit multiple disagreements amongst key members, such as Bolivia, Argentina, and Brazil. Initially, the regional initiative critical of ICSID was attractive also to other UNASUR countries, which together had faced 111 cases before the institution by 2012, constituting 31% of its total caseload.⁴⁴ Ecuador made great efforts to foster consensus, with five meetings held in Quito in 2014. But after over five years of high-level diplomatic meetings on the issue, fundamental disagreements still existed. After Argentina elected a centre-right government, and the workers' party government in Brazil came to an end in 2016, the political climate had already fundamentally shifted, and Correa's government's efforts for an UNASUR arbitration center were eventually put to bed. Despite the efforts of GoE, its attempt to develop stronger alternatives by establishing a new regional arbitration center were not successful.

Seeking legitimacy

The GoE also wished to provide legitimacy for its BIT reform efforts in the eyes of the wider international community prior to the terminations with important partners. These efforts were meant to mitigate international backlash to the unilateral withdrawals from the regime. Ecuadorians were closely following the decisions in South Africa, India, and Indonesia to terminate their BITs, and even had

43. Montal 2019, 291.

44. Fiezzoni 2012.

ambitions to coordinate simultaneous withdrawal together with other developing countries. These efforts got closest in 2012, when GoE attended a Chatham House meeting with a high-level delegate from South Africa, as well as NGO representatives; an agreement was reached to terminate the BITs together on the same day.⁴⁵ However, when authorization was sought from Quito, the intra-governmental debate resumed regarding the fate of the BITs. While South Africa began terminating its BITs with a notification letter to the Belgian Ambassador in Pretoria on 7th of September 2012, Ecuador did not move to terminate for another five years.

In May 2013, Correa ordered the Citizens' Audit Commission (CAITISA) to investigate into all the BITs that Ecuador had signed. The mandate of CAITISA was to audit each individual treaty: how they were ratified, what the features of each individual treaty were, and what were the recommendations with regards to keeping, terminating, or renegotiating them. The audit, which was conducted between 2013 and 2015, revealed that not only were there more BITs than the government had even realized, but many of the BITs had also not undergone the appropriate legal process required for ratification.⁴⁶ The Commission was also tasked to assess whether it could be possible to keep some specific BITs and terminate others that carried higher risk of ISDS. For example, the BIT with Switzerland was so old that it did not include ISDS provisions; and the BIT with China included slightly different provisions. However, in the end, CAITISA recommended the termination of all remaining BITs, as the arguments for their termination were fundamentally the same: regardless of whether ISDS was anti-constitutional, investment treaties had not resulted in any significant increases in FDI, and the exposure to international arbitration by foreign investors was therefore fundamentally unjustifiable.⁴⁷ In addition, it would have been politically difficult to execute selective withdrawal, as the legitimacy of GoE's withdrawal efforts rested on uniform stance towards all BITs:

Can you imagine if the only bilateral investment treaty that had not been terminated had been the one with China? This would have been

45. Interview E010.

46. Interview E004.

47. CAITISA 2017.

unacceptable. It would have just destroyed our whole argument that there was an inherent problem with bilateral investment treaties.⁴⁸

It was obvious that CAITISA also served highly political purposes of the reformists in government. The clear intention was to provide further legitimacy for GoE's efforts: in addition to government representatives, CAITISA involved individuals from academia and NGOs who were highly critical and active with issues regarding foreign investment and the ISDS system, some of whom were internationally recognized experts.⁴⁹ On the contrary, no individuals from the private sector were invited to join the Commission. The work of CAITISA was highly publicized within Ecuador for the first year of its work, and it also helped to publicize the ongoing reform efforts. However, towards the end of CAITISA's review, the attention paid to the BIT audit waned. When CAITISA finished its review and briefed the GoE in 2015 about the 668-page report, recommending the unilateral termination of the remaining BITs, no action was taken.⁵⁰ As the government official explained their decision, "we were strategically waiting for the precise moment... it was just the time when we could not make public the report."⁵¹

Paralyzed reform process

Several factors put Ecuador in an uncomfortable position with regards to continuing the investment treaty terminations at the time, and Correa's government hesitated to take any radical steps that would have further upset its relations with major lenders and investors. Firstly, the major commodities decline in late 2014 hit Ecuador badly, with the price of crude oil plummeting. Year 2015 was also the first year during Correa's presidency that Ecuador experienced zero growth in its GDP, and 2016 saw negative growth rates of some -1.5%.⁵² A disastrous earthquake also hit Ecuador

48. Interview E008.

49. GoE took CAITISA very seriously; a representative of GoE was even flown from Quito to Singapore specifically for the purpose of meeting with one of the international members to request their participation in CAITISA. Interview E006.

50. GoE had been aware of CAITISA's recommendations already in 2014, before the full report was ready.

51. Interview E008.

52. World Development Indicators 2020.

on the 16th of April 2016 with devastating consequences for the local economy, as well as the tuna and banana industries heavily concentrated in the affected region. For GoE, CAITISA's report and the recommendations for major withdrawal from the BIT regime came at the worst possible time: "Pissing off the international community when we most needed particularly the multilaterals to kick in... This was the wrong moment."⁵³ The bad economic conditions decreased the available alternatives of Ecuador in relation to the BITs that were still in force, as GoE was highly dependent on keeping the relations with the key partners undisturbed.

Importantly, the negotiations were ongoing regarding Ecuador joining the free trade agreement already in place between the European Union, Colombia, and Peru, which directly prevented GoE in terminating BITs with European partners. Correa's initial stance was against joining the FTA, but the economic realities especially for key exporting sectors necessitated pragmatism: the province of Manabí suffered most of the damage caused by the 2016 Earthquake, which is the home to Ecuador's tuna industry, and the greatest exporting region to the EU. Until 2015, Ecuador had enjoyed being part of the Generalized System of Preferences (GSP) of the EU, which allows significant tariff reductions to developing countries when exporting into the single market. As Ecuador's economy had grown beyond the limits allowed for the GSP+ category, conclusion of an FTA was required if Ecuador wanted to continue enjoying the benefits of low-tariff exports. There were explicit threats at the inter-governmental level that if Ecuador were to terminate the BITs with EU member states, not only would there not be an FTA, but it would also lose its preferential access to the domestic markets in the EU.⁵⁴ As a minister explained,

There was no way we could get away with not signing [the FTA]. You're talking about \$400 million in exports per year that would have been jeopardized... The message was loud and clear. There is no way we are touching [BITs] or the negotiations will cease.⁵⁵

The FTA negotiations with the EU, GoE's efforts to develop alternative incentives for attracting and reassuring foreign investors, and the broader economic conditions

53. Interview E008.

54. Interview E004; Interview E010.

55. Interview E008.

were the main reasons why Ecuador did not pursue termination of its most critical BITs until 2017. While BITs were largely found to not have attracted significant amounts of FDI, terminating them would have had direct consequences regarding partnerships with China, the EU, and the US. More importantly, investment was closely intertwined with other areas of international political economy, such as trade and foreign debt: whereas the US had major leverage over Ecuador due to its influence over IMF lending, and EU over the trade provisions vital for Ecuadorian exporters, China was able to demand alternative arrangements for access to ISDS due to the major infrastructure projects under development. As Ecuador slowly improved its economic position towards 2017 and mechanisms to appease the partner states through alternative arrangements fell into place, these developments translated into stronger bargaining power in relation to the BITs.

5.4 Final terminations, 2017

By the spring of 2017, GoE had successfully removed the major constraints that had prevented it from terminating the remaining BITs. Ecuador had enacted the Incentives for Public-Private Partnerships and Foreign Investment Act in December 2015 providing various tax incentives for potential investment partners, which came into force 1st of January 2016. Together with the 2010 Production Code, GoE had therefore established legal mechanisms aimed to reassure investors and to make Ecuador more open to international business. The economic conditions in the country were also beginning to improve, with GDP growth at 2.4% after the negative growth in the previous year. While Correa had been reluctant to seek further financial assistance from the IMF, it yet received a \$364 mil. support package under the Rapid Financing Instrument, as well as further loans from China and the World Bank.⁵⁶ Most importantly, Ecuador executed the Accession Protocol to the Multiparty Trade Agreement with the EU in November 2016, and officially joined the EU-Andean Community FTA on 1st of January 2017.

56. Beittel 2018.

The decisive move to terminate the BITs followed closely after finalizing the FTA with the EU. In April 2017, the Commission for Sovereignty and International Affairs issued a report of the denunciation of the Ecuador-Italy BIT for the consideration of the National Assembly, which is the only report that was made publicly available before the final decision of the National Assembly. On 3 May 2017, it approved the denunciation of the remaining 12 BITs with Argentina, Bolivia, Canada, Chile, China, Italy, the Netherlands, Peru, Spain, Switzerland, US, and Venezuela. According to the President of Commission of Sovereignty and International Affairs, the objective of the unilateral denunciation of BITs is “to renegotiate but from the bargaining position of equality of the parties.”⁵⁷

It was not a coincidence that in May 2017, only days after the National Assembly approval of the terminations, the CAITISA report was finally made public, after having been concluded three years prior. A big media spectacle was made of the announcement of BIT terminations as well as CAITISA’s findings with members of the Commission attending, and Correa himself announcing the withdrawal from the unjust investment treaty regime.⁵⁸ The final timing of the terminations was carefully planned when no more political obstacles remained. It was also important for Correa to terminate all the remaining BITs at the same time: the diplomatic signal to the US, the Europeans, as well as China was that no specific partner was being favored, and that the major problem laid fundamentally with core principles of international investment protection.⁵⁹ By terminating the remaining BITs at the same time, accompanied by the publication of the CAITISA report and declarations of intent to renegotiate, GoE were mitigating the costs of hostile signalling from the final withdrawal, and attempting to open the door for future negotiations for new cooperative agreements.

Correa terminated the BITs as one of his last acts as president. In the April 2017 elections, Lenin Moreno was elected as the new president. While Moreno ran as the candidate for Correa’s PAIS Alliance party, he quickly distanced himself from

57. Cervantes-Knox and Thomas 2017.

58. Interview E005.

59. Interview E003.

the former president's leftist policies after taking office. Correa's last government foresaw their last opportunity to act to withdraw from investment treaties and timed the terminations to the very last days of the outgoing government.

5.5 Termination as the only option

GoE's approach to withdrawing from BITs has been criticized as ideological and principled, with commentators pointing out that a more moderate approach would have been more effective in limiting the country's ISDS exposure. Despite Ecuador's withdrawal from BITs and ICSID, Ecuador continues to face ISDS claims because of the sunset clauses, usually around 10-15 years, triggered by the unilateral denunciation of BITs. For example, the BIT with the UK includes a 15-year sunset clause, meaning that the treaty will remain in force until 2032.⁶⁰ Ecuador's decision to denounce the ICSID convention has created legal uncertainty over whether any new ISDS claims can be initiated at the World Bank institution; however, any disputes initiated prior to the terminations continue to proceed in practice.⁶¹ In theory, a better approach could have avoided survival clauses by renegotiating the terms of the BIT, or by mutually terminating the treaties together with the partners. However, neither of these alternative strategies to pursue BIT reform was likely to be successful in achieving the kind of radical change GoE was hoping for. The approach taken by Ecuador closely maps to the realities of bargaining power asymmetries in the global economy.

