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What Can Best Explain the Prevalence of Bilateralism in the Investment Regime?

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Abstract

Most efforts to negotiate a multilateral agreement on the liberalization and protection of investment have failed despite the fact that there are more than 2,400 bilateral investment treaties in existence. We have coined this phenomenon the "lateralism paradox." Within this article, we consider five hypotheses that focus respectively on power asymmetries, incentives for defection, strategic linkages, domestic constraints, and ongoing adaptation. We found that the first four explanations are not supported by empirical evidence from the post-NAFTA period. We conclude that bilateralism appears to be the only feasible approach for negotiating investment rules, as well as the most sensible process to ensure continuous and dynamic adaptation.

What Can Best Explain the Prevalence of Bilateralism in the Investment Regime?

This article seeks to explain a key characteristic of the investment regime. Indeed, a closer look at the regime's treaties clearly reveals a "lateralism paradox." On the one hand, most of the attempts to conclude a comprehensive multilateral agreement on the protection of foreign investment have failed (Schrijver 2001, 21-25; Young and Tavares 2004, 2). Although some multilateral investment instruments exist,[1] none of these provides compulsory rules for the liberalization and protection of investment as does Chapter 11 of the North American Free Trade Agreement (NAFTA), effective since 1994. And it is not because there have been no attempts. The investment chapter of the 1948 Havana Charter, the 1959 Abs-Shawcross Convention on Investments Abroad, the 1967 OECD Convention on the Protection of Foreign Property, and the 1998 Multilateral Agreement on Investment (MAI) were never adopted. The launch of investment negotiations was initially on the Doha agenda of the WTO, but a package deal adopted in July 2004 provided that investment issues were not be negotiated in the Doha Round.

On the other hand, the very same countries which have resisted any multilateral agreement on investment have signed bilateral investment treaties (BITs). Today, there are more than 2,400 BITs involving more than 175 countries (UNCTAD 2005, 24).[2] Following the NAFTA model, most of them prohibit discrimination, actions tantamount to expropriation without compensation, money transfer bans, violations of the minimum standard of treatment, and performance requirements. To ensure compliance with these substantive obligations, they entitle investors of signatory nations to binding arbitration actions against a host government.

How can one explain that states agree on certain provisions at the bilateral level and disagree on almost identical provisions at the multilateral level? Why is the investment regime driven by bilateralism? As Andrew T. Guzman (1998, 667-69), one of the few scholars who have investigated these questions, we think that the "enlightenment theory" is an untenable explanation. One cannot claim that states rejected a multilateral agreement on investment prior to realizing that they could gain from such a treaty, prompting them to enter into bilateral negotiations. Indeed, the unsuccessful attempts to negotiate a multilateral agreement on investment overlapped with the proliferation of BITs. Then, what can explain this lateralism paradox?

This article assesses and compares five hypotheses that help explain the simultaneous failure of multilateralism and the success of bilateralism. We will investigate, in succession, explanations that focus on power asymmetries, incentives for defection or the prisoner's dilemma, strategic linkages, domestic constraints, and ongoing adaptation. These hypotheses have been advanced in the literature on investment, although often in an intuitive or spontaneous manner. We will systematically confront each of them with empirical evidence from the post-NAFTA period. We will conclude that even though the investment regime is not integrated into a

multilateral instrument, its overall coherence owing to the similarity and diffusion of norms and rules within different settings, coupled with some key advantages of bilateralism for both home and host states, are most likely to make the lateralism paradox endure. In particular, we will see that it is a greater ability to provide for ongoing adaptation, especially in the context of a stalemate in the multilateral setting, that best accounts for the resilience of bilateralism as the key feature of the investment regime. Our findings might be of interest for the study of numerous other regimes in which bilateralism has recently become the new driving force (intellectual property, international criminal law, trade, etc.).

Power Asymmetries

Most scholars intuitively explain the lateralism paradox by a power-based approach to negotiation, according to which the distribution of participants' power explains outcomes. This is what Jeswald W. Salacuse (2004, 75) assumed when he wrote that "the great success of the bilateral approach no doubt had something to do with the power asymmetries that exist between developed, capital exporting states and developing capital importing states in a bilateral negotiating structure." Similarly, Pierre Sauvé (2006, 342) considers that "such asymmetries go a long way towards explaining the far-reaching and potentially intrusive nature of disciplines that host countries have been increasingly willing to accept."

This hypothesis postulates that investment negotiations oppose two groups of countries: on the one hand, few powerful capital exporting countries that seek to protect their investments through international law, and, on the other, a large number of weak capital importing countries that seek to protect their sovereignty. Under this postulate, two complementary assertions can be made. First, weaker countries can build coalitions at the multilateral level that could increase their bargaining power, foster more symmetrical relations, and allow them to block the negotiations. Second, weaker countries are isolated in a bilateral setting, stuck in strong asymmetrical relations, and resigned to accept norms favoured by the more powerful countries. While power equality tends to lead to a static condition under which participants get stuck in disagreements and conflicts, inequality allows the most powerful actor to move a regime forward. It follows that bilateralism flourishes while multilateralism perishes.

Undoubtedly, developing countries' coalitions played a key role in the failure of the WTO negotiations on investment. As soon as investment negotiations were seriously envisaged at the 1996 Singapore conference, a "Like-Minded Group" was created to counter the inclusion of investment as a new issue for the WTO. After that, the 2001 Doha Declaration provided that negotiations on investment could be launched in 2003 only if member states agreed on negotiation modalities. The Core Group of developing countries resisting investment rules and other "Singapore issues" was then created. At the 2003 Cancun conference, it was supported by the African Group, the African Caribbean Pacific Group, and the Least Developed Countries

Group. On the final day of the conference, Singapore issues emerged as the apparent dealbreaker, leading the conference's chair "to finally throw in the towel" (Narlikar and Tussie 2004, 250).

