International Journal of Computing and Business Research (IJCBR)

ISSN (Online) : 2229-6166

Volume 4 Issue 3 September 2013

BILATERAL INVESTMENT TREATIES AND FOREIGN DIRECT INVESTMENTS - AN EMPIRICAL STUDY

Anshu Jain
D. A. V. (PG) College
Karnal, Haryana, India

Abstract

In growing countries policymakers have progressively immobilized their desires on bilateral investment treaties in order to improve their chances in the worldwide competition for foreign direct investment (FDI). Nevertheless, the effectualness of Bilateral Investment Treaties in inducing higher Foreign Direct Investment influxes could still be discoursed.

Introduction

A notable feature of the on-going globalization process of production and services via Foreign Direct Investment (FDI) has been the growth of International investiture Treaties and Bilateral Investment Treaties (BILATERAL INVESTMENT TREATIES s), in particular. As a matter of fact, "Bilateral Investment Treaties are agreements between two countries for the mutual fillip, forwarding and protection of investments in each other's territories by companies based in either country." Foreign Direct Investment reflects the accusative of setting up a lasting interest by a occupant initiative in an economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The need for Foreign Direct Investment may be resource seeking, market seeking, strategic asset driven and efficiency seeking, Foreign Direct Investment, under the general objective of lucrativeness.

The "purpose of investment treaties is closely tied to the removal of obstacles that may stand in the way of allowing and channeling more foreign investment into the host states." This view has been clearly expressed by one of the EU officials currently in charge of the future European Union investment agreement4, when he mentioned that the main purpose of the agreement is to attract FDI to the EU, which is currently channeled to Asia and other destinations.

Investment Promotion:

Most of the Bilateral Investment Treaties reviewed do not specify any promotional activities that should be undertaken by the Governments of the Bilateral Investment Treaties partners to encourage investment flows between the two countries, either as host or home countries. The approach to promotion of foreign investment taken by BILATERAL INVESTMENT TREATIES s is mainly indirect, relying in the first place on their protection provisions to create a favourable investment climate. This in turn is expected to deliver FDI flows (UNCTAD, 1998).31 Thus, as in earlier practice, and in spite of BILATERAL INVESTMENT TREATIES s' clearly stated objective of promoting FDI flows between the countries, there is only a vague and general commitment of the contracting parties to "encourage" or "promote" investment, usually formulated in connection with the preamble, where the language tends to be hortatory in nature, or with the admission provisions.

Conventionalized Facts on BILATERAL INVESTMENT TREATIES s and Unilateral FDI relaxation:

The conclusion of BILATERAL INVESTMENT TREATIES s and unilateral FDI liberalization developed in unison with each other. It is in both ways that host countries increasingly attempted to attract FDI inflows, notably since the early 1990s. The number of BILATERAL INVESTMENT TREATIES s remained fairly limited until the late 1970s. The conclusion of BILATERAL INVESTMENT TREATIES s gathered considerable momentum during the last 15 years when the number of BILATERAL INVESTMENT TREATIES s soared from about 400 to almost 2,500 at the end of 2005

Considering the contractual parties that have concluded BILATERAL INVESTMENT TREATIES s, developed countries are involved as a signatory in 60 percent of all BILATERAL INVESTMENT TREATIES s in force at the end of 2005, with either developing countries (39 percent), transition countries (13 percent) or another developed country (8 percent) representing the second signatory. Neumayer and Spess (2005: 1573) argue that it is mainly BILATERAL INVESTMENT TREATIES s concluded between a developed and a developing (or transition) country that can be expected to have significant effects on FDI flows from the former to the latter. It should be noted, however, that various developing countries account for a rising share of worldwide FDI outflows. Taken together, developing source countries accounted for 12 percent of total outward FDI stocks in 2005 (UNCTAD, 2006).11 At the same time, an increasing number of BILATERAL INVESTMENT TREATIES s have been concluded among developing countries. Hence, it makes sense to account for developing countries as source countries, too, as well as for BILATERAL INVESTMENT TREATIES s concluded among developing countries. We will test for the robustness of our results by running separate estimates for developed and developing source countries.