GoE as well as the CAITISA report recognized the implications of unilateral denunciation and the applicable subset clauses prior to the terminations. However, the consensus amongst all involved was that unilateral termination was the best *and only* way for Ecuador to pursue the reform of its investment treaties. The key problem Ecuador had with BITs was their ISDS provisions. Along with recommending not to include dispute settlement provisions, the new model for negotiating investment

60. Ecuador - United Kingdom BIT 1994.

61. An ICSID ruling on the 27th of September 2019 told GoE to pay the Franco-British oil company Perenco US\$ 449 mil. in compensation. *Perenco Ecuador Ltd. v. Republic of Ecuador and Empresa Estatal Petroleos del Ecuador (Petroecuador)* 2019

agreements formulated in the CAITISA report also advocates the exclusion of other substantive provisions such as the most-favorable nation (MFN) and preferential treatment provisions. However, the legal and policy community in Ecuador had no illusions about the prospects of renegotiation with such dramatic aims:

We saw that the only solution was really to get rid of ISDS. And in a renegotiation, that's what the government of Ecuador would have to ask [for]. And we knew that none of the countries with whom they have to rewrite these treaties would agree to [it].⁶²

This won't happen. All these concepts are almost customary now, and you don't have the leverage to [negotiate their exclusion].... maybe if you were the US. Maybe if you were Brazil. But this is Ecuador. It's just not happening.⁶³

The proposed model agreement was thought to be unrealistic in any renegotiation attempt with the most vital partner states because of their fundamentally stronger bargaining power position. While renegotiations of BITs might be achievable regarding narrowing down the scope or clarifying some language of existing provisions, fundamental changes desired by GoE were beyond the scope of possibilities.

The alternative of attempting to mutually terminate some of the BITs was also seriously considered by Ecuador, but the power asymmetries with treaty partners again formed a fundamental obstacle. The status quo provisions in place benefited especially the European and US investors, and the relevant governments lacked any incentive to be open to the requests to mutually terminate. Ministers of Correa's government understood the negotiations over investment governance and trade yet another instance of neo-colonialism, whereby different rules applied to Western partners and the countries from the global South.⁶⁴ While the EU was itself starting to initiate distancing itself from ISDS practice among member states at the time, it was not sympathetic to Ecuadorian efforts relying on similar arguments.⁶⁵ Unilateral termination of BITs was considered the best way to "start the clock"

62. Interview E003.

63. Interview E001.

64. Interview E008; Interview E010.

65. Dalton 2014.

for limiting exposure to ISDS by new investors, and even make future negotiations over investment governance possible:

“[T]o renegotiate BITs, you have to have a strategic position to get the two parties on the same table to renegotiate the treaty. If I am Ecuador, and you are the UK, how can I get you on the same table as me to renegotiate the BIT if the BIT benefits you with a lot of issues? If you’re okay with the BIT, you don’t want to renegotiate the treaty. So the first step is to have a decision that you . . . want to terminate the BIT. You can open the door to the renegotiation with a new BIT, if you want. That was the strategic reason to terminate, and leave that door open to renegotiate later with better terms.⁶⁶

GoE made efforts to attempt mutual termination of its BIT with Argentina, which was thought to be more sympathetic to the efforts of Ecuador. However, the process was taking too long, and GoE was growing frustrated waiting.⁶⁷ In the end, the best approach was decided to be unilateral termination of all Ecuador’s BITs, which came with the added benefit of a strong signal to partner states and foreign investor about determination for fundamental reform. Ecuador therefore executed the withdrawal from its BITs with the intent to exit the agreements. However, it also left open the possibility to leverage the strategic benefit that might materialize from first exiting for future negotiations.

5.6 Conclusion

Despite the near-perfect political conditions for terminating its BITs, Ecuador faced severe obstacles for the execution of withdrawal from the regime. President Correa’s leftist governments had through his two terms in office a highly motivated executive and the electoral majority in government. Furthermore, the numerous ISDS disputes with foreign companies had turned the national sentiment highly against the regime. It had also gained legitimacy for its reform efforts through consultations with other governments, such as South Africa, and the internationally recognized Citizens Audit Commission recommending withdrawal. Despite the

66. Interview E004.

67. Interview E010.

favorable conditions, Correa was unable to execute the final withdrawal from BITs with the most vital partners until the very last days in office.

GoE executed the withdrawal from its BITs in distinct waves, the first BITs getting terminated in 2008 and the final ones in 2017. The timing of the terminations is explained by economic conditions as well as GoE's desire to wait for alternative measures intended to attract foreign investors, enable negotiation of alternative legal arrangements such as investment contracts, and the conclusion of a free trade agreement with the EU. The first nine "easy" BITs were terminated swiftly without much controversy with inconsequential partners in 2008 amidst favorable economic conditions. However, the crucial BITs with European partners, the United States, and China required GoE to wait for the opportune moment, when sufficient bargaining power was achieved.

Correa's governments' intended legacy was to establish a new constitution, which took force after the first BIT terminations in 2008. However, any following withdrawals required approval of both the Constitutional Court and the National Assembly as per the new constitution, complicating the procedure. By 2011, further BITs with Finland, Germany, Sweden, and the UK were approved for termination, however both the National Assembly as well as the executive were selective regarding which BITs to terminate. While the largely inconsequential BIT with Finland was terminated without delay, there was hesitation with regards to the rest of the BITs with EU members. GoE was also waiting for the new production law to be enacted, which streamlined the process of negotiating state-investor contracts with ISDS provisions, which played a key role in appeasing especially the vital Chinese investors.

The final terminations finally took place in 2017, including the critical BITs with the US and China. GoE was purposefully waiting for the FTA to be concluded prior to terminating the rest of its BITs, and the terminations were concluded only shortly afterwards. It was clear that Ecuador, despite strong incentives to withdraw from ISDS especially in the World Bank tribunals, was severely limited by its dependency on the economic partnerships with key states in its efforts to execute termination of its BITs. Only when the favorable conditions and alternative

agreements were finally in place did Ecuador have strong enough bargaining power to finalize the withdrawal from its BITs.

6

Terminating to Renegotiate: Indonesia

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Like Ecuador, Indonesia also took the decisive step to announce termination of its BITs to respond to the increasing threat of ISDS. The Indonesian economy as well as society had experienced a dramatic transformation in the last few decades of the 20th century, and interest from foreign investors had been surging especially towards the mining sector following the Commodities Boom of the 2000s. However, in contrast to the Ecuadorian experience, the issue of withdrawing from the investment treaty regime was not politically controversial in Indonesia, and there was little general awareness of BITs prior to the beginning of the withdrawal process.¹ In addition, while both governments had bad experiences with ISDS, the motivations of Indonesia were different from those of Ecuador. The reformists in Ecuador were fundamentally opposed to the regime favoring foreign investors over sovereign states, but Indonesia wanted to modernize its outdated BITs and find a way to balance

1. Interview I001.

between investment facilitation and the state's ability to regulate in its national interest within the existing regime. But to initiate reform, Indonesia had to first demonstrate its preparedness to terminate existing BITs.

While the legislative procedure to terminate BITs in Indonesia was not as complicated as it was in Ecuador, where the prior approval of the Constitutional Court and the National Assembly were required, Indonesia had a different limitation on how quickly it could carry out terminations: most Indonesia's BITs included the so-called "tacit renewal" termination clause. These clauses automatically renew the treaty unless the BIT is terminated within an acceptable time frame prior to the automatic renewal, commonly for a period of 10 years.² If the appropriate termination window was missed, Indonesia would have to wait another decade before the next opportunity to terminate. Keeping an eye of these windows of acceptable denunciation, Indonesia started to systematically send notifications of termination to treaty partners whose BITs were coming up for renewal in 2014.

However, after terminating over 20 BITs, Indonesia stopped its withdrawal process in 2016. The government of Indonesia (GoI) learned that mutual termination of BITs would avoid the sunset clauses and would therefore be a preferable way to pursue investment treaty reform. The possibility started appearing increasingly achievable after mutually terminating the BIT with Argentina in October 2016. In addition, the demonstrated willingness to unilaterally withdraw from BITs opened the door to negotiations for new agreements with the most important partners, a possibility which also became realistic as the negotiations with Australia for a Comprehensive Economic Agreement began in August 2016.

It was therefore neither a decline in economic conditions nor the lack of alternatives which brought Indonesia's withdrawal process into a halt. Instead, GoI realized it could leverage its momentum for reform to approach the most important economic partners and negotiate new BITs based on its new model BIT, such as that with Singapore (2018), or Comprehensive Economic Partnership Agreements (CEPAs), such as the one concluded with Australia (2019). The strong

2. Bernasconi-Osterwalder et al. 2020.

bargaining position from attractiveness for investors and demonstrated credible exit threat enabled Indonesia to formulate a nuanced approach to investment treaty reform, terminating some of its unnecessary investment treaties and updating others with the most important partners.

6.1 Clash of resource nationalism and ISDS

The natural resource rich Indonesia has a long history of shifting policies towards foreign investors. After receiving independence in 1945 from the Dutch Empire, the post-independence government of President Sukarno pursued a series of isolationist economic policies, along with turbulent international relations striving for self-determination and geopolitical balancing during the Cold War. In 1965, Sukarno withdrew from the United Nations in protest to the international organization's support for the British proclamation of Malaysia; he nationalized all foreign private firms except for oil companies; and left the IMF and the World Bank. Sukarno's Indonesia represented exactly the kind of politically unstable country which could allegedly benefit from joining the investment treaty regime to reassure foreign capital that their investments would be secured.

After General Suharto ousted the Sukarno government in a military coup, his New Order administration was notably pro-West, and led Indonesia towards reintegration to the world economy. Indonesia rejoined the Bretton Woods institutions in 1967 and ratified the ICSID convention in 1968.³ Indonesia also began to form BITs with European partners: between 1968 and 1976 it signed investment treaties with the Netherlands, Denmark, Germany, Norway, Belgium, France, Switzerland, and the United Kingdom.

The last three decades of the 20th century led to remarkable socioeconomic improvement in Indonesia, leading to economic growth, an increase in literacy rates, and improving life expectancy. The IMF has attributed Indonesian development to macroeconomic stability, which created favorable conditions for private businesses to

3. Crockett 2017, 838.

execute their projects.⁴ In 1999, Indonesia joined the G20 as the largest democracy in the world after India and the US, and it implemented the Foreign Capital Investment Law to attract further new investment in 2007. In 2014, Indonesia had become the world's ninth largest economy with gross national income (PPP) almost at parity with the UK and France.⁵

As the Indonesian economy has grown more sophisticated, the weaknesses of its institutions have however become apparent with wide-spread corruption and unpredictability of the domestic justice system.⁶ Within Indonesia, it is an opinion shared by many that “there is little reason (if any) to put much confidence in our judiciary and other law enforcement apparatus.”⁷ Suharto's authoritarian government faced persistent allegations of corruption, and the public outrage escalated in the 1990s due to the president's children acquiring business monopolies across a range of industries. The democratic politics succeeding Suharto's regime have been marked by constant pledges to expose corrupt practices by presidential candidates. Yet, Transparency International ranked Indonesia 107th out of 174 countries in 2014, and its judiciary has the perceived degree of corruption of similar level as its political parties and the parliament.⁸

Despite Indonesia being a very different country today than it was a few decades ago, “the one thing that has not changed is the Indonesian legal system. It is as corrupt and non-transparent, and subject to irrational decisions as it was in the 1960.”⁹ Furthermore, challenges persist with regards business climate in Indonesia, with the World Bank ranking Indonesia as 72nd out of 190 countries on its Ease of Doing Business ranking, behind Singapore (2nd), Malaysia (24th), Thailand (26th), and Vietnam (68th).¹⁰ Indonesia has therefore provided a textbook case of a nation which, in theory, could reassure foreign investors about the respect for their property rights via international agreements. By 2011, Indonesia had

4. Boorman and Hume 2003.

5. World Development Indicators 2020.

6. Dick and Mulholland 2016.

7. Lumbantobing 2021.

8. Corruption Perceptions Index, Transparency International 2014.

9. Interview I005.

10. Doing Business, World Bank 2018.

established an extensive network of over 67 BITs, as well as various multilateral investment and framework agreements among the Association of Southeast Asian Nations (ASEAN) and their partners.

Export ban and growing disputes

A shift in the way Indonesia viewed its extractive industries and the involvement of foreign investors in it occurred following the global boom in mining between 2003 and 2014, when the demand from China increased the prices of commodities dramatically. During the period, the revenues for both central and regional governments in Indonesia had soared. However, amid concerns over the scarcity of natural resources, policymakers became worried that raw minerals were exported too quickly and cheaply out of Indonesia.¹¹ As a result, President Susilo Bambang Yudhoyono (SBY) wanted to incentivize mining companies to process minerals in Indonesia, and hence also stop the practice of simply selling commodities cheaply to developed countries.