In the face of these block-type coalitions, developed countries did not always behave as a united group. During the MAI negotiations, the United States and some European delegations disagreed on many issues, including the provisions on taxation, the American Helms-Burton law, the consideration of countries belonging to customs unions, and the inclusion of cultural industries (Graham 2000, 27-34). As Walter (2001, 162) observed, the isolation of the United States "was increased by the defection of Britain to the moderate camp after the election of the Labour government in May 1997, producing a majority consensus within Europe." Ultimately, the withdrawal of the French delegation from the MAI talks in 1998 contributed to the collapse of the negotiations. The socialist French Prime Minister Lionel Jospin argued "that a new framework was needed that included all countries, including the developing nations" (Salacuse 2004, 84).

At the WTO negotiations, the US delegation, even though still promoting multilateral rules on investment liberalization, has not taken the leadership that can be expected from the world's first capital exporter (or second capital exporter if European Union (EU) members' outflows are aggregated). The United States rightly assumes that it could not act on this issue as the benevolent hegemon, a notion conceptualized by Charles Kindleberger (1981), according to which a dominant power unilaterally creates an international regime, internalizes the costs of cooperation, and provides a public good. The extensive scope of investor protection that the United States envisions, including the elimination of performance requirements and the right of establishment, could hardly be accepted as a global public good by other WTO members. A considerable amount of coercive power would thus be required to adopt and maintain a multilateral agreement reflecting US preferences. Furthermore, the United States is not willing to make significant concessions and prefers no deal to a deal that would not correspond to its interests in all respects. From its viewpoint, any effort to push investment negotiations at the WTO would lead to unsatisfactory results. Consequently, at the WTO Ministerial conferences in Seattle, Doha, and Cancun, the American delegation did not take the lead in investment negotiations (Kennedy 2003, 78; IUST 2003, 1, 13-14; Sauvé 2006, 330; Loppacher and Kerr 2006, 41).

The EU, followed by Japan, South Korea, and Switzerland, have pushed harder for investment negotiations at the WTO (Peterson 2003). Some developing countries, including Chile, Costa Rica, Turkey, and Morocco have been quite receptive to their arguments (Sauvé 2006, 331). However, the EU lacks credibility to act as the main leader for a multilateral agreement on investment. For some, the European position is "a red herring intended to draw attention away from negotiations on agricultural trade reform and the EU common agricultural policy" (Kennedy 2003, 77; Loppacher and Kerr 2006, 44). For others, the European Commissioner for Trade is pushing for an agreement on investment under the umbrella of a trade

organization to emphasize its competence on investment, still mainly under the control of national authorities (von Moltke 2003, 1; Graham 2000, 190).

Although developed countries do not act as a united coalition in the investment regime, major capital exporters are nevertheless committed to protect their foreign investments. Consequently, they have looked at other ways to ensure the protection and liberalization of investment. The logic is not new: "If the multilateral road is obstructed, then we will just have to explore these other roads" (Frankel 1997, 5). This is more or less what the United States Trade Representative (USTR) expressed after the failure of the WTO Ministerial conference in Cancun: "America will not wait for the won't-do countries" (Zoellick 2003a, 23).

Within bilateral negotiations, many developing countries are particularly vulnerable. The debt crisis and the increasing share of foreign investment in their economies made them dependent on developed countries (Deblock 2005, 135). In addition, when the communist block fell apart, many former communist countries were looking for western allies. Developed countries took advantage of this vulnerability to pressure developing countries into signing BITs. As a *de facto* result, developing countries agreed to protect the investments of developed countries. BITs were "initially exclusively addressed to relations between home and host, developed and developing, countries" (UNCTAD 1999a, 47).

The triad members, namely the EU, Japan, and the United States, had a great propensity to conclude BITs with countries that are part of their respective regional economic blocks, reflecting their investment outflows and their political zones of influence (UNCTAD 2003, 25). Only countries like India, that have more relative power when negotiating with developed nations, refrained for some time from signing BITs (Salacuse 2004, 75). Moreover, some developing countries, with regional power and with enough capital to invest in other developing states, behaved similarly to developed countries. China, for example, signed more than 95 BITs, and Egypt more than 85, most of them with other developing countries.

Thus, this first hypothesis focusing on power asymmetries provides a simple and powerful explanation for the lateralism paradox that seems to be matched with empirical evidence. On the one hand, the lack of leadership which developed countries extend to the coalition of developing countries explains the failure of multilateral negotiations on investment. On the other hand, the power asymmetries characterizing bilateral relations lead to a proliferation of bilateral treaties. Developed countries dissatisfied with specific rules put forward in multilateral fora were able to push for their preferred rules in bilateral negotiations. For instance, France and Canada, in their respective BITs concluded with developing countries, provide for a specific exception in favour of cultural policies, something they could not achieve at the multilateral level (France 1998, art. 10.6; Canada 2004, art. 3.2). For Loppacher and Kerr (2006, 55), "the ability of the United States to protect the same sectors (communications, atomic energy, mining, air transportation services, costumes brokerage, social services, and maritime transportation services) in all of its agreements shows its power in the negotiations and its ability to simply demand their inclusion."

However, the power asymmetries' hypothesis is incomplete. It is insufficient to explain why developing countries did not react to the rise of bilateralism by requesting a forum shifting to a multilateral organization where their coalition could ensure that international regulations on investment protection sufficiently maintain their development policies (Ganesan 1998, 16; Sauvé 2006, 350). It also fails to explain why the BITs do not differ significantly according to the level of asymmetry and the policy preferences of the two partners in question (UNCTAD 1999b). Moreover, focusing exclusively on power asymmetries cannot explain why some of the least developed countries are *demandeurs* for BITs with developed states, underlining the need to search beyond power asymmetries. To better understand these behaviours, one needs to look at the individual interests of developing countries and the collective action problem they face.