International Journal of Computing and Business Research (IJCBR)

ISSN (Online) : 2229-6166

Volume 4 Issue 3 September 2013

Table 1. BILATERAL INVESTMENT TREATIES s and FDI: Data and Statistics

BILATERAL INVESTMENT TREATIES s Data: Number of Signed and Ratified BILATERAL INVESTMENT TREATIES s				
	1980–1990	1991–2000	2001–2004	
Signed BILATERAL INVESTMENT TREATIES s	11	80	50	
Ratified BILATERAL INVESTMENT TREATIES s	5	57	40	
Number of Signed BILATERAL INVESTMENT TREATIES s by Income Level of Contracting Partner				
High income OECD	3	26	15	
High income non-OECD	0	3	1	
Upper middle income	3	8	6	
Lower middle income	4	29	17	
Low income	1	14	11	
Number of Ratified BILATERAL INVESTMENT TREATIES s by Income Level of Contracting Partner				
High income OECD	3	22	14	
High income non-OECD	0	1	0	
Upper middle income	0	8	3	
Low middle income	1	20	19	
Low income	1	6	4	
Ramsey RESET Test and Variance Inflation Factor				
	Signed		Ratified	

	RESET F-test (p value)	Mean VIF	RESET F-test (p value)	Mean VIF
All	0.456	2.74	.597	2.67
High income OECD	0.437	2.69	0.487	2.64
High income non-OECD	0.578	2.65	0.065	2.76
Upper middle income	0.508	2.64	0.533	2.63
Lower middle income	0.614	2.7 0.	0.509	2.69
Low Income	0.347	2.72	0.612	2.62

Encroachment of BILATERAL INVESTMENT TREATIES S on FDI:

The encroachment of BILATERAL INVESTMENT TREATIES s on FDI has been examined in the FDI and international law literature(s). The findings in both have been mixed. Earlier studies, namely UNCTAD (1998) and Hallward-Driemeier (2003) found insignificant impact on FDI, while the more recent studies, namely Egger and Merlo (2007), Egger and Pfaffermayr (2004), Neumayer and Spess (2005), and Tobin and Rose-Ackerman (2006), found a significant positive impact on FDI.

UNCTAD's (1998) landmark study has examined the impact of BILATERAL INVESTMENT TREATIES s on FDI using both time series and cross section analyses. Time series analysis has been conducted using data over eleven years and two hundred BILATERAL INVESTMENT TREATIES s signed between fourteen home and seventy two host countries. The study finds that BILATERAL INVESTMENT TREATIES s have a positive, albeit not a strong effect on FDI. However, the impact of BILATERAL INVESTMENT TREATIES s was most statistically significant for the share of a home country partner to a BILATERAL INVESTMENT TREATIES in a host country's total inflows, and for the share of a particular host country in a home country's total FDI outflows. The cross section analysis of the study finds a positive impact of BILATERAL INVESTMENT TREATIES s on the absolute level of FDI flows and on FDI flows relative to GDP. The overall conclusion of the cross section analysis is that BILATERAL INVESTMENT TREATIES s play a minor and secondary role in attracting FDI, while the leading determinant appears to be market size. Similar to the conclusion of the UNCTAD study, Hallward-Driemeier (2003) finds little evidence of a beneficial impact of BILATERAL INVESTMENT TREATIES s on FDI in countries with reasonably strong institutions in examining the impact of ratified BILATERAL INVESTMENT TREATIES s on bilateral FDI flows from twenty OECD countries to thirty one developing countries over the period 1980–2000.

Blustered as an significant commitment device that attracts foreign investors, the number of bilateral investment treaties (BILATERAL INVESTMENT TREATIES s) ratified by developing countries has grown dramatically. Hallward-Driemeier tests empirically whether BILATERAL INVESTMENT TREATIES s have actually had an important role in increasing the foreign direct investment (FDI) flows to signatory countries. While half of OECD FDI into developing countries by 2000 was covered by a BILATERAL INVESTMENT TREATIES , this increase is accounted for by additional country pairs entering into agreements rather than signatory hosts gaining significant additional FDI. The results also indicate that such treaties act more as complements than as substitutes for good institutional quality and local property rights, the rationale often cited by developing countries for ratifying BILATERAL INVESTMENT TREATIES s. The relevance of these findings is heightened not only by the proliferation of such treaties, but by recent high profile legal cases. These cases show that the rights given to foreign investors may not only exceed those enjoyed by domestic investors, but expose policymakers to potentially large-scale liabilities and curtail the feasibility of different reform options. Formalizing relationships and protecting against dynamic inconsistency problems are still important, but the results should caution policymakers to look closely at the terms of agreements. This paper—a product of Investment Climate, Development Research Group—is part of a larger effort in the group to understand the determinants of productive investment.

Typical shield protections under BILATERAL INVESTMENT TREATIES s

The key protection offered by the majority of bilateral investment treaties is to allow international arBilateral Investment Treaties ration in the event of an investment dispute, rather than forcing foreign investors to sue the host –state in its own courts. The specific content and protections provided by BILATERAL INVESTMENT TREATIES s do vary and it is essential to check the wordings of any particular treaty, as there are often important differences. BILATERAL INVESTMENT TREATIES s usually provide for the following standards of protection for an investor:

- Fair and Equitable Treatment (FET): This is the most frequently invoked standard in the investment disputes. According to this concept, host states are to maintain stable and predictable regulatory environments for the investment and respect the legitimate expectations upon which the investors initially relied when they made investment.
- Most Favoured Nation (MFN) treatment: This clause enables the investor to claim any favourable right that is available to any other state having BILATERAL INVESTMENT TREATIES with the host state. The clause offers both procedural and substantive protection to the investors.
- Full protection and security: The concept of full protection and

security is to ensure that a host state takes active measures to protect a foreign investment from adverse effects of actions of (a) the host state (b) its organs or even (c) third parties.