To this end, the government of SBY established a new mining law in 2009, which effectively introduced a ban on the export of raw minerals. The policy was largely justified on nationalist terms. As the Coordinating Minister for Economic Affairs Hatta Rajasa speculated at the time, “if we continue to only export raw materials, then this nation will become a nation of coolies, a nation that depends on other nations.”¹² When the new President Joko Widodo inherited the initiated mining law from his predecessor following his election campaign in 2014, there were hopes from the business elites and foreign investors that he would adopt a more moderate approach to management of natural resources.¹³ Eventually, he however decided to carry on with the implementation of the raw materials export ban, justifying his decision based on his vision of a development trajectory for Indonesia.

Indonesia’s new attitude towards resource extraction became known as Indonesia’s growing natural resource nationalism by observers.¹⁴ However, it clashed with the multiple investment agreements it had signed over the previous decades. In

11. Warburton 2017.

12. Merdeka 2013.

13. Gore and Vetere 2014.

14. Abraham 2018.

accordance with the general trends of investment governance, most of Indonesia's investment agreements delegate ISDS authority to international tribunals. Despite the challenges with the domestic justice system and political instability, as well as the large amounts of foreign participation especially in extractive industries, Indonesia faced relatively few ISDS cases: only eight arbitration cases have been brought against it, and only one was decided in favor of the claimant.¹⁵ However, GoI started to become increasingly weary of ISDS as investors began to utilize the provisions in investment treaties. The substantive costs of engaging in arbitration proceedings and the resulting negative publicity have created a sense in GoI that "investment arbitration claims are not just whether you win or lose the case",¹⁶ and that limiting its exposure to ISDS is fundamentally desirable.

Concerns over ISDS became particularly salient in 2012, when the British Churchill Mining and the Australian Planet Mining initiated claims against Indonesia at ICSID. The two foreign mining giants had formed the East Kutai Coal Project (EKCP) together with an Indonesian company Ridlatama Group and found large deposits of coal for which the foreign companies held majority shares in mining licenses. Because a local company Nusantra Group had previously held licenses for the same mining area, the regional government of Kutai decided to cancel Churchill and Planet Mining's licenses in favor of the local company.¹⁷ After failing to appeal to the Indonesian Supreme Court, the companies initiated international arbitration claims. The claims based on Indonesia's BITs with UK and Australia constituted nearly US\$ 2bil. in damages.

SBY found it outrageous that the central government was held accountable despite the alleged violations having been conducted by the regional government. He noted that the implications of the ongoing ISDS proceedings could have severe consequences:

15. UNCTAD Investment Dispute Settlement Navigator 2020 The only dispute which has been decided in favor of the investor was a dispute with Amco Asia Corporation and others in 1981 in relation to GoI cancelling the US company's business license.

16. Interview I002.

17. Price 2017.

Don't let us be on the losing or the wrong side, because the implications will be very large. . . I do not want those multinational companies to do anything they desire with their international back-up and put pressure on developing countries such as Indonesia.”¹⁸

Although GoI never directly stated that the Churchill and Planet Mining cases were the reason it launched the review of its investment treaties, the dispute marked an important wakeup call for the state with regards to its obligations dictated in BITs.

When the export ban of raw materials eventually came into force in January 2014, this provoked another landmark ISDS case against Indonesia. Newmont Mining Corporation, a US-incorporated company, initiated arbitral proceedings at ICSID. While the Churchill and Planet Mining disputes were already under way, the conflict with Newmont had further unpleasant characteristics, which became known as some of the notorious negative implications of investment arbitration. The claim opposed directly GoI's efforts to regulate exports for the benefit of long-term domestic development strategy in the mining sector, a measure which many developing country governments were sympathetic to. Furthermore, Newmont initiated the ISDS claim through its Dutch shell company PT Newmont Nusa Tenggara to gain access to ISDS, as the US does not have an investment treaty with Indonesia. The conflict has also been subject to a lot of media speculation: allegedly, GoI threatened to withdraw the company's mining licenses if it did not cancel its claim for arbitration.¹⁹ Allegations also rose that ISDS had been used by the company to blackmail GoI: after the sudden decision of Newmont to withdraw its claims on the 29th of August 2014, and the GoI allowed it to resume raw materials exports as a result.²⁰ The conflict between Newmont and GoI has illustrated that ISDS can be used as a bargaining tool, rather than a genuine means to solve investment disputes.

18. Saragih 2012.

19. Price 2017, 138.

20. Taylor and Supriatna 2014.

6.2 First terminations, 2014

On the 13th of March 2014, the Dutch embassy in Jakarta announced that Indonesia had sent a notice of their intentions to terminate the BIT between the two states. Notification to the embassy was followed by a high-level bilateral meeting, where Vice President Boediono explained to the Dutch Prime Minister Mark Rutte that Indonesia's intention was to withdraw from its investment treaties with all partners as they approach expiry.²¹ The notification was taken as the decision by GoI to "jump on the bandwagon" of BIT terminations.²² International media and policy observers announced that Indonesia was joining the efforts of many developing countries to terminate their investment treaties, as Indonesia's move followed the terminations by Bolivia, South Africa, Ecuador, and Venezuela. Some applauded Indonesia's decision as brave.²³

A technically more accurate description of Indonesia's actions was to "let its BITs lapse." Rather than unilaterally denouncing the BIT as for Ecuador had done, Indonesia simply notified about its intentions to not allow the automatic renewal included in the treaty to be triggered.²⁴ However, due to the appropriate window for termination and required notification period included in the BIT, the termination would not take place before the 30th of June 2015. In addition, the eventual termination triggered a 15-year survival period as dictated by the sunset clause.²⁵ Even though the effective termination of the BIT was therefore far from imminent, with the investor protections staying in place until 2030, the announcement as well as the following media attention sent a strong message that GoI was intending to join other states withdrawing from BITs.

At the time, withdrawal from the Dutch BIT was interpreted as highly symbolic. The investment treaty network of the Netherlands had become notorious as one of the most generous in terms of providing protections and allowing broad interpretation

21. "Boediono meets with Netherlands PM" 2014.

22. "BIT by BIT in Indonesia" 2014.

23. "After South Africa, Indonesia takes a brave decision to terminate its Bilateral Investment Treaty with the Netherlands" 2014.

24. Ewing-Chow and Losari 2014.

25. Indonesia - Netherlands BIT 1994.

of the treaty language. For example, “nationality” of an investor is defined broadly to refer to either natural persons, or a legal person constituted under the law of either signatory state in the Indonesia – Netherlands BIT.²⁶ This implied that any entity that could claim to have the “nationality” of a signatory state could gain protection under the BIT. Indeed, a 2011 report by the Centre for Research on Multinational Corporations (SOMO) found that the Dutch investment treaty policy was encouraging treaty-shopping by multinational corporations: foreign companies were able to enjoy investment protections based on the Dutch BITs by virtue of some 20,000 “mailbox” companies registered in the Netherlands, without any employees or economic activity in the country.²⁷ This was also how Newmont had been able to bring claims against GoI. It was therefore not a coincidence that the Dutch BIT was the first one to receive the termination announcement.

The announcements were followed by diplomatic efforts to reassure foreign governments that Indonesia did not intend to fully exit the investment treaty regime. In her Annual Press Statement, the Minister for Foreign Affairs Retno Marsudi emphasized that Indonesia intended to create a new regime for governing foreign investment, while committing to attracting foreign investors and simplifying the permit procedure.²⁸ Likewise, in his policy brief to the South Centre, the Minister for Treaties for Economic, Social and Cultural Affairs Abdulkadir Jailani explained the rationale of GoI to initiate its BIT reform at length: many of its BITs were very old and referenced Indonesia’s old investment law prior to 2007. Jailani also emphasized that “. . . Indonesia has not lost faith in IIAs in general. Indonesia merely intends to modernize and to renegotiate its IIAs with a view to providing greater capacity to regulate in the public interest.”²⁹ While it was in GoI’s interest to attempt to mitigate any possible hostility perceived by international business, it proceeded to formulate its new negotiating template for future BITs, and as later became inevitable, negotiate new BITs and CEPAs with key partners.

26. *Ibid.* Article 2.

27. Os and Knotterus 2011.

28. t. R. o. I. Ministry of Foreign Affairs 2005.

29. Jailani 2015.

Pre-election nationalism

The timing of the withdrawal from BITs coincided with allegedly strong pre-election nationalism in Indonesia. The first terminations were conducted under the incumbent President SBY, who had already expressed his deep concerns over exports of raw materials and frustration over the accumulating ISDS challenges from foreign companies. There was also a broader rising sentiment of economic nationalism driven by an expanding economy and a consumer-oriented middle class.³⁰

SBY was constitutionally prevented from seeking a third term in office in 2014, and the hotly contested presidential election was fought between Joko Widodo, a son of a wood-seller, and a former general Prabowo Subianto. While Subianto was closely associated with the establishment elites and had the backing of major media outlets, Widodo was considered more in touch with the common people having grown up in a small village. He ran on a platform to establish a break from Indonesia's authoritarian past and achieve better social welfare for the poor.³¹ The campaign speeches in the 2014 elections were highly nationalistic, and often focused on the need to reduce dependence on FDI and to strengthen domestic businesses and production.³² When Joko Widodo won the election, he inherited both the ongoing process of systematically terminating BITs, which were coming up for the acceptable window for termination, as well as the execution of the export ban on raw minerals.

Strong economy and confidence

While the timing of elections maps closely to the beginning of GoI's withdrawal from BITs, the changes in economic conditions had created broader favorable conditions for the beginning of the reform efforts. The demand for Indonesia's natural resources from abroad had resulted in a steady increase of investment flows for the years building up to 2014. The five leading economic sectors of mining, machinery and electronic industry, construction food industry, and food crops and plantation attract the majority of FDI to Indonesia, accounting for US\$ 2.9bn or 43.3% of total capital

30. Bland and Donnan 2014.

31. "Joko Widodo wins Indonesia presidential election" 2014.

32. "BIT by BIT in Indonesia" 2014.

from foreign investors at the end of 2014.³³ The Indonesian Investment Coordinating Board (BKPM) also reported statistics that the initiation of BIT terminations had not had an observable impact on the FDI realization in the last quarter of the year. In addition to fostering greater incentives to reap more benefits from the activities of multinational companies, the rising interest from foreign investors reassured GoI that its natural resources would continue to be in high demand:

Indonesia has become more confident... its natural resources, in particular its mining resources, are in such high demand in the rest of the world, that regardless of what the investment dispute resolution mechanism is, foreign investors will still come. . . . The prospects for large profits from investing in Indonesian mining projects was so attractive that people were prepared to come, regardless of the risks involved.³⁴

In relation to investment treaties, increased demand meant that there was less danger that taking decisive action to limit GoI's exposure to ISDS provisions would scare away investors. The fact that Indonesia had experienced a substantive improvement in its general economic status likewise did not go unnoticed: there was a realization at specific government bodies, namely the Ministry of Foreign Affairs and the BKPM, that Indonesia could take advantage of its new economic position and initiate a more assertive policy to reassert its control over investment governance. The technocratic bureaucracies of GoI have become to reflect their economic power in relation to other states within Southeast Asia as well as globally:

The current position of Indonesia is better right now than several years ago. . . . Our current GDP. . . is not too far behind Australia and Mexico. I think we will be [in] quite a good position to increase Indonesia's position in front of partners from related countries.³⁵

Indonesia's ability to begin its BIT terminations was therefore a combination of the politically opportune climate in favor of limiting rights of multinational corporations, as well as the heightened sense that "foreign investors need Indonesia more than Indonesia needs foreign investors."³⁶ Although there was little awareness in

33. BKPM 2015.

34. Interview I005.

35. Interview I002.

36. Interview I005.

the wider public about the details of investment treaties or disputes, the withdrawal from BITs fitted well with the reformist agenda of the new administration of Widodo. However, after the highly publicized initial termination announcements, the process of sending out notifications to treaty partners was handled by specialist bodies of government, which took a highly technocratic approach to carrying out further BIT terminations.