A Prisoner's Dilemma

The prisoner's dilemma is a second hypothesis to help understand the lateralism paradox. Guzman (1998, 666-67) posits that developing countries face a prisoner's dilemma in that they have to choose between protecting their sovereignty and attracting foreign investment. As a group, they are better off rejecting a multilateral agreement on investment. But as individual countries, they are better off signing BITs. Since the demand for capital flows exceeds their supply, developing countries must compete between themselves for available investments. Guzman argues that, given the rational interest of a country, a coalition could last until one state deserts the group. Once a developing country signs a BIT, it secures a competitive advantage over others to attract foreign investments. Then, all the other developing countries must follow in order to catch up with this comparative advantage. This explanation is similar to Baldwin's "domino theory of regionalism" under which preferential trade agreements produce trade diversion, which then generates a pressure for inclusion (1997, 876-83).

The prisoner dilemma's explanation could also apply to the rising number of BITs between developing countries. The investment outflows from developing nations have grown faster over the past 15 years than those from developed countries. Moreover, the outflows from developing countries are increasingly hosted by other developing states. Recent estimates suggest that "by the end of the decade, more than one-third of the investment flow in developing countries will originate from other developing countries" (UNCTAD 2004b, 19-20). Considering these estimates, it is not surprising that developing countries are competing against each other to attract investments from other developing countries. Almost 45 percent of the BITs have been concluded between developing countries (UNCTAD 2003, 89).

Guzman's idea centred on incentives for defection provides a convincing explanation for the exponentially growing number of BITs. However, it is hard to conceive that the multiplier effect could last forever. While it might be true that BITs created investment diversions in favour of the first developing countries that signed them, it is doubtful that the 2000th BIT could still provide them with a comparative advantage. Given that more than 170 countries are engaged in

the BIT "competition," it is likely that nobody will notice the winner of the race as there are too many runners.

Furthermore, the prisoner dilemma's hypothesis is not fully corroborated by economic findings. A number of studies have shown that BITs do not, or only marginally, increase investment flows (Walter 2002; Hallward-Driemeier 2003; UNCTAD 2003, 89). Countries which shy away from BITs, like Brazil and Nigeria, have seen large investment flows, "while many Central African or Central American nations have seen little investment despite having entered into rafts of BITs" (Peterson 2004, 10). In a recent report, the World Bank (2004, 117) concluded that signing a BIT "may enhance the credibility of a reform program, but evidence that these have observable consequences is scarce." A first BIT may signal to investors that a host country is resolved to offer a secure investment climate, but the twentieth would have little influence on investors' decisions. Market size, strength of legal institutions, political stability, and human resources play a far greater role in influencing the location of overseas investment. So why are many developing countries still *demandeurs* for new BITs?

Strategic Linkages

A third hypothesis for the lateralism paradox pertains to negotiating tactics used by participants. In a context of asymmetry between two participants, one of the most frequently used tactics is linkage (Haas 1980, 373; Martin 1992, 779). Linkage can be used either by stronger or weaker countries. In the investment regime, it is mainly the developed countries that successfully use it. As David Leebron (2002, 12) notes, "stronger nations will seek issue linkage so as to extend hegemonic power within one issue area to another." Hence, many developed countries link the investment regime with regimes where their bargaining power is stronger, like the trade regime. In doing so, they can either decrease payoff associated with defection or increase payoff for mutual cooperation (Martin 1992, 779). The United States, for example, explicitly uses its coveted domestic market to obtain tradeoffs. The African Growth and Opportunity Act makes it clear that African countries which want to benefit from preferential treatment must liberalize investment flows and accept an investor-state dispute settlement mechanism (US 2003, sec. 104(a)(1)(c)). Likewise, in a speech delivered in Jordan in 2003, the USTR stated that signing a BIT is a first step toward a comprehensive FTA (Zoellick 2003b).

Most FTAs that the United States, Canada, Japan, and Australia have signed with developing countries include an investment chapter with obligations similar to those provided in typical BITs.[3] Under these conditions, there is much more than investment flows that are at stake with international investment regulations. While most developing countries cannot attract more investment flows by signing more BITs, they could significantly increase their exports and attract investment flows by signing an FTA with a developed country. Hence, the prisoner dilemma's hypothesis could be expanded to include that individual developing countries defect from their

coalition and sign FTAs to obtain advantages over other developing countries in their competition to attract foreign investors and to reach foreign markets.

Linkage also provides further incentives for developed countries to conclude agreements on investment. While investment chapters of FTAs are typically analyzed similarly to other BITs, they are closely connected with the FTAs' other chapters. For example, investment chapters are often connected with intellectual property rights (IPR) chapters, another priority for many developed states in their relations with developing countries. When IPRs are included in the definition of investment, the chapter devoted to investment endows copyright or patent holders with rights and recourses that go beyond those provided in the IPR chapter. Investment chapters usually provide that the right to receive a compensation for expropriation does not apply if the measure is consistent with the IPR chapter of the same FTA. But a measure inconsistent with the IPR chapter of a bilateral FTA, although consistent with all multilateral IPR agreements, could allow the IPR holder to file a claim under investor-state dispute settlement provisions. This kind of linkage gives developed countries - concerned about the protection of their IPRs - the incentive to negotiate on investment within the framework of an FTA.