- Protection from expropriation: Expropriation is the confiscation of a foreign asset by the host state with no or minimal payment, thus depriving the foreign investor of his reasonable expectations of profits and returns.

Disputes resolution under BILATERAL INVESTMENT TREATIES s:

Typically, where BILATERAL INVESTMENT TREATIES exists, investors are free to bring Investment Treaty ArBilateral Investment Treaties ration [ITA] actions in any one of the arBilateral Investment Treaties ral institutions identified in the treaty, and the host state is required to submit to the jurisdiction of the arBilateral Investment Treaties ration institution. They fundamentally differ from commercial arBilateral Investment Treaties rations in two very specific ways; firstly investment treaty arBilateral Investment Treaties ration is based on either on (a) an investment treaty (b) host state's national investment law or in certain circumstances, investment agreement, whereas commercial arBilateral Investment Treaties ration is based on an arBilateral Investment Treaties ration agreement. Secondly, in investment treaty arBilateral Investment Treaties ration, the arBilateral Investment Treaties ral tribunal judges the host states' behaviour towards a foreign investor. In commercial arBilateral Investment Treaties ration, the arBilateral Investment Treaties ral tribunal judges the contract between the parties i.e. its conclusion, performance and termination.

Most of BILATERAL INVESTMENT TREATIES s allow investors to bring their disputes before one of the following arBilateral Investment Treaties ration institutions:

- International Centre for the Settlement of Investment disputes (ICSID)

- International Chamber of Commerce (ICC)
- Stockholm Chamber of Commerce (SCC)
- Parties may also choose less formal ad hoc methods, such as conducting the ArBilateral Investment Treaties ration under the UNCITRAL ArBilateral Investment Treaties ration rules. It is pertinent to note that India has not signed the ICSID Convention. As a result, India cannot be a party to ICSID proceedings. However, Indian investment treaties often provide that in an event either party is not an ICSID member; foreign investors may initiate ad hoc arBilateral Investment Treaties ration proceedings in accordance with UNCITRAL ArBilateral Investment Treaties ration rules.

Conclusions:

Policymakers in almost all developing countries are engaged in fierce competition for FDI. However, it has remained disputed how effective the means are that national policymakers have at their disposal when attempting to attract FDI inflows. In this paper, we focus on the impact of BILATERAL INVESTMENT TREATIES s that have increasingly been concluded in order to reduce uncertainty of foreign investors in a credible way and, thus, to promote FDI flows to developing countries.

Few earlier studies have addressed the effectiveness of BILATERAL INVESTMENT TREATIES s, and the available empirical evidence is inconclusive. Depending on the particular study, we argue that previous evaluations of the effectiveness of BILATERAL INVESTMENT TREATIES s are distorted due to sample selection and omitted variable biases as well as the potential of BILATERAL INVESTMENT TREATIES s in the regressions. We attempt to overcome these econometric concerns by covering a much larger sample of host and source countries, by accounting for unilateral FDI liberalization, and by including an appropriate instrumental variable approach.

References:

1. http://www.unctadxi.org/templates/Page____1006.aspx For a more concise definition, see e.g. Dolzer and Schreuer, (2008).
2. The official definition is 254 pages.
3. For an empirical assessment of infrastructure and taxes as determinants of FDI see Bellak et al. (2009).
4. Mr. L. Rubinacci, Head of Unit, Services and Investment (B1), DG Trade, European Commission, on 2nd March 2013 at the Diplomatic Academy, Vienna.

5. Carr, D.L., J.R. Markusen and K.E. Maskus (2001). Estimating The Knowledge-Capital Model of the Multinational Enterprise. American Economic Review 91 (3): 693-708.
6. Chinn, M.D., and H. Ito (2005). What Matters for Financial Development? Capital Controls, Institutions, and Interactions. NBER Working Paper 11370. Cambridge, Mass (National Bureau of Economic Research).
7. Deardorff, A. (1998). Determinants of Bilateral Trade: Does Gravity Work in a Neo-classical World. In: J. Frankel (ed.), Regionalization in the World Economy. Chicago (University of Chicago Press): 7-22.
8. Daude, C., and M. Fratzscher (2006). The Pecking Order of Cross-Border Investment. Working Paper Series 590. Frankfurt (European Central Bank).