6.3 Terminating systematically

Indonesia began a thorough review of its 64 BITs and five investment chapters under FTAs, motivated by intentions to limit ISDS exposure, modernize its investment governance framework, and investigate the possibilities to terminate and renegotiate them. After the initially highly political tone of withdrawing from the BIT with the Netherlands, the review was primarily conducted by two bodies of GoI: the Ministry of Foreign Affairs (MoFA) and the BKPM. Beyond the two agencies, there has generally been limited knowledge of issues related to investment treaties in Indonesia, even after increased media attention following BIT terminations.³⁷ The bureaucracies led by the two departments began to keep track of Indonesia's investment treaties and when their appropriate termination windows were approaching. For example, the BIT with Spain, signed in 1995, outlines that

This agreement shall enter into force on the date on which the two Parties shall have notified each other that the respective constitutional formalities required for the entry into force of international agreements have been completed. It shall remain in force for an initial period of ten years and, by tacit renewal, for consecutive ten years period. Either party may terminate this Agreement by prior notification in writing, six months before the date of its expiration.³⁸

Because the BIT with Spain had come into force on the 18th of December 1996, the automatic renewal was to be triggered on the same date in 2016. To prevent the tacit renewal, GoI served its notice to Spain in June 2016, and the BIT became

37. Lumbantobing 2021.

38. Indonesia - Spain BIT 1995.

officially terminated on the 18th of December 2016.³⁹ As with most of Indonesia's BITs, the treaty with Spain continues to provide access to ISDS for investments made prior to the termination date for additional ten years.

It was important for GoI to terminate BITs properly, as per the provisions outlined in the BITs. The gradual procedure to terminations was thought to avoid any negative political implications or "bilateral backlash" that might undermine Indonesia's position with partner states.⁴⁰ The intention was that the process would signal that GoI was conducting a technocratic review process, rather than acting out of anti-investor sentiment. Like in Ecuador, GoI concluded that indiscriminate approach to withdrawals would provide the best approach to eliminate ISDS exposure. As a negotiator described the policy to not discriminate between BIT partners, "when we decided to reform investment treaties, we terminated all the possible treaties that we could terminate at that time. We didn't choose which countries... we just terminate all of them."⁴¹

In additional efforts to mitigate negative consequences of BIT terminations, GoI adopted additional measures regarding its domestic laws regarding foreign investment. In June 2016, GoI published its draft regulation concerning the future of ISDS: it aimed to reassure foreign companies that they would continue to have access to ISDS despite the ongoing BIT terminations.⁴² Furthermore, presidential regulation number 44 was enacted in 2016: the so-called "negative list" liberalized investment activities by relaxing numerous restrictions in sectors that were of key interest to foreign investors.⁴³ It was therefore clear that GoI realized the importance of providing alternative means and reassurances for investors if it intended to avoid any negative consequences of its withdrawal process.

By March 2015, BKPM confirmed that GoI had cancelled a total of 18 BITs, namely with Netherlands, Bulgaria, Italy, South Korea, Malaysia, Egypt, Slovakia,

39. It was also possible to serve the notices earlier than the exact outlined window, as was the case with the Kazakhstan BIT: by 2015, GoI had sent its notice of termination, even though the BIT was not up for renewal until 2017.

40. Jailani 2015.

41. Interview I002.

42. Crockett 2017.

43. President of the Republic of Indonesia 2016.

Spain, China, Kyrgyzstan, Laos, France, Cambodia, India, Norway, Romania, Turkey, and Vietnam.⁴⁴ Despite the intentions for a systematic process for terminations, there were several BITs for which the window of termination had already passed, and the related BITs had therefore automatically renewed until 2024. It was therefore unclear whether the notifications sent to Egypt, India, South Korea, and Vietnam were meant to be retrospective, a long-term notice of termination in ten years, or an invitation for renegotiations.⁴⁵ By 2021, a total of 22 Indonesian BITs have been unilaterally terminated.

6.4 Three routes to reform

In 2015, GoI decided to change its approach to systematically notify partner states about BIT terminations. Indonesia entered a different phase in its investment treaty reform, with its focus shifting from withdrawal to renegotiations. The first reason for stopping the unilateral terminations of BITs were the sunset clauses, which kept being triggered every time an old BIT was terminated through unilateral notification by Indonesia.⁴⁶ It was thought better to halt the withdrawal process and focus on investigating whether better approaches were possible to eliminate ISDS obligations in old BITs. To mitigate some of the negative publicity that the withdrawals had resulted in, GoE also ramped up its efforts to pursue alternative agreements. The period generally marked a time of busy economic negotiations:

There was a time when there were so many negotiations happening simultaneously, especially between 2015-2016. We had at the time RCEP [Regional Comprehensive Economic Partnership], Indonesia-Australia CEPA, Indonesia-Turkey, Indonesia-Chile, Indonesia-Korea, the ASEAN-Hong Kong... six at least. In addition, the investment treaty negotiations, such as with the United Arab Emirates and with Singapore, which is part of the result we accomplished.⁴⁷

The second reason for the shift in process was that Indonesia had been developing a new model BIT since the decision to start the investment treaty reform process

44. Indonesia for Global Justice 2015.

45. Price 2017, 135.

46. Interview I002.

47. Interview I003.

in 2014. The model was intended to become its new negotiating position for all investment-related instruments. Other states had also developed their own model BITs, such as India, South Africa, and Brazil, whose example Indonesia was closely observing.⁴⁸ Although the Indonesian model BIT has not been made public, once the model was formulated, Indonesia decided to begin a push for new negotiations. While unilateral terminations had enabled many old BITs to remain in force for multiple more years, GoI renegotiation efforts were helped indirectly by the decisive message sent by the first unilateral terminations, creating a sense of urgency especially with vital regional partners.

Alternative strategies to eliminate old BITs began to seem more realistic at the same time the new model BIT was finalized. To avoid the sunset clauses in the existing BITs, there were two ways in which Indonesia could proceed: mutual termination without renegotiation or mutual termination with renegotiation.⁴⁹ In addition, a third, riskier strategy was to first terminate the BIT unilaterally, and then attempt to negotiate a replacement treaty at a later stage. Indonesia successfully executed these strategies with Argentina, Australia, and Singapore respectively.

The first approach, mutual termination without renegotiation, was to attempt to achieve agreement with the treaty partner to mutually terminate the existing BITs. Although partner states would effectively have to agree to give up the expansive protections provided in the agreement, GoI successfully managed to mutually terminate its BIT with Argentina on the 19th of October 2016. Several factors made the Argentinian BIT ideal for attempting this approach. As the next window to terminate the treaty would not have arrived until 2021, there was no time pressure to decide quickly whether unilateral termination was necessary to prevent tacit renewal. In addition, Argentina, which is one the most frequently litigated host states under ISDS clauses, was sympathetic to the cause of BIT terminations, and it agreed to mutually terminate without negotiations for a replacement agreement. Vivaly, there had also been little economic activity between Indonesia and Argentina since the

48. Interview I003

49. Bernasconi-Osterwalder et al. 2020, 6.

BIT had been signed in 1995, at the height of the expansion of the regime. Neither party had strong interest in attempting to salvage the investment agreement.⁵⁰

The second way to avoid the sunset clauses, mutual termination with renegotiation, was to negotiate a replacement agreement with the BIT partner, which replaces the old BIT and effectively terminates it.⁵¹ Indonesia successfully pursued the strategy through negotiations with Australia. Like Argentina, Australia had also gotten its share of ISDS claims: the dispute with the tobacco company Philip Morris initiated in 2011 had become a warning example globally for how multinational companies can attempt to prevent government regulation in the benefit of public health.⁵² The BIT with Australia was also not up for tacit renewal until 2023, taking time-pressure off from the approaching the counterparts. Australia was therefore an opportune partner suggest terminating the old BIT with. However, in contrast to the low-level economic activity with Argentina, the economic exchange between Australia and Indonesia is significant. In addition to vast investment by Australian companies, Indonesia is also a growing market for exporters from Australia: two-way trade between the economies in goods and services hit US\$ 17.8 bn in 2018-2019.⁵³ Simple mutual termination of the BIT was therefore considered suboptimal, and the possibility to unlock further potential seemed attractive for both parties. The bilateral conversations regarding forming a CEPA had first been initiated already in 2010, and the talks gained new momentum in August 2016 at an inter-ministerial meeting in Jakarta, following Indonesia's withdrawals from BITs.⁵⁴ The substantive negotiations for the IA-CEPA were concluded on the 31st of August 2018, and the agreement entered into force on the 5th of July 2020. As part of the negotiations, it was agreed that the old BIT was to be terminated, along with the provisions of the sunset clause.

The importance of the partnership with Australia, and the lack thereof with Argentina, influenced whether mutual termination with or without renegotiation

50. Interview I001.

51. Bernasconi-Osterwalder et al. 2020, 6.

52. *Philip Morris Asia Limited v The Commonwealth of Australia* 2017.

53. Australia-Indonesia CEPA 2019.

54. Australian Government Department of Foreign Affairs and Trade 2016.

Table 6.1: Indonesia: Three strategies to eliminate sunset clauses

Partner	Argentina	Australia	Singapore
Importance of partnership	Low	High	High
Tacit renewal approaching	No	No	Yes
Partner's ISDS experience	High	High	Low
Replacement agreement	NA	IA-CEPA (2019)	Indonesia-Singapore BIT (2019)

was preferable. Indonesia's approach towards the BIT with Singapore represents the third means to pursue reform – unilateral termination followed by negotiation of a replacement treaty. Singapore is a vitally important partner for Indonesia, with Singapore being a top investor in Indonesia since 2014, and bilateral trade hitting US\$ 59bn in 2019.⁵⁵ Unlike the BITs with Australia and Argentina, the tacit renewal of the treaty was approaching already in 2016, and hence the window to terminate the existing BIT was imminent. It was necessary for GoI to act promptly, as tacit renewal would have lifted any incentives for the Government of Singapore (GoS) to engage in prompt renegotiation of the BIT. By serving a notification of termination, Indonesia triggered the 10-year sunset clause. However, the mutual interest to promptly renegotiating a replacement agreement were promising given the attractiveness of Indonesia as one of the key target countries of FDI from Singapore. Following the termination announcement by Indonesia, negotiations for a new BIT were soon underway. Singaporean Prime Minister Lee Sien Loong and President Widodo met in Bali on the 11th of October 2019, and signed the new BIT, effectively eliminating the sunset clause of the old BIT.⁵⁶

Success of renegotiations

The initial unilateral BIT terminations had created an interesting dynamic regarding Indonesia's investment relations with partner states. By illustrating its preparedness to systematically terminate existing BITs that were no longer acceptable to it,

55. S. Ministry of Foreign Affairs 2020.

56. Ibid.

Indonesia created momentum to push for renegotiation also with close partners that were important to Indonesia. GoI was also confident that it was in a strong position regarding attracting FDI, despite the potential backlash that would result from unilateral terminations. Indonesia has pursued fresh negotiations with numerous partners since: in addition to the concluded IA-CEPA and Singapore BIT, GoI has signed the Chile-Indonesia CEPA (2017), EFTA States-Indonesia CEPA (2017), Regional Comprehensive Economic Partnership Agreement (2020), and the South Korea-Indonesia CEPA (2020). Furthermore, as of 2021, negotiations are ongoing for the Indonesia-European Union CEPA as well as joining the Trans-Pacific Partnership (TPP).

Renegotiation efforts with Australia and Singapore have been considered successful for Indonesia regarding the changes it has achieved for its ISDS obligations and general investment governance. Because GoI did not make its model BIT public, its exact negotiation priorities are not known; however, certain goals for GoI's reform efforts have become clear from interviews, press releases, and policy briefs by key individuals. Some of the concrete goals have included shortening of the sunset clauses, establishing certain substantive and procedural limitations especially to ISDS provisions, and achieving greater consistency across the investment agreements. There was also indication that GoI was going to take a pragmatic approach to future negotiations. In his policy brief, Minister Jailani cautions that future negotiations should resist temptation "to include broadly drafted clauses on public policy exceptions" to not defeat the purpose of signing a new investment treaty in the first place.⁵⁷ He also outlines that "excluding ISDS provisions altogether might not be a wise approach", suggesting that the Indonesian goal was never to fully withdraw from the ISDS system, but to merely redefine its scope.