Thus, linkages give both developing and developed countries an incentive to enter into comprehensive FTAs. As UNCTAD (2004b, 7-8) observed, while the annual number of BITs concluded has declined over the last couple of years, "the number of bilateral [...] (FTAs) and regional free trade agreements (RTAs) - which, today, typically include provisions covering FDI - continues to increase." This is particularly true for the United States. While most of the US BITs were concluded before 1995, four US FTAs were signed in the year 2004 alone.

Linkage helps explain why developed and developing countries are still heavily engaged in investment negotiations. However, it provides little explanation for the prevalence of bilateralism over multilateralism. According to Baldwin, the domino effect of bilateral agreements is a curve that goes back to multilateralism. Bilateralism is only "half of the trade liberalization 'wheel' that has been rolling towards global free trade since 1958" (1997, 886). One can only presume that all the participants would eventually gain from switching from a bilaterally driven regime to a multilaterally driven regime. Thousands of bilateral agreements just amount to a complex and difficult-to-manage state of affairs (Bhagwati 2002). A multilateral agreement would most likely reduce negotiation costs, as well as uncertainties over dispute settlement.

Why did the United States, the EU, Japan, Switzerland, and Korea fail to successfully use tactical linkages in multilateral negotiations over investment? One can argue that linkages are easier in bilateral than in multilateral negotiations. Leebron (2002, 14) claims that strategic linkages are more controversial in the multilateral context: "While it might be feasible to pursue bilateral relations and bilateral agreements when everything is on the table, multilateral arrangements pose formidable obstacles to doing so." He argues that, at the bilateral level, strategic linkages are frequently achieved simply by negotiation and "once agreement on both

issues is obtained, no further linkage is required" (Ibid., 15). At the multilateral level, strategic linkages often need institutional relationships between two issues, leading to "conglomerate regimes." It would most likely have been regarded as unacceptable had the MAI negotiators at the OECD brought tariff reductions, loan conditions, environmental protection, or the fight against terrorism to the negotiating table. Such tradeoffs probably would have been seen as illegitimate for MAI negotiators (Alvarez 2002, 150).

However, the WTO context offers more linkage opportunities to push forward investment rules (Hoekman and Saggi 1999, 17). The WTO is precisely a "conglomerate structure" that has trade and investment under its umbrella and that provides the basis for a grand bargain. The single undertaking, a core characteristic of the WTO negotiating process, aims precisely to facilitate linkages between issue areas. The General Agreement on Trade in Services, the Agreement on Trade-Related Aspects of Intellectual Property Rights, and the TRIMs "constitute a convenient and effective foundation upon which a comprehensive investment agreement could be built" (Dymond and Hart 2004, 269). From the point of view of developed countries, linkages at the WTO can strategically exacerbate the collective action problems of developing states that have to reach a common position on many different issue areas. This element could explain why developing countries have not formed a blocking coalition capable of demanding conditions rather than just delaying multilateral rounds. Nevertheless, these linkage opportunities at the WTO were not fully exploited by developed countries to reach a comprehensive multilateral agreement on investment. As Smythe (1998, 98) observed, "there is little evidence of any attempt by the powerful capital exporters to link [investment] to other issues." Strategic linkages thus cannot provide a full explanation for the lateralism paradox.

Domestic Pressures and Constraints

Incentives for defection explain why the "BIT race" started among developing countries, and strategic linkages explain why countries are still *demandeurs* for investment negotiations. However, neither explanation satisfactorily answers the question of why the bilaterally driven regime did not switch to a multilaterally driven regime, even after a plethora of BITs and numerous FTAs had been signed. One can argue that these hypotheses provide partial explanations because they only look at one part of the game. Indeed, a BIT protecting foreign investors, as well as the successful use of coercive tactics by a foreign country, have impacts on domestic politics. Similarly, domestic politics influences international policy regarding investment. As Robert Putnam (1988, 434) argued, "[t]he politics of many international negotiations can usefully be conceived as a two-level game." State negotiators must anticipate their domestic "win-sets," i.e., the sets of all possible international agreements that would be acceptable at the domestic level, before negotiations end (Ibid., 436). International agreements are possible only if the domestic win-sets of all parties overlap. Accordingly, Putnam (1988, 438) predicts that "the smaller the win-set, the greater the risk that the negotiations will break down."

To understand the lateralism paradox, one must then compare the size of win-sets for bilateral and multilateral agreements. The size of a win-set depends on many variables, including domestic ratification procedures and preferences of non-state participants (Ibid., 442).[4] Domestic ratification procedures can significantly restrict or expand the negotiators' flexibility to negotiate a multilateral agreement on investment. Interestingly, the two potential leaders for a multilateral agreement on investment, namely the EU and the United States, both have ratification procedures that considerably reduce their win-sets for multilateral negotiations. Under article 133 of the Treaty establishing the European Community, the Commission is responsible for conducting trade negotiations on behalf of member states in consultation with a special committee. However, investment is not considered a trade issue. Though the Commission could act as spokesman for the EU in negotiations on investment, the approval of each European country is needed. During the MAI negotiations, individual EU member states negotiated on their own behalf. As a result, France was able to withdraw from the process while other European countries wanted to continue the discussions. The MAI history might have been different had the European Commission, which was an advocate of the agreement, been responsible for conducting negotiations on behalf of member states. But considering the current procedures, it appears easier for European countries to individually negotiate BITs with third countries than to coordinate a common investment policy for a multilateral agreement. In 1998, the year the MAI negotiations collapsed, Spain and the United Kingdom each signed two BITs, Germany and Italy each signed four, and France nine - all in the space of one year!

Domestic ratification procedures also reduce the US win-set for a multilateral treaty on investment. As the US Constitution provides that Congress has the power to regulate trade with other countries, the American negotiators must conclude an agreement that Congress would presumably approve of. In 2002, Congress clarified in the Trade Promotion Authority (TPA) its priorities concerning investment. Mainly as a result of the controversy sparked by the investor-state disputes within NAFTA where the provisions were perceived as being abused by investors, the TPA sets forth that the negotiating objectives of the United States are, among other things, to establish standards for expropriation consistent with US law (US 2002, sec. 2102(b)(3)). This demand dramatically reduces the USTR's win-set and its chance to conclude a multilateral agreement on investment. European countries are unlikely to be enthusiastic about replacing their criteria for the consideration of indirect expropriation with American ones. The TPA discourages countries to enter into negotiations with the United States because they feel that there is not much room for negotiation. Conversely, once the negotiations are started, the TPA increases the USTR's bargaining power, as states know that bargaining outside the TPA can lead to "involuntary defection."[5] This might partly explain why many countries are opposed to start any negotiation on investment within the WTO. It also contributes to explain how the USTR is able to standardize all its BITs and FTAs to the US set model.

Another variable on the size of win-sets is the distribution of power, preferences, and coalitions among non-state participants. This variable can also help explain the lateralism

paradox of the investment regime. Non-governmental organizations (NGOs), trade unions, and advocacy groups can no longer be ignored by negotiators of multilateral agreements. Their influence was clearly felt during the MAI negotiations (Sikkel 2001; Walter 2001, 152). While there is no single reason for the collapse of these negotiations, analysts are unanimous in recognizing the role of NGOs. Despite their diversity, NGOs managed to coordinate their actions and to agree on a joint statement.[6] Using the Internet to network and the media to be heard, a transnational alliance of environmentalists, developmentalists, trade unionists, protectionists, and nationalists provided focal points for all opponents of the proposed MAI and trade liberalization at large. As the document *Lessons from the MAI* concludes, "negotiators underestimated the intensity of the public debate the MAI would provoke" (UNCTAD 1999a, 23-24).

Since the collapse of the MAI negotiations, the NGOs have consolidated their influence on the investment regime. In developing countries, they provide seminars, research papers, and South-South coordination platforms. In so doing, they strengthen the opposition of developing countries' negotiators to investment negotiations at the WTO - an effort that bore fruit at the Cancun meeting. In developed countries, given that various investment disputes have been related to environmental measures (including the *Ethyl*, *S.D. Myers*, and *Methanex* cases), environmental NGOs advocate for the protection of the sovereign right of the state to adopt measures for sensible public policy objectives. Some of these NGOs successfully obtain seats on US advisory groups on investment, previously comprised exclusively of business executives (Walter 2001, 166). With the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and other organizations, they were able to convince key congressmen that foreign investors should not be accorded greater substantive rights than American investors in the United States (US 2002, sec. 2101).

How could this rising influence of NGOs explain the lateralism paradox? Presumably, NGOs opposed to capital liberalization invest more energy on potential multilateral agreements than on bilateral ones. This tendency simply reflects the transnational nature of NGO advocacy networks. To have more impact, NGOs from different countries must coordinate their actions and focus on common issues, which are by definition multilateral. In addition, focusing on multilateral negotiations has proven to attract media attention. Alarm bells on upcoming multilateral agreements are more attention-grabbing than an analysis of the 2000th BIT. Multilateral organizations, including the WTO, the World Bank and the OECD, created civil society committees, registered NGOs as observers, and hold public symposia. The involvement of transnational advocacy networks in multilateral negotiations even led scholars to coin the term "complex multilateralism" (O'Brien, Goetz, Scholte, and Williams 2000). Curiously though, no one seems to talk about "complex bilateralism…"

Moreover, multinational corporations did not show an indefectible support for a multilateral agreement on investment. One possible explanation is that the web of existing BITs already provides a relatively transparent, stable, and predictable legal framework in most

countries (Kennedy 2003, 85). Thus, during the MAI negotiations, the business community lost most of its interest in the process after it became clear that taxation provisions would be carved out and that "no significant new liberalization would be gained immediately" (UNCTAD 1999a, 24; Graham 2000, 19). Similarly, the business community lost interest in investment negotiations at the WTO when the right of establishment was taken off the negotiation agenda (Graham 1996, 89). The business community also fears that the inclusion of investment issues in the Doha Round "would create, as did the MAI negotiations, a new lightning rod for labour and environmental activism that would jeopardize the whole round" (Graham 2000, 192). Consequently, multinational corporations support capital liberalization at the multilateral level, "but not with the same enthusiasm with which NGOs attacked it" (Sikkel 2001, 175).

Judging from the little benefits which a multilateral agreement implies for investors and the vivacity of NGOs' opposition to a multilateral agreement, the developed countries' win-sets were relatively small at the end of the MAI negotiations and even smaller during the WTO Cancun conference. Negotiators presumably enjoy larger win-sets in bilateral negotiations, given that these are less controversial in domestic politics. Although NGOs' strategic focus on multilateral negotiations is certainly a key element, as it entails lesser domestic pressures and constraints on bilateral negotiations, this cannot, on its own, explain the lateralism paradox. It would be naive to think that negotiators simply echo slogans chanted at demonstrations. It would also be too simplistic to assume that negotiators' actions reflect the balance of power between civil society, the business community, and the state. In fact, one needs to go beyond the assumption that negotiators do not have independently-specified interests and ideas.