Indonesia-Australia CEPA

An example of successful renegotiations following initial exit is the CEPA concluded with Australia. The finalized IA-CEPA shows signs that Indonesians were highly

57. Jailani 2015.

successful in pushing for their preferences regarding the investment provisions of the agreement. The ability of GoI to abolish the sunset clause of the Australian BIT was a clear indicator of successful renegotiation efforts following terminations by GoI. Because the sunset clause would have continued to apply for some 20 BITs, it was an achievement for Indonesia to convince Australians to give up the traditional protections the old BIT provided for their investors.⁵⁸ According to interviewees, it was not likely that Australia had equally reformist motivations towards the investment chapter as Indonesia did, even though it had also been on the respondent side of ISDS disputes with foreign investors. Because of the risks associated for Australian investors due to the fragmented, inconsistent, and corrupted legal system in Indonesia, the abolishment of formerly strong investment protections was likely due to insistence by Indonesian negotiators, rather than shared preferences with their Australian counterparts.

The IA-CEPA does not allow for traditional ISDS, but several limitations have been included. For example, a person possessing the nationality or citizenship of a signatory party cannot pursue a claim against that party,⁵⁹ and any claims that arise in relation governmental measures intended to protect or promote public health are excluded.⁶⁰ Furthermore, Indonesia has successfully insisted that the central government cannot be held liable for any violations conducted by any of its regional governments, such as was the case in the disputes with Churchill and Planet Mining. Furthermore, no claims are allowed based on foreign ownership limitations or divestiture obligations, which generally apply to foreign investors in the Indonesian mining sector.⁶¹

In addition, an interesting feature of the IA-CEPA investment chapter appears to contradict the customary norm of reciprocity in investment agreements, and clearly favors Indonesia. If a claim is made against GoI based on the IA-CEPA, the domestic courts of Indonesia are included as the forum where the claim should be

58. Interview I001.

59. Australia-Indonesia CEPA 2019, Chapter 14, Section A, Article 14.20, 3.

60. *Ibid.* Section B, Article 14.21, 1.b.

61. Luke 2020.

brought to by the investor; however, similar option is not included for Indonesian investors wishing to bring a claim against Australia.⁶² The formulation has surprised many as exceptional:

... Australia has agreed to allow for Australian investors to have to resolve their disputes with the government of Indonesia in the courts of Indonesia, while Indonesian investors in Australia get to go to international arbitration... We think it is particularly concerning that the Australian Government was prepared to give that up. I assume the rationale was that ‘there are so many opportunities for Australians in Indonesia that if this treaty goes through, the value of those opportunities outweighs the reduced protections that we’re going to agree to compared to the old BIT.’”

Indonesia therefore has been successfully in pushing for some of its preferences in the renegotiations with Australia that have followed the initial withdrawal from some 20 of its BITs.

6.5 Conclusion

Indonesia followed the example of a handful of other developing countries in 2014, when it decided to begin the process of withdrawing from its BITs by sending notices to partner states that it would not allow tacit renewal of the agreements as they approached expiry. The Netherlands was the first partner state to get its BIT with Indonesia terminated, leading observers to interpret GoI decision as highly symbolic due to the notoriety of the Dutch BIT network as well as colonial history.

The outrage leading to the political withdrawal decision was partially caused by the landmark ISDS disputes with Churchill and Planet Mining as well as that with Newmont Mining, which primarily increased the issue salience of BIT reform within the Indonesian political leadership. However, a vital role was played by the strong attractiveness of Indonesia as an investment destination: following the Commodities Boom of 2000s the prices of raw materials had surged, and the increasing demand especially toward the Indonesian mining sector convinced GoI that foreign companies would continue investing in Indonesia despite the BIT

62. Australia-Indonesia CEPA 2019, Chapter 14, Section B, Article 14.25, 1.a.

terminations. The termination process that eventually followed was handed over to specialist agencies within GoI, that started to systematically terminate BITs according to their specific provisions. The technocratic, indiscriminate process to terminations was intended to mitigate any negative signaling to partner states.

Indonesia decided to change its approach to BIT reform after 22 BITs had been terminated. The reasons for the shift were primarily the realization within GoI that unilateral terminations would trigger the sunset clauses, which in most cases effectively kept the ISDS obligations in place for another decade. When the Indonesian model BIT was ready to guide renegotiation efforts, GoI changed its tactic to approach partner states for their cooperation regarding terminating old BITs. It successfully pursued three approaches to eliminating the sunset clauses of existing BITs: mutual termination without renegotiation with Argentina, mutual termination with renegotiation with Australia, and unilateral termination followed by negotiation of a new agreement with Singapore.

Indonesia has so-far successfully leveraged its attractiveness as a destination for FDI, as well as the momentum created by the initial unilateral termination to begin to renegotiate its investment governance architecture from a position of stronger bargaining power with key partners. GoI does not intend to replace all terminated BITs, as the benefits of agreeing to limit its state regulatory freedom have not materialized in closer economic ties with some partners, such as Argentina. It however continues to selectively negotiate investment treaties and more comprehensive economic agreements with the most attractive partners.

7

Insights from case studies

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The experiences of Ecuador and Indonesia illustrate how bargaining power enables states to leverage withdrawal from investment treaties for their reform goals. While Ecuador wanted a clean exit from its BITs and the ISDS system dominated by ICSID, Indonesia wanted to find the most optimal strategy to modernize its stock of investment agreements and limit its ISDS exposure in the process. Bargaining power played a key role in both of their reform efforts. Specifically, strong economic conditions and attractiveness to foreign investors decreased dependency on the investment treaties and reassured both governments that the consequences of withdrawal from BITs would not have drastic consequences for their economies. In addition, new international and domestic legal arrangements that could attract FDI and appease BIT partner states were actively pursued by both governments

to develop their alternatives to BITs. Improved bargaining power through such developments helped Ecuador to exit from the regime and enabled Indonesia to conduct strategic exit to initiate fresh negotiations with important regional partners.

In this chapter, I briefly highlight key insights from the two case studies. I focus on the factors central to my theory, as well as alternative explanations. First, Section 7.1 summarizes which concrete factors improved the alternatives for Ecuador and Indonesia in relation to their BITs, and hence constituted their bargaining power. Second, I exclude the two key alternative explanations of ISDS experience and political ideology based on evidence from the case studies in Section 7.2. The role played by ISDS experience can only explain some of the initial incentives to seek BIT reform by Ecuador and Indonesia. However, it cannot explain the exact timing of withdrawals of Ecuador, nor Indonesia's strategy to negotiate new investment agreements following the withdrawals. In addition, while political ideology in the form of anti-capitalist populism in Ecuador and resource nationalism in Indonesia were present in the case studies, they cannot explain the timing of withdrawals, nor the strategic approach taken by both governments with regards to BIT reform. In section 7.3, I summarize the insights regarding the strategic elements of the reform process: while Indonesia was able to leverage initial withdrawal for new negotiations, the same was not possible for Ecuador. Despite withdrawing from ICSID and terminating the first "easy" BITs, GoE failed to establish a credible exit threat. Because Ecuador's powerful treaty partners did not believe GoE would terminate its most important BITs, no new negotiations were initiated. Unilateral termination of BITs became the only reform option for Ecuador. Section 7.4 concludes.

7.1 Sources of bargaining power

7.1.1 Economic conditions

In the cases of Ecuador and Indonesia, the strength of the economy significantly improved both states' bargaining power by improving their alternatives to BITs. At times of high economic growth, inward FDI, and high prices of commodities the governments became less concerned about any backlash from investors or partner

states that might result from withdrawing from BITs. Both Indonesia and Ecuador first decided to start unilaterally terminating their BITs when their economic prospects were positive. The role of economic conditions in shaping the timing of withdrawal from investment treaties therefore proved crucial.

Ecuador initiated its BIT terminations in 2008, when the strong economic position lowered its dependence on traditional economic partners and gave GoE the confidence to initiate withdrawal from ICSID, the key World Bank arbitration center, as well as terminate nine BITs. At the time, Ecuador's GDP had doubled during the preceding eight years, and the record oil prices attracted peak FDI towards its petrochemicals sector. However, GoE did not want to endanger revenue received from the foreign oil companies, which were used to fund on-going social reform programs. Therefore, Ecuador only terminated BITs with largely inconsequential partners in 2008, and not with states whose investors were heavily invested in oil in Ecuador.

Furthermore, GoE's reform efforts slowed down after the initial terminations and stopped for the period from 2011 until 2017. This was because Ecuador's economy took a substantial turn for the worse: several economic disasters hit the Latin American country hard, such as the global financial crisis of 2008, which resulted in a crash in oil prices and GoE defaulting on the country's debt. In addition, the year 2016 saw negative economic growth rates for the first time in a decade, as well as a severe earthquake with drastic consequences for the country's key export industries. Economic conditions hindered GoE from pursuing further BIT withdrawals, until finally terminating the rest of the treaties in 2017. Ecuador did not want to continue terminating investment treaties at a time when its dependency on foreign investment and partner states was at its highest.

Likewise, at the time of initiating BIT terminations, Indonesia had experienced remarkable socioeconomic development with regards to its society since initially joining the BIT regime. By 2014, Indonesia had transformed from a politically unstable developing country to the world's ninth largest economy, with great appeal for business opportunities due to its large population and natural resources. The Commodities Boom of the 2000s drove up the demand for raw materials and

translated into keen interest from foreign investors towards Indonesia's mining sector. The strong economic position gave GoI confidence that its inward FDI would not be hindered by termination of BITs, and that foreign investors would want to come regardless. This confidence translated into decisive political action by the executive to begin withdrawing from outdated BITs in 2014.

7.1.2 Alternative agreements and legal arrangements

Both governments actively developed alternatives to their BITs for attracting FDI and appeasing partner states both before initiating their withdrawal processes and as they were underway. The goal was partly to replace the functions of BITs and mitigate any negative backlash their termination might result in. Once such instruments were in place, both governments were able to act decisively to withdraw from their BITs. Indonesia had initiated ambitious economic negotiations prior to the withdrawal decision, such as the free trade agreement with the EU, and concluded for example the ASEAN Comprehensive Investment Agreement (ACIA) which came into force two years prior to the start of BIT reform. Indonesia also announced that it intends to join the TPP as its BIT terminations were in full swing. BIT reform was therefore occurring simultaneously with efforts to develop alternative international agreements.

For Ecuador, alternative agreements with important partner states were crucial in improving its bargaining power and eventually enabling it to unilaterally terminate the most important BITs. The negotiations of the FTA with the EU were of the highest priority for GoE: Ecuador was about to lose its preferential access to the EU single market, which was crucial for the Ecuadorian exporters. GoE was threatened by European governments that if Ecuador terminated its BITs with EU partners, the FTA negotiations would halt. GoE only took the vital step to terminate the most important BITs after the FTA was concluded. The agreement appeased moderate factions and reassured GoE that despite withdrawal from BITs, any negative backlash from investors or partner states would not endanger its economic prospects due to the new free trade agreement having been concluded. Furthermore,

Ecuador enacted the Domestic Production Code (2010) to guide negotiations for investor-state contracts, and the contracts proved vital in appeasing the Chinese investors who were heavily involved in large infrastructure projects in Ecuador.

Neither Ecuador nor Indonesia was making decisions regarding their BITs in isolation from other areas of economic cooperation. Indonesia was motivated to standardize its investment agreements to better align not only with its new preferences, but also quickly expanding framework of ASEAN agreements. It also became easier for Indonesia to negotiate investment provisions as part of larger agreements, such as CEPAs, where they could negotiate across multiple issue areas. Likewise for Ecuador, investment governance was closely tied with concerns of international financing and trade. Although BITs are narrow, single-issue treaties, they continue to provide a means of economic diplomacy, influencing other areas of cooperation in the global economy.