Ongoing Adaptation

Negotiators' ideas undoubtedly contribute to define their state's interests. As their ideas evolve, as a result of learning or socialization processes, their vision of their state's interests can also change, influencing its policy objectives and strategies. Consequently, it might be misleading to consider that the investment regime is primarily defined by a fixed antagonism between capital exporting and capital importing countries. A country's interests are not only determined by its investment flows, but also by dominant ideas within its government. In fact, dominant ideas within capital exporting and capital importing states seem to have evolved during the last decade, altering the structure for interactions in the investment regime. Although they still believe to have different interests, particularly regarding a multilateral agreement, the two groups of countries are gradually coming to the similar conclusion that the incremental nature of bilateralism allows to continue the liberalization process while minimizing risks and permitting an ongoing adaptation. The apparent contradiction between the hostility to a multilateral agreement and the enthusiasm for bilateralism could then "be explained by the capacity of the latter to adapt to the priorities and preferences of the partner state" (Dymond and Hart 2004, 268)

Arguably, negotiators from developing countries became more favourable to BITs as a result of a process that John Ikenberry and Charles Kupchan call “socialization through normative persuasion.” Under this process, elites from one state are subject “to ideological persuasion and transnational learning through various forms of direct contact with [elites of other states]” (1990, 290). The best example of a socialization forum for developing countries’ negotiators is the rounds organized since 1999 within the United Nations Conference on Trade and Development (UNCTAD). These negotiation rounds bring together a group of BIT negotiators from 10 to 20 states, both developed and developing. To facilitate communication and networking, separate negotiation rounds are organized for English-speaking, French-speaking, and Spanish-speaking civil servants. As mentioned in an UNCTAD report (2004a, 3), these negotiation rounds constitute a forum where developing countries’ negotiators “can meet other negotiators and share their experiences.” Clearly, they also constitute occasions where developing countries’ representatives are exposed to discourses from developed countries and UNCTAD on the virtues of capital liberalization. According to UNCTAD, the 13 rounds organized to date have resulted in the conclusion of around 180 BITs, mostly between developing countries. This socialization process partly explains why developing countries with little investment flows among them have signed BITs. The rationale behind the Lebanon-Togo or the Botswana-Egypt BIT would otherwise be difficult to explain. The socialization process might also explain why BITs negotiated between two developing countries are similar in many respects to those promoted by developed countries (Haslam 2004).

However, these developing countries’ negotiators who are increasingly engaged in BITs tend to return to their traditional position once at the multilateral level. They are then more directly exposed to the discourse of countries consistently opposed to investment negotiations and of international NGOs that focus their actions on multilateral negotiations. In addition, in many developing countries, there is deep suspicion of the multilateral economic organizations, based on previous experiences. These factors substantially reduce the negotiators’ enthusiasm for multilateral negotiations on investment. Hence, negotiators from a group of African countries, including Angola, Benin, Burkina Faso, the Democratic Republic of Congo, Guinea, Madagascar, Mauritania, and Togo, signed BITs among themselves and declared in a joint communication that further work on investment should be dropped from the multilateral process.[7]

As for developed countries, until the late 1990s, i.e., prior to the controversy sparked by the first investor-state cases under NAFTA, their negotiators tended to see investment negotiations as a technical issue. This might partly explain the profusion of developed countries’ BITs in the 1990s. However, over the last decade, developed countries’ views on investment negotiations have been redefined. This has not only been as a result of growing opposition within citizenries, but also because they realized that their interests were at stake. As Loppacher and Kerr (2006, 47) observed, “Many of the cases that have been brought under NAFTA’s Chapter Eleven […] stand in sharp contrast to what the drafters of the NAFTA had in mind.” The first surprising feature of NAFTA cases is the unexpectedly high number of claims filed against

developed countries. Traditionally, investment treaties used to provide "protection from harmful state interference in countries that otherwise have weak or corrupt judicial systems" (Krueger 2003, 420). In NAFTA, the intention was to protect US and Canadian investments from a historically unpredictable Mexican regulatory environment (Rubins 2003, 866). However, the three NAFTA member states have received approximately the same number of notices of intent to seek arbitration. In January 2007, the US government was the defending party in five simultaneous cases.[8] Therefore, the United States and other developed countries have come to see themselves not only as capital exporters, but also as host states exposed to foreign investors' claims (Aguilar Alvarez and Park 2003, 393; Jones 2002, 528).

A second surprising feature of the NAFTA cases is that most of them have not been launched against direct government actions to harm investment, such as a transfer of property, but against measures "tantamount to expropriation" and, arguably, adopted for sensible public policy objectives, such as the protection of worker's rights, public health, the environment, or social justice. As such policy areas are generally under the purview of sub-state authorities, the latter were the first to openly criticize NAFTA Chapter 11 as a model for subsequent BITs (Capling and Nossal 2006, 162). Given the broad scope of international investment rules, it might be quite difficult to predict if a measure could lead to a claim when a public authority enacts it. Investor-state procedures against developed countries are not only recurrent and unforeseeable, they can also be costly. Investor claims against the United States government have ranged from US$ 20 million to 1 billion.[9] As of January 2007, no Chapter 11 tribunal had issued a final award against the United States, but this might change as many cases are still under adjudication. Some US departments, especially those responsible for environmental protection and justice, also called for safeguards against frivolous investor claims. Such concerns were partially answered as the TPA provided that foreign investors should not be granted greater substantive rights than American investors in the United States (US 2002, sec. 2101). In Canada, the minister of International Trade went as far as saying that he would not sign a treaty for a Free Trade Area of the Americas if the investment chapter were identical to NAFTA Chapter 11 and previous Canadian BITs (see Canada 2002).

Although developed countries are still committed to liberalizing and protecting foreign investment, they appear to be less self-confident about the risk of litigation. One consequence of this general climate of reduced certainty is that BITs have been concluded at a slower pace. The number of BITs dropped in 1997, when the first investor claims under NAFTA and the drafts of the proposed MAI became known, and even more so after the collapse of the MAI in 1998. While 211 BITs were signed in 1996, only 73 were signed in 2004 (UNCTAD 2005, 24). Another consequence of this uncertain climate was the adoption of Notes of Interpretation by the NAFTA Free Trade Commission in July 2001 (FTC 2001). Previous to the adoption of these Notes, some arbitration tribunals adopted broad interpretations of the provision on minimum treatment. Following these decisions and the public debate they generated, the NAFTA member states adopted a narrower interpretation of minimum treatment. The Notes limit the meaning of international law to

"customary" minimum standard and stipulate that a breach of another NAFTA provision does not establish that there has been a breach of minimum standard.