Both states also installed domestic investment laws intended to incentivize foreign companies. The goal was to minimize the negative effects of hostile signaling which withdrawing from BITs could have with regards to inward investment flows. Ecuador enacted the Public-Private Partnerships Law (2015), which provided tax incentives for foreign investors. Following the initial terminations, Indonesia also set out to improve its image for foreign investors. The Indonesian Investment Coordinating Board published its draft ISDS regulation which was intended to supplement the 2007 investment law in June 2016, and to reassure investors that they would continue to have access to international arbitration despite the BIT terminations. Furthermore, the so called “negative list” presidential regulation of 2016 relaxed restrictions on foreign investment in numerous sectors.

Both states were acutely aware of the potentially damaging effect withdrawal from BITs could result in with foreign investors. Although both governments were convinced that BITs had not actually attracted FDI since signing them, it did not change the governments’ concerns regarding potential backlash that might result following withdrawal. There were serious concerns regarding negative signaling both to foreign investors and partner states. Both Ecuador and Indonesia made great

efforts to mitigate such signaling and improve their alternatives to BITs before, during, and following their withdrawal from BITs.

7.2 Alternative explanations

7.2.1 ISDS experience

Both Ecuador and Indonesia initiated BIT terminations following high-profile ISDS disputes with foreign investors. However, their international arbitration experience cannot explain the timing of and the delays in the countries' investment treaty reform processes. ISDS can only explain their initial motivation towards reform, whereas bargaining power was more important in determining the timing of specific terminations, as well as the kind of strategies pursued by Indonesia following initial withdrawal decision.

The landmark disputes with foreign investors first motivated both Ecuador and Indonesia to initiate BIT terminations. Although Indonesia has only faced relatively few ISDS cases, the disputes with Churchill and Planet Mining as well as Newmont Mining were crucial in triggering GoI to press on with limiting its ISDS obligations. Likewise, GoE faced numerous arbitration claims, including the at-the-time largest claim by Occidental Petroleum of US\$ 1.71bn. Both states had grown highly concerned of the implications of their BITs regarding the extent to which foreign investors can bring the host governments into international arbitration.

ISDS cases therefore taught the governments about the risks of BITs and catalyzed the review processes in Ecuador and Indonesia about whether they were worth keeping. However, neither government acted immediately in response to ISDS cases. The stages of terminations in Ecuador closely track developments in the most important attributes of bargaining power – economic power and alternative agreements – while GoE was unable to respond to ISDS claims as they occurred with BIT terminations.

Likewise, Indonesia's ISDS experience can explain little about the country's reform dynamic that continues to unfold. The impact of strategic exit as a powerful tool to initiate fresh negotiations became evident when Indonesia halted its process

to unilaterally terminating BITs in favor of a more strategic approach to negotiate new, replacing agreements. The initial withdrawals helped Indonesia to credibly signal its exit threat and bring the most important partner states back to the negotiation table. ISDS continues to be an issue that can be negotiated over, rather than a fundamentally objectionable feature.

7.2.2 Political ideology

Like ISDS experience, while political ideology played a role in withdrawal from BITs for both Ecuador and Indonesia, it cannot explain the key decisions or their timing. Ecuador elected the left-wing President Correa into power in 2006, who was explicitly motivated to free his country from the dominance of Western-led capitalism as well as the unfair ISDS-system. After the initial terminations of the most inconsequential BITs in 2008, the clear anti-BITs stance of GoI did not help Ecuadorians to swiftly withdraw from the most important BITs – including the BIT with the United States, which has resulted in the largest bulk of the faced international arbitration cases so far. Even the unprecedented parliamentary majority of Correa during his second term did not enable termination of the remaining BITs, until Ecuador's economic conditions and the vital FTA with the European Union had been concluded.

Likewise, Indonesia's resource nationalism can explain some of the heightened motivations of political leaders to terminate BITs. However, it cannot explain the events following the initiation of withdrawal. President Yudhoyono had declared ISDS as dangerous for Indonesia because of ISDS claims, and he sent the first notice of intent to not renew its BITs to the embassy of the Netherlands towards the end of his term in office. Furthermore, the pre-election nationalism in Indonesia manifested in the speeches of the candidates, highly critical of foreign investors involvement in the country's extractive sectors. However, as the BIT terminations were initiated by a politician who was not eligible to run for a third term in office, pre-election nationalism and related attempts to appeal to voters could not well-explain the motivations to start BIT terminations. After the elections, President Widodo continued the withdrawal process initiated by his predecessor. However,

the decision to halt the terminations in 2016 and to pursue new negotiations with BIT partners instead did not match the general wave of resource nationalism that continues to influence Indonesian politics.

Political ideology can therefore motivate political actors and increase the salience of reform. It can provide a powerful incentive to begin the assessment of investment treaty commitments. However, after the initial incentives are introduced, the governments had to start examining their bargaining power position, and to assess whether they could act upon the incentives brought by political ideology.

7.3 Partner importance and prospects for renegotiation

After establishing that reform of BITs was in their interest, Ecuador and Indonesia had to decide, which course of action would best serve their goals. Both states decided initially that unilateral termination of their BITs was the best approach. However, while exit formed the only feasible way to achieve BIT reform for Ecuador, Indonesia found ways to leverage the unilateral terminations to initiate new negotiations to replace the old treaties, and hence successfully conducted strategic exit.

Ecuador conducted a thorough review of its BITs, and whether they could be amended more politically acceptable and compatible with the new constitution. However, due to the radical changes that would have to be demanded in all BITs, the possibilities of renegotiation were narrow. GoE struggled to establish a credible exit threat: despite terminating the inconsequential BITs early on in its withdrawal process, the rest of the partner states did not believe Ecuador would carry on terminating the more important BITs. Furthermore, while Ecuador found the key partners of the US, China, and Europe important, these partners did not value partnership with Ecuador to the same extent. The partnerships were therefore highly unequal. Hence, prospects for renegotiation or mutual termination were unachievable, and unilateral termination was the optimal choice, with the hopes of potentially re-opening new negotiations in the future.

Indonesia had a wider range of options within its reach due to its importance to key regional partner states, because of its natural resources and growing markets. The initial unilateral terminations effectively signaled determination that GoI was prepared to systematically withdraw from outdated treaties, and that if partner states wanted to continue to have treaty-based protections for their investors in Indonesia, they would have to re-open negotiations. GoI unilaterally terminated its BIT with Singapore, and the states successfully negotiated a new BIT in 2018. Furthermore, Indonesia successfully concluded the IA-CEPA, where Australia accommodated many Indonesian preferences especially in the investment chapter.

The key difference between Ecuador and Indonesia was their relationship with BIT partner states. While Ecuador was dependent on highly unbalanced partnerships, Indonesia received greater reciprocity from key regional partners. Furthermore, Indonesia managed to jump start new negotiations by initiating reform through unilateral terminations. Even though Ecuador is yet to have used its unilateral terminations for the purposes of strategic exit, and therefore negotiating new agreements, recent developments in Ecuadorian politics suggests that the new liberal government may attempt to follow the route taken by Indonesia with vital partners.¹ Despite the different motivations, withdrawal from BITs served the reform goals of the two revisionist states after sufficient bargaining power was achieved.

7.4 Conclusion

The cases of Ecuador and Indonesia effectively illustrate how bargaining power shapes decisions to first, withdraw from BITs, and second, to successfully negotiate new investment treaties. As a result of improved economic conditions, prospects for the attraction of FDI, and additional legal initiatives, both Ecuador and Indonesia were able to initiate their termination processes. Improvement in factors which decreased the states' dependence on existing BITs and minimized the prospects of negative backlash from foreign investors and partner states made it possible for the revisionist states to take decisive steps to withdraw from investment treaties.

1. "Ecuador Signs the ICSID Convention" 2021.

ISDS experience and emergence of political ideologies critical of foreign investors generated learning effects of the risks of BITs. Both factors therefore catalyzed an assessment of whether the existing investment treaties were worth keeping in place. These factors, however, did not directly enable the governments of Ecuador and Indonesia to withdraw from the investment treaty regime. Rather, the governments had to strategically assess whether their outside options to BITs were sufficient to enable them to benefit from deviating from their old treaty commitments.

The relationships with partner states determined which approach to BIT reform was optimal for the two revisionist states. While Indonesia has successfully pursued new negotiations with the most important partner states, Ecuador unilaterally terminated the rest of its BITs as the best way to achieve the reform it desired.

8

Conclusion

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8.1 Argument

The past decade has marked a shift in the international investment treaty regime, as some states have withdrawn from their BITs and others have begun to renegotiate them. Past research on change in the global governance of investments has largely focused on the backlash against international investment arbitration. This thesis highlights the role of bargaining power, usually treated as a mere background factor, in explaining governments' policy choices regarding BITs. Focusing on the bargaining power of signatory states sheds light on recent developments in the regime, which has been fundamentally shaped by the asymmetric negotiations between developed and developing countries.

States reduce their dependence on old BITs by improving their alternatives to them, which enhance their bargaining power in the related negotiations. Because

the main purpose of BITs especially for developing country governments has been to attract FDI, developments which make the country attractive for investment independent of investment treaties boosts its alternatives to BITs. Favorable economic conditions and rapid economic growth can expand the prospects for capital attraction and reassure governments that foreign investors will want to come regardless of the extent of treaty-based investment protections. Furthermore, states can incentivize investment through domestic legal arrangements, providing alternatives for the attraction of FDI. New international agreements such as free trade agreements also improve governments' alternatives to BITs, as they can replace the functions of BITs fostering both economic cooperation and diplomacy with partner states.

Because governments make economic policy under conditions of imperfect information, they have not immediately demanded reform of their BITs following improvements in their bargaining power. Facing ISDS cases has taught the affected governments about the true risks of BITs either through rational learning or breaking the previously dominant boundedly rational decision-making logic. ISDS can therefore catalyze the signatory states to reassess their existing treaty-commitments considering their new bargaining position. Only after the emergence of reform incentives through learning do the governments reconsider their bargaining position in light of their alternatives to the BITs. Without sufficient alternatives in place, or confidence that they can be achieved, governments will not act to withdraw or demand renegotiation of their BITs.

Once a state has decided to pursue BIT reform, it can choose between the strategies of exit, renegotiation, and strategic exit. Attempting renegotiation of existing agreements is difficult if those agreements clearly favor the partner state, as they have no incentive to initiate costly renegotiations or give concessions. Exit can therefore prove the only route to reforming BITs, despite the costs of negative signaling to partner states and investors, and the common survival clauses being triggered at unilateral termination. Alternatively, states can attempt strategic exit, whereby they first unilaterally terminate the BIT and initiate new

negotiations at a later stage. The initial unilateral termination provides a costly signal and demonstrates determination to walk away from the BIT in the absence of renegotiations. Strategic exit can force the partner state back to the negotiating table. Withdrawal from BITs can therefore serve two distinct purposes: to exit from unfavorable treaties, or to strategically attempt forcing new negotiations with important partners after the initial withdrawal.

Whether or not exit, renegotiation, or strategic exit from BITs will take place depends on how important the signatory states consider their partnership. Revisionist states with strong alternatives and incentives for reform will likely exit from BITs with unimportant partners, as there is little benefit from keeping the treaties and the costs of hostile signalling are small. Renegotiation of BITs is most likely between important partners, as both have a lot to lose from the collapse of the agreement and tend to have efficient avenues for communicating any dissatisfaction. However, if the revisionist state considers the partner state important, but the partner does not value the revisionist state in return, strategic exit becomes the best available choice. If cooperative gains still exist from having an agreement in place, strategic exit can help the revisionist state initiate fresh negotiations with the partner.

8.2 Findings

I find support for the argument from cross-national evidence and through two case studies. States have become more likely to terminate and renegotiate their investment treaties when economic conditions are favorable. Furthermore, the likelihood of BIT reform increases when alternative international agreements or other measures to protect and encourage investment are developed. These factors indicate the states' improved alternatives to investment agreements, and therefore their bargaining power in BIT negotiations.