A third consequence of the general climate of uncertainty is the revision of previous BIT models. In 2003, Canada updated its model "to reflect and incorporate the results of its growing experience with the implementation and operation of the investment chapter of the NAFTA" (Canada 2004). Likewise, the US administration drafted a new BIT model in 2004. The new American and Canadian BIT models provide additional safeguards to avoid "frivolous claims." Following the NAFTA Notes of interpretation, they clarify the meaning of the minimum standard of treatment. They add three criteria that must be used to consider an expropriation, namely, the economic impact, the interference with expectations, and the character of the government action. They also provide for increased transparency of arbitral proceedings, including the opening of the hearings to the public, the publication of the main documents, and the possibility to submit *amicus curiae* briefs (Gagné and Morin 2006, 369-71).

A fourth consequence is that the United States and other developed countries appear less enthusiastic to conclude an agreement on investment among themselves than they were in the 1990s. Arguably, developed countries have already established a strong system of investment protection and most national courts issue fair and impartial judgments over foreign investment. Investment flows in countries with well-developed legal systems are accordingly little sensitive to the existence of an investment treaty (Guzman 1998, 680). But an agreement on investment protection among developed countries is not only unnecessary; it represents also a threat of overlitigation. As the NAFTA experience has shown, claims by investors from one industrialized country against another developed state tend to increase significantly, sometimes put billions of dollars at stake, are often unforeseeable, and are always controversial in public opinion. In fact, all of the NAFTA cases against the United States have, so far, been filed by Canadian investors! Consequently, the United States agreed to the Australian proposal not to include investor-state dispute provisions in their bilateral FTA (US 2004), whereas both countries systematically include such a mechanism in their FTAs with developing countries. This perspective could explain why the United States did not show a strong leadership on investment at the 2003 Cancun conference.

Since the legal, political, and economic implications of investment liberalization are unclear, a flexible framework of negotiation and implementation becomes a key objective. Is the bilateral process more flexible than the multilateral one? We think that successive waves of bilateralism constitute a step-by-step process that better minimizes risks. First, a bilateral setting gives negotiators more flexibility to set rules *à la carte*, according to specific political and economic contexts (UNCTAD 1999c, 47). Developed countries may prefer to include an investor-state dispute settlement mechanism in their BITs with developing states and not in their BITs with major capital exporting countries. Western nations may also want to avoid a one-size-fits-all approach to include broader security exceptions in BITs with countries like China that are

not traditional allies but that might soon become major investors in developed states. Recently, the United Kingdom adjusted its standard practice within its BITs concluded with Panama and Vietnam by exempting a number of sectors, such as communications and certain natural resources, from national treatment and other treaty provisions for British investors (Peterson 2004, 6). The latter instance shows that the flexibility offered by BITs may also better accommodate development objectives and serve the interests of Southern states, making bilateralism a preferable option to multilateralism for both developed and developing countries.

Second, bilateralism gives negotiators the possibility to draw lessons from past experiences and to adjust their models for subsequent negotiations. This is what the United States and Canada have done recently when they revised their BIT models and concluded FTAs. Bilateralism makes it easier for countries to renegotiate and to draw back on undue commitment (Bayne 2003, 167). In fact, countries are increasingly embarking on the renegotiation of their existing BITs, "bringing the accumulated total of renegotiated BITs to 85 by 2004" (UNCTAD 2005, 26). Third, under a bilateral regime, negotiators can not only draw lessons from their own experience, but also from others'. Although the individual agreements are not connected to each other and are still far from being uniform, many seem to evolve in the same direction. The FTA between Korea and Chile replicates the provisions of the NAFTA's Notes of Interpretation on the minimum standard of treatment (KCFTA, art. 10.5). Canada, Japan, and Singapore were probably inspired by the US normative experience when they decided to include a right of establishment based on national treatment and most-favoured-nation in their own BITs. At the same time, it seems that China, India, and Brazil have taken up the somewhat softer protections offered in European BITs, which are also somewhat less intrusive for national sovereignty (Blackwood and McBride, 2006).

Under the hypothesis of ongoing adaptation, successive waves of bilateralism can be conceived as an evolutionary process under which negotiators are in a collective learning position, ensuring the continuous flexibility of the regime. In fact, the dynamic between bilateralism and multilateralism might be conceived under an organic rather than a mechanic metaphor. Arguably, the process of investment liberalization is not a structure of building blocks (Kline and Ludema 1997) or a rotating wheel (Baldwin 1997). Bilateralism does not and should not necessarily lead to a multilateral agreement at some point down the road. Rather, the juxtaposition of hundreds of bilateral agreements might be seen in itself as a systemic form of multilateralism, just like an ecosystem results from the interconnection of a web of hundreds of individual species. Hence, despite the diversity among the BITs, an authoritative interpretation between two countries might be incorporated in subsequent BITs between third countries and eventually affect the customary law of investment protection. Finally, if the web of bilateral agreements *is* multilateralism, there might not be any lateralism paradox.

Conclusion

UNCTAD (2003, 93) raised a crucial policy question for investment governance: “What are the advantages and disadvantages of bilateral, regional and multilateral approaches to negotiating [international investment agreements]?” Any reasonable attempt to answer this question requires that one understands why the investment regime still adheres to the tenet of bilateralism. One also needs to understand why most efforts to negotiate a multilateral agreement on investment protection and liberalization failed, despite the fact that there are more than 2,400 BITs. We have coined this phenomenon the “lateralism paradox.”