Chapter 3 presented the cross-national analysis leveraging a panel dataset on BITs that had entered into force between 1963 and 2019. Increased bargaining power corresponds systematically to an increased risk of unilateral termination and

renegotiation of BITs. Specifically, the change in the economic power asymmetry between the signatory parties since treaty signature, as well as economic growth, are predictors of change in investment treaties. In addition to improvement in GDP, the rule of law in the initially weaker state has strong independent effects on the likelihood of BIT reform. These results suggest that bargaining power improvement of those initially disadvantaged in treaty negotiations have had a significant impact in the ongoing changes in the regime.

I find that the impact of ISDS on BIT reform is conditioned by bargaining power constraints. This confirms the findings of past research that in the aggregate, past ISDS experience by signatory states corresponds to an increased risk of BIT reform. States have experienced learning effects and become incentivized to terminate and renegotiate BITs both in response to ISDS claims they themselves have faced, but also in response to general global increases in investment arbitration involving other states. However, the effect of ISDS disputes on the likelihood of BIT reform depends on bargaining power of the initially weaker state. Those states can only take advantage of learning from ISDS when they have improved their alternatives through stronger economic conditions, rule of law, or caught up with the partner state in terms of relative power.

Differences are found in the predictors of unilateral termination and renegotiation of BITs. Economic growth in both signatory states, and improved rule of law in the weaker state make the risks of termination and renegotiation higher. However, stronger bureaucratic quality of the weaker state increases the chances of successful renegotiation of the BIT, while it has no impact on the prospects of unilateral termination. The findings increase the confidence that in the aggregate, bargaining power explains variation in the outcomes of BITs that are otherwise unaccounted for. States that become economically stronger since first signing up to the investment treaty regime and have improved their conditions of rule of law, become less dependent on BITs for the purposes of attracting FDI and convincing investors about the security of their property rights. Such changes therefore make change

in existing investment treaties more likely, especially for states that initially were in the weaker bargaining position when joining the regime.

In addition to the cross-national evidence, I further examined the impact of bargaining power on investment treaty reform through the cases of Ecuador and Indonesia. The case studies enable the consideration of more context-specific attributes of bargaining power, and the within-case variation enables the exclusion of key alternative explanations. Furthermore, the two purposes of withdrawal can be examined through the cases: while Ecuador adapted exit to withdraw from ISDS, Indonesia conducted strategic exit by successfully concluding new economic negotiations with important partners following initial unilateral terminations. The evidence shows that changes in factors contributing to the governments' bargaining power explained the progress of their BIT reform efforts over alternative explanations, and that withdrawal has been successfully leveraged to initiate new successful investment treaty negotiations.

The case of Ecuador illustrated that every country is constrained by its bargaining power when attempting to reform its investment treaty commitments. The Ecuadorian government was unable to complete the termination of its BITs until sufficient alternatives were in place. There were various factors that favored swift withdrawal: President Correa had a strong, left-wing mandate and a parliamentary majority; negative ISDS experiences had raised the political salience and popular support for investment treaty reform; and the citizens' audit commission had brought legitimacy for the reform efforts. However, only after economic recovery and conclusion of vital FTA with the EU was Ecuador able to unilaterally terminate its BITs with the most important partners. The case shows that regardless of any other factors, it was the improvement of bargaining power which eventually enabled Ecuador to withdraw from the investment treaty regime.

In Indonesia, the process of withdrawal from BITs was likewise enabled by improved bargaining power. Following strong economic performance and increased interest from foreign investors, the government of Indonesia became confident that investment treaties were no longer necessary for attracting foreign investment.

After unilaterally terminating many of its BITs, Indonesia began the process of negotiating replacement agreements with important regional partners. It was able to modernize the terms of investment protection in the new BIT with Singapore, as well as negotiate to eliminate the survival clause of its BIT with Australia upon conclusion of a new CEPA between the states. The case of Indonesia shows how withdrawal from investment treaties can facilitate reform in the investment treaty regime beyond simple exit and catalyze new negotiations within vital partnerships.

Overall, the findings from the cross-national analysis and the two case studies together show how bargaining power can explain some of the complex dynamics of change in the investment treaty regime. As states decrease their dependence on BITs as tools for attracting foreign investment and economic diplomacy, they become able to walk away from disadvantageous agreements and more forcefully demand their renegotiation. With improved bargaining leverage in economic negotiations comes more opportunity to shape global governance regimes.

8.3 Future directions for research

The findings of this thesis raise new questions regarding global governance of investments, which provide opportunities for future research. First, whether the trend of increasing withdrawals from BITs is likely to continue is an open empirical question. Recent developments, such as increasing ISDS cases because of the Covid-19 pandemic are likely to create further momentum with regards to reform of BITs.¹ I argue that withdrawal from BITs is often necessary to signal credible exit threat to partner states and to catalyze reform of existing treaty commitments. On the one hand, hostile signaling through withdrawal is likely to diminish as termination of BITs becomes increasingly commonplace, and as many states recognize the need for reform in the old treaty architecture. This trend can make withdrawal easier to execute for states previously concerned of scaring away foreign investors, hence also weakening the strength of the signal.

1. Uribe and Danish 2021.

On the other hand, with the increasing recognition of problems with BITs, more states have become open to the idea of renegotiation and the establishment of more comprehensive economic agreements, which can take over the provisions previously outlined in single-issue investment treaties. It is possible that some of the obstacles to mutual termination and renegotiation of BITs are lowered through general shift in the attitudes of governments towards old investment treaties. New, low-cost proposals, such as issuance of joint statements for how BIT-provisions should be interpreted by tribunals can decrease the barriers to achieving renegotiation-like outcomes.² Even status quo states benefitting from existing treaties are likely to accept the inevitability of reform, as awareness of the weaknesses of the regime spreads. Therefore, withdrawal from the regime may not be the only possible option for revisionist states to initiate change in the terms of investment cooperation.

Second, the practice of international investment arbitration is also likely to react to the demands for reform from member states. Even if change in treaty provisions with regards to ISDS does not change, it is likely that the arbitration practice and interpretations in key tribunals will adjust to the most common concerns of disputing parties. Concerns of frivolous litigation under investment treaty law may prove overstated in the long-term, as arbitrators adjust to only rule on claims which are most easily proven.³ Some states have also launched efforts to streamline the fragmented arbitration practice of *ad hoc* tribunals, with the European Union promoting a new multilateral investment court system with permanent judges and more transparent proceedings.⁴ It may not be necessary to abolish or redefine ISDS provisions in existing investment treaties if its practice can be brought in line with its theoretically beneficial purpose. The investment treaty regime and its defining structures do not exist in isolation from the sentiment of states operating within it.

Third, it is likely that the priorities over which audiences should be signalled to through signing and withdrawing from BITs are shifting over time. While Western developed countries used to be the primary sources of capital, different developments

2. Poulsen and Gertz 2021.

3. Johns, Thrall, and Wellhausen 2020.

4. Hallak 2020.

such as the emergence of new powerful states in the world economy and domestic political conditions can change the calculus regarding different strategic options. In addition to providing potential bargaining power boosts to governments, new audiences change the priorities over whom signals are being sent: withdrawal from a treaty with one state might be a welcome signal to another, and treaty-politics can be leveraged also for signalling domestically. The changes in international and domestic audiences may influence different states in different ways, and provide promising future research directions for exploring additional variation in outcomes in the BIT regime.

Finally, the interlinkages between the investment treaty regime and other areas of global economic governance provide fruitful areas for future research. The governments of Ecuador and Indonesia were both conducting their investment treaty reform in the context of other areas of economic cooperation, such as trade, finance, and taxation. Bundling of issue areas under more comprehensive economic agreements can provide opportunities to negotiate more effectively, as demands with regards to investment regulation can be accompanied with concessions on other areas, such as market access. Coalition building between the weaker parties in negotiations also becomes increasingly possible if multilateralism in investment governance becomes more widespread.

8.4 Contributions

The study of investment agreements has attracted increasing attention in the past decades, with expanding attention from policy, legal, and political economy scholars. Scholarship on treaty design, dispute settlement processes and arbitration awards, as well as the politics of international investment relations is accumulating fast. My research has extended this growing body of literature on the investment treaty regime and provided generalizable insights using investment treaties as a case of treaty-based international cooperation.

This thesis provides several contributions to the study of the international investment treaty regime and global economic governance more generally. It brings

bargaining power, often treated merely as a background factor, to the focus in explaining regime-level changes with regards to international investment treaties. In doing so, the thesis can explain the inaction of many states, and why reforming international regimes is always costly for individual states. While many experts and bureaucrats are knowledgeable and vocal regarding the need for reform, governments must face the uncertainties involved with withdrawing from the regime and upsetting the existing structures of cooperation. Bringing bargaining power to the center of analysis helps to highlight these realities and explains why the reorientation of the regime is a long and slow process.

Furthermore, by paying attention to the bargaining dynamics characteristic to any international negotiation, this thesis has provided better understanding of the link between ISDS experience and BIT withdrawal. The observation that increasing instance of ISDS has led to a backlash against investment treaties alone overlooks the extent to which states are constrained by their bargaining power when deciding how to approach adjusting their international legal commitments. I have shown that while ISDS claims can result in dissatisfaction with BITs and therefore strong incentives for terminating them, only some states are in the position to decisively pursue change. Every state is constrained by their bargaining power with regards to negotiating international agreements, and the investment treaty regime is no exception in this regard.

The thesis also contributes to the understanding of the sources of power for weaker states in the modern global economy. While economic power continues to provide a fundamental source of leverage in economic negotiations, my research has uncovered other ways in which the economically weaker parties have been able to improve their position in relation to and decrease their dependence on influential partner states. Developing countries have actively pursued stronger alternatives through economic partnerships with non-traditional partners, additional sources of capital inflows, and new instruments of investment facilitation. The pursuit of such alternatives to investment treaties has improved their bargaining power as a

result. Weaker states can therefore achieve stronger agency in the world economy and expand their scope of possibilities within global economic governance.

Finally, an important contribution of the thesis concerns the understanding of why states exit international regimes. There has been a recent increase in the scholarly and policy interest towards the phenomenon of backlash against globalization, as manifested by unilateral exits of states from international organizations and termination of international agreements. The research on withdrawals from BITs has provided an excellent laboratory to examine the dynamics of regime withdrawal, as the large number of agreements, near-universal coverage, and frequent instance of exit enable examination of broader trends across states and time. The thesis has uncovered that while exit often reflects dissatisfaction with the regime and is fueled by nationalistic sentiments, it can also provide a strategic tool for initiating change to improve outcomes in undesirable international regimes. Withdrawal can therefore provide a useful, albeit risky, approach to reaching for better terms of international cooperation.

Appendices

A

Additional results

Table A.1: Independent effects including expired and mutually terminated BITs, Cox PH models with dyad-clustered SEs

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Power change 1_{t-2}	0.2676 (0.3860)		-0.0909 (0.3989)		-1.4505 (0.7605)	
Power change 2_{t-2}	1.1857*** (0.2861)		1.0876*** (0.2914)		1.5316** (0.5024)	
Relative power change $_{t-2}$		-0.7454* (0.3565)		-0.7098* (0.3438)		-1.4797** (0.5062)
Economic growth 1_{t-2}	0.0268*** (0.0037)	0.0281*** (0.0035)	0.0258*** (0.0035)	0.0259*** (0.0034)	0.0344*** (0.0082)	0.0365*** (0.0079)
Economic growth 2_{t-2}	0.0153 (0.0093)	0.0169* (0.0082)	0.0179* (0.0070)	0.0189** (0.0064)	0.0229*** (0.0057)	0.0222*** (0.0061)
Law and order 1_{t-2}	-0.1861** (0.0599)	-0.2092*** (0.0573)	-0.0088 (0.0760)	-0.0061 (0.0759)	-0.0942 (0.1633)	-0.1035 (0.1707)
Law and order 2_{t-2}	0.0648 (0.0583)	0.0380 (0.0560)	0.1249* (0.0625)	0.1049 (0.0616)	0.4368*** (0.0926)	0.4219*** (0.0937)
Investment profile 1_{t-2}	0.0470 (0.0291)	0.0458 (0.0289)	0.0100 (0.0307)	0.0025 (0.0312)	-0.0349 (0.0709)	-0.0497 (0.0740)
Investment profile 2_{t-2}	0.0135 (0.0322)	0.0246 (0.0316)	-0.0124 (0.0338)	-0.0094 (0.0340)	-0.0547 (0.0758)	-0.0491 (0.0790)
FTAs in force $_{t-2}$	0.1569 (0.0917)	0.1750 (0.0898)	0.1183 (0.0928)	0.1248 (0.0921)	0.0072 (0.1910)	-0.0055 (0.1991)
ISDS respondent any 1_{t-2}			0.5316*** (0.1445)	0.6219*** (0.1492)	0.3230 (0.2248)	0.4010 (0.2333)
ISDS respondent any 2_{t-2}			0.7975*** (0.1537)	0.8823*** (0.1587)	0.7731** (0.2626)	0.8632** (0.2809)
Uni. termination total $_{t-2}$					0.0411*** (0.0071)	0.0396*** (0.0073)
Leftist executive 1_{t-2}					-0.1031 (0.1885)	-0.1148 (0.1932)
Leftist executive 2_{t-2}					0.4303* (0.2160)	0.4642* (0.2248)
Democracy 1_{t-2}					-0.0984 (0.1201)	-0.0774 (0.1263)
Democracy 1_{t-2}					-0.0984 (0.1201)	-0.0774 (0.1263)
Socioeconomic conditions 1_{t-2}					0.2107* (0.1043)	0.2346* (0.1072)
Socioeconomic conditions 2_{t-2}					-0.1882* (0.0821)	-0.1965* (0.0853)
Democratic accountability 1_{t-2}					0.3061 (0.2132)	0.2638 (0.2228)
Democratic accountability 2_{t-2}					-0.0208 (0.1131)	-0.0314 (0.1131)
Bureaucratic quality 1_{t-2}					-0.0415 (0.2252)	0.0523 (0.2360)
Bureaucratic quality 2_{t-2}					0.6918*** (0.1571)	0.7257*** (0.1624)
Corruption 1_{t-2}					-0.1953 (0.1536)	-0.2407 (0.1627)
Corruption 2_{t-2}					-0.3233* (0.1543)	-0.2744 (0.1587)
Government stability 1_{t-2}					-0.0209 (0.0866)	-0.0485 (0.0888)
Government stability 2_{t-2}					-0.1198 (0.0691)	-0.1192 (0.0699)
Intra-EU $_{t-2}$					-0.1495 (0.3554)	-0.1366 (0.3764)
AIC	6260.3672	5910.4248	6210.1964	5848.1856	2185.5887	2032.4009
R ²	0.0018	0.0012	0.0034	0.0033	0.0129	0.0127
Max. R ²	0.1742	0.1687	0.1742	0.1687	0.1696	0.1618
Num. events	315	296	315	296	127	118
Num. obs.	32933	32118	32933	32118	12333	12092
Missings	19085	19900	19085	19900	39685	39926

*** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$; $p < 0.1$

Table A.2: Interaction effects including expired and mutually terminated BITs, Cox PH models with dyad-clustered SEs

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
Interaction effects								
Power change 1_{t-2} *ISDS respondent 1_{t-2}	-0.0542 (0.1032)						-0.0460 (0.1138)	
Power change 2_{t-2} *ISDS respondent 2_{t-2}	0.4477*** (0.0843)						0.3475*** (0.0808)	
Relative power change 1_{t-2} *ISDS respondent 1_{t-2}		0.0789 (0.0470)						0.0530 (0.0449)
Relative power change 2_{t-2} *ISDS respondent 2_{t-2}		-0.2145*** (0.0615)						-0.1754** (0.0620)
Economic growth 1_{t-2} *ISDS respondent 1_{t-2}			-0.0002 (0.0026)					
Economic growth 2_{t-2} *ISDS respondent 2_{t-2}			0.0018* (0.0009)					
Law and order 1_{t-2} *ISDS respondent 1_{t-2}				-0.0082 (0.0069)				
Law and order 2_{t-2} *ISDS respondent 2_{t-2}				0.0635*** (0.0095)				
Investment profile 1_{t-2} *ISDS respondent 1_{t-2}					-0.0054 (0.0044)			
Investment profile 2_{t-2} *ISDS respondent 2_{t-2}					0.0147** (0.0046)			
FTAs in force 1_{t-2} *ISDS respondent 1_{t-2}						-0.0321 (0.0223)		
FTAs in force 2_{t-2} *ISDS respondent 2_{t-2}						0.0122 (0.0096)		
Independent effects								
Power change 1_{t-2}	-1.6764* (0.8402)						-1.5348 (0.8466)	
Power change 2_{t-2}	-0.3809 (0.7260)						-0.1760 (0.7566)	
Relative power change 1_{t-2}		-0.1674 (0.6266)	-1.1983* (0.4987)	-1.2374* (0.5131)	-1.1810* (0.5096)	-1.1803* (0.5054)		-0.2227 (0.6860)
Economic growth 1_{t-2}	0.0389*** (0.0079)	0.0377*** (0.0082)	0.0388*** (0.0114)	0.0380*** (0.0084)	0.0392*** (0.0081)	0.0389*** (0.0079)	0.0400*** (0.0105)	0.0393*** (0.0107)
Economic growth 2_{t-2}	0.0244*** (0.0049)	0.0269*** (0.0053)	0.0167* (0.0066)	0.0188** (0.0068)	0.0253*** (0.0057)	0.0253*** (0.0056)	0.0220*** (0.0061)	0.0258*** (0.0060)
Law and order 1_{t-2}	0.0865 (0.1676)	0.0593 (0.1742)	0.0357 (0.1762)	0.1796 (0.1870)	0.1038 (0.1839)	0.0308 (0.1799)	0.1711 (0.1838)	0.1313 (0.1826)
Law and order 2_{t-2}	0.4686*** (0.1037)	0.4878*** (0.1037)	0.4866*** (0.1053)	0.2052 (0.1142)	0.4991*** (0.1067)	0.4960*** (0.1061)	0.2441* (0.1087)	0.2046 (0.1152)
Investment profile 1_{t-2}	-0.0290 (0.0747)	-0.0365 (0.0772)	-0.0693 (0.0787)	-0.0629 (0.0827)	-0.0143 (0.0858)	-0.0718 (0.0770)	-0.0005 (0.0830)	-0.0282 (0.0855)
Investment profile 2_{t-2}	-0.0543 (0.0894)	-0.0171 (0.0943)	0.0223 (0.0949)	-0.0362 (0.0932)	-0.0853 (0.0995)	0.0009 (0.0946)	-0.0018 (0.0988)	-0.0142 (0.1035)
FTAs in force 1_{t-2}	0.0612 (0.2152)	0.0592 (0.2133)	0.0223 (0.2156)	0.0194 (0.2157)	0.0055 (0.2233)	0.1146 (0.2652)	-0.0710 (0.3277)	0.0451 (0.2846)
ISDS respondent 1_{t-2}	0.0229 (0.0244)	0.0219* (0.0100)	0.0106 (0.0128)	0.0404 (0.0276)	0.0568 (0.0388)	0.0152 (0.0096)	0.0704 (0.0425)	0.0730 (0.0390)
ISDS respondent 2_{t-2}	-0.1189*** (0.0295)	-0.0024 (0.0115)	0.0146 (0.0083)	-0.1547*** (0.0284)	-0.0828* (0.0332)	0.0181* (0.0081)	-0.1229** (0.0378)	-0.1169** (0.0395)
ISDS total 1_{t-2}	0.0346*** (0.0069)	0.0368*** (0.0070)	0.0378*** (0.0074)	0.0318*** (0.0072)	0.0373*** (0.0074)	0.0379*** (0.0075)	0.0311*** (0.0070)	0.0316*** (0.0070)
Uni. termination total 1_{t-2}	0.0153* (0.0074)	0.0181* (0.0077)	0.0176* (0.0078)	0.0176* (0.0079)	0.0167* (0.0081)	0.0183* (0.0079)	0.0200** (0.0076)	0.0195* (0.0079)
Controls	yes	yes	yes	yes	yes	yes	yes	yes
AIC	2123.4045	1985.6882	2003.3701	1964.8659	1997.6404	2000.7091	2109.7530	1965.1028
R ²	0.0183	0.0170	0.0155	0.0187	0.0160	0.0158	0.0207	0.0199
Max. R ²	0.1696	0.1618	0.1618	0.1618	0.1618	0.1618	0.1696	0.1618
Num. events	127	118	118	118	118	118	127	118
Num. obs.	12333	12092	12092	12092	12092	12092	12333	12092
Missings	39685	39926	39926	39926	39926	39926	39685	39926

***p < 0.001; **p < 0.01; *p < 0.05; †p < 0.1

B

Interviews

B.1 Example interview questionnaires

B.1.1 Government

General negotiations

- How are economic negotiations usually initiated?
- How does [country name] decide which countries to negotiate economic agreements with? Which negotiations are prioritized?
- Has [country name]'s ability to negotiate economic agreements changed over time?
- Has there been any change in interest from new partners?

Investment treaty terminations

- When did the government/agency first decide that reform of investment treaties is necessary?
- What were the main reasons leading [country name] to terminate its investment treaties? Why did you decide/recommend on this course of action?
- Did the government/agency receive advice from external sources, e.g. other governments, NGOs, international organizations?
- How did/does the government decide which investment treaties get terminated or renegotiated?
- Was the termination of BIT the only available option? Were there efforts to attempt renegotiation or mutual termination?
- (Why) did the government's attitude towards investment treaty reform change since the start of the reform?

After terminations

Has the strategy to terminate investment treaties been successful overall?

Do you think the government has achieved its goals?

Do you think terminating investment treaties has made it easier/harder for [country name] to negotiate new international agreements?

B.1.2 Private sector

Relations with investors

What kind of reputation does [country name] have regarding investment governance? Has this changed overtime?

Could you describe the process by foreign investors to navigate the legal environment in [country name]?

How important are investment treaties for investors? Do they care about access to international dispute settlement specifically?

Investment treaty terminations

In your opinion, what were some of the main concerns leading [country name] to terminate its investment treaties?

In your opinion, was the strategy of the government optimal?

How were the government's intentions perceived by the private sector?

After terminations

How have the [country name]'s decision to terminate investment agreements impacted the investment climate right after terminations/some years later?

In your opinion, have any investors been discouraged to investment because of investment treaty terminations?

What legal protections are there for foreign investors in [country name] since termination of investment agreements?

B.1.3 Third sector

Involvement in investment treaty reform

Could you describe how you initially got involved with [country name]'s investment treaty reform/investment policy?

Did the government accept advice from external sources, e.g. other governments, NGOs, international organizations?

Investment treaty terminations

What were some of the main concerns leading [country name] to terminate investment treaties?

What were some challenges faced by the government when terminating investment treaties?

Why did you recommend unilateral termination of BITs? Was the possibility of renegotiation or mutual termination considered?

(Why) did the government's attitude towards investment treaty reform change since the start of the reform?

After terminations

Do you think the strategy to terminate investment treaties was a successful one overall?

Do you think [country name] has experienced a drastic change in foreign direct investment/legal protections for investment since the terminations?

Do you think terminating investment treaties has made it easier/harder for [country name] to negotiate new international agreements?

Do you think terminating investment treaties has made it easier/harder for [country name] to negotiate new international agreements?

B.2 Interviews conducted

Table B.1: Conducted interviews

Code	Date	Category	Length
INDONESIA			
I001	10/02/2021	Private	30 min
I002	17/02/2021	Government	40 min
I003	19/02/2021	Government	1 hr
I004	01/03/2021	Third	40 min
I005	10/05/2021	Private	30 min
ECUADOR			
E001	04/05/2021	Private	50 min
E002	07/05/2021	Third	45 min
E003	10/05/2021	Third	1 hr
E004	11/05/2021	Third	45 min
E005	12/05/2021	Third	1 hr
E006	18/05/2021	Third	35 min
E007	19/05/2021	Third	45 min
E008	21/05/2021	Government	1 hr 15 min
E009	28/05/2021	Government	40 min
E010	30/05/2021	Government	55 min

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