In this article, we have looked at five hypotheses for this lateralism paradox. Firstly, as is commonly assumed, the large number of BITs negotiated during the last decade can be explained by the increased relative power that bilateralism confers on developed countries, preventing developing countries from forging coalitions, as they tend to do at the multilateral level. Secondly, bilateralism can be thought of as a process that gives developing countries incentives to defect from their group in the hope of attracting more investments. Thirdly, it can be understood as an alternative better adapted for strategic linkages, especially with the trade regime. Fourthly, bilateralism can be seen as an avenue less monitored by NGOs, allowing a larger win-set for negotiators. And, finally, bilateralism can be conceived as a cautious approach, desirable for both developed and developing countries, as it is better suited for ongoing adaptation.

We have confronted each of these hypotheses to empirical evidence. Although none of them can account for all the dimensions and complexities of the lateralism paradox, they all point to its resilience. The approach centred on power asymmetries is appropriate to understand the historical failures of multilateralism, while the prisoner’s dilemma that confronted developing countries can explain the initial explosion of BITs. But our study focuses on the post-NAFTA period, when most new BITs are signed between developing countries, when previous treaties and BIT models are revised, and when developed countries, particularly the United States, are less enthusiastic about a multilateral agreement on investment. We thus find that the last hypothesis, centred on cautious adaptation, seems the most convincing and original explanation for the contemporary lateralism paradox.

It has long been argued that a multilateral agreement on investment is needed to replace the complex “spaghetti bowl” of bilateral agreements (Dymond and Hart 2004, 268). For Sauvé, “the quest for an ultimate multilateral, WTO-anchored, destination must be kept in mind and inform the actions of those countries that continue to believe in the desirability of such a rule-making journey” (2006, 350). As he mentions, this quest raises the question of the “value-added” that could be expected from a framework for investment at the multilateral level. There is no doubt that some features of a multilateral agreement, notably the possibility to have a more

consistent case law and eventually a sort of appeals mechanism, would represent a significant improvement.

However, to the extent that the unilateral, bilateral, and regional liberalization of investment policies proceeds and that investment continues to flow at increased rates, "the case for a multilateral approach to such liberalization is weakened" (Graham 2000, 187; Dymond and Hart 2004, 271). One could seriously doubt that a multilateral regime would be more successful than a dynamic network of BITs in increasing international investment flows. There is a situation of near paralysis and a high level of controversy over investment negotiations at the WTO. Not to mention that, within states, opposition from constituency groups to investment talks has focused on multilateral negotiations. Hence, following the controversy sparked by the NAFTA investor-state cases, the resulting changes that were brought to subsequent BITs and FTAs could hardly have been secured in a multilateral setting. Above all, multilateralism could certainly not have responded as easily to the developed countries' concern over litigation when concluding BITs or FTAs with other major capital exporting countries.

On the advantages of multilateralism and bilateralism for investment liberalization and protection, our study offers a new and original argument in favour of a bilaterally driven regime. It demonstrates that bilateralism offers an adaptation tool to gradually integrate lessons from past experiences. Under this perspective, it would be incomplete to sustain that a multilateral investment agreement might not be feasible for political reasons. It might also not be desirable, both for developed and developing countries.

Notes

1. These are, principally, the Code on the Liberalization of Capital Movements and Current Invisible Operations, adopted in 1961 and modified in 1986, the Declaration on International Investment and Multinational Enterprises, containing the Guidelines for Multinational Enterprises, adopted in 1976, and the National Treatment Instrument, concluded in 1976, all within the auspices of the Organization for Economic Cooperation and Development (OECD); the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, adopted in 1965, and the Guidelines on the Treatment of Foreign Direct Investment, effective since 1992, both under the World Bank; the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, adopted in 1977 within the International Labour Organization; and the Agreement on Trade-Related Investment Measures (TRIMs), in force since 1995 within the World Trade Organization (WTO).

2. Except when specified, investment chapters of bilateral free trade agreements (FTAs) are considered as a type of BITs.

3. In the US FTA with Bahrain, there is no chapter on investment. Yet, in this case, a BIT concluded in 1999 and effective since 2001 is to take care of investment issues.

4. The size of a win-set also depends on negotiators' strategies, for example, by exploiting linkages with popular provisions. However, we will not expand on this variable as strategic linkages were already discussed in the previous section.

5. Defined as "the behaviour of an agent who is unable to deliver on a promise because of failed ratification" (Putnam 1988, 438).

6. *Joint NGO Statement on the Multilateral Agreement on Investment* (1997). http://www.twnside.org.sg/title/565-cn.htm.

7. Bangladesh (on behalf of 33 Least-Developed Countries), Botswana, China, Cuba, Egypt, India, Indonesia, Kenya, Malaysia, Nigeria, Philippines, Tanzania, Uganda, Venezuela, Zambia, and Zimbabwe (2003), *Singapore Issues: The Way Forward: Joint Communication submitted to World Trade Organization General Council* (WT/GC/W/52), 2.

8. This is reflective of a global tendency to litigation. While the International Centre for Settlement of Investment Disputes (ICSID) had registered only 21 arbitration cases during its first 20 years, it registered 26 cases during the single year of 2003. Although not all dispute cases relate to a BIT, ICSID (2004, 4) mentions that "[t]he largest number of the new cases were submitted, as in previous years, under the ICSID arbitration provisions of [BITs]."

9. NAFTA cases have shown that there is a substantial difference between the amounts claimed and the amounts ultimately awarded. Nevertheless, these amounts, increased by legal fees, could be significant enough to make public authorities worry. Even more so if one considers that an award against a state party, even for a minor amount, could have heavy political costs.

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