A CRITICAL ANALYSIS OF ECONOMIC BENEFITS OF BILATERAL INVESTMENT TREATIES

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Introduction

In theory and in law objective of Bilateral Investment Treaties (BIT) is to encourage and protect investment in both countries. In case of BIT between the developing nation and an industrialized state, the industrialized country will be the source and the developing country will be the recipient of virtually all investments undertaken. Many developing countries desperately short of capital, would strongly oppose any measure that encourage their own nationals to invest their capital abroad rather than at home. It is for this reason, the title of certain BITs refer to 'Encouragement and reciprocal protection of Investments' rather than more common resignation, reciprocal encouragement and protection of investments[1].

Developing countries often compete for foreign investment with the hope that foreign direct investment (FDI) will bring a wide range of economic benefits. These benefits include increased levels of investment and economic activity, working training, well-paid jobs and technology transfers that enhance the productivity of local firms. In addition, foreign investment may be viewed as a particularly attractive means of increasing developing country investment stocks since foreign investment is much less likely than other financial flows to leave the host country if the host experiences a financial crisis. Although multinational firms may have negative effects on host country market such as intensified competition with local firms, policy makers generally assume that FDI is beneficial on net.

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[1] Jeswald A. Salacuse , BIT by BIT: The Growth of Bilateral Investment Treaties And their impact on foreign direct investment,

include increased levels of investment and economic activity, worker training, well-paid jobs and technology transfers that enhance the productivity of local firms. In addition, foreign investment may be viewed as a particularly attractive means of increasing developing country investment stocks since foreign investment is much less likely than other financial flows to leave the host country if the host experiences a financial crisis[2].

US Ambassador to India Richard Rahul Verma at the conference organised by Society of Indian Law Firms said "The absence of a bilateral investment treaty between our two countries is an impediment to growing our trade and investment." There has been "significant progress" in the ease of doing business scenario in India." We think it is important because it would contribute to economic growth and foreign direct investment. I think you need to look at other countries in Asia as well in Europe in Latin America and see whether the wall that currently exists on professional legal services is still the right thing if you want to grow the two-way trade number, if you want to attract more businesses and more professionals into India[3].

Impact of BITs in Promotion of FDI

It is very difficult to answer and very big question like 'role played by BTI in development of FDI' because in international scenario there is no uniformity of opinion with regard to impact of BITs on FDI. This can be properly understood by analyzing some literature review. While some studies focus on the positive impact Between BITs and FDI inflows. Others did not come up with such encouraging results.

Negative opinions:

1. According to Tim Buthe and Helen V. Milner[4] hypothesized that the effect of bilateral investment treaties in inward foreign direct investment flows into developing countries. The more number of bilateral treaties to which developing country was a party gives an opportunity to attract more investment and provides investment location.

[2] Deborah L. Swenson, Why Do developing countries sign BITs?, Ed.,Karl P. Sauvant & Lisa E. sachs, The Effect of Treaties on Foreign Direct Investment, Oxford Publication, Page no. 437

[3] Absence of bilateral investment treaty with India an impediment to bilateral trade: US, Economic Times, February 18, 2016, https:// economictimes. indiatimes. com/ news/ economy/foreign-trade/absence-of-bilateral-investment-treaty-with-india-an-impediment-to-bilateral-trade-us/articleshow/ 51042568.cms?from=mdr, visited on 08-01-2020.

[4] Tim Buthe and Helen V. Milner in his "Bilateral Investment Treaties and Foreign Direct Investment: A Political Analysis", Karl P. Sauvant and Lisa E. Sachs (ed.) "The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows, Oxford University Press, 2009, Page no. 171.

2. Peter Egger & and Michael Peaffermayr[5] analysed that if the treaties were properly implemented BITs exerted a positive and significant effect on outward FDI of home countries. He used bilateral outward FDI stock data from 19 OECD countries and 57 countries (including OECD member countries).
3. Eric Neumayer and Laura Spess[6] His study focus on the developing countries are mixed and found that larger the number of BITs negotiated, better was the flow of FDI inflows to the developing countries.
4. UNCTAD[7] data analysis on bilateral FDI flows between the BIT signatory countries shows that the influence of BIT on FDI is weak, especially in redirecting the share of FDI flowing from or to BIT signatory countries. In the cross-country comparison of FDI determinants, the overall conclusion is that BITs appear to play a minor and secondary role in influencing FDI inflows.

Positive Opinions:

1. Mary Hallward-Driemeier[8] analyzed the impact of BITs using bilateral FDI flows from 20 OECD countries to 31 developing countries and found that BITs did not serve to attract additional FDI.
2. Tobin and Rose-Ackerman (2003)[9] found the number of BITs having little impact on a country's ability to attract FDI. However, there appears to be an interaction between the conclusion of BITs, on the one hand, and the level of political risk and property rights protection, on the other. Countries that are relatively risky seem to be able to attract somewhat more FDI by signing BITs.

[5] Peter Egger & and Michael Peaffermayr "The impact of Bilateral Investment Treaties on Foreign Direct Investment, Karl P. Sauvant and Lisa E. Sachs (ed.) "The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows, Oxford University Press, 2009, Page no. 253.

[6] Eric Neumayer and Laura Spess, Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?, Karl P. Sauvant and Lisa E. Sachs (ed.) "The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows, Oxford University Press, 2009, page no 225.

[7] UNCTAD "the Impact on Foreign Direct Investment of BITs", Karl P. Sauvant and Lisa E. Sachs (ed.) "The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows, Oxford University Press, 2009, page no. 347.

[8] Mary Hallward-Driemeier, Do Bilateral Investment Treaties Attract FDI? Only A BIT……And They Could BITE, Karl P. Sauvant and Lisa E. Sachs (ed.) "The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows, Oxford University Press, 2009, page no. 349.

[9] Tobin J., Rose-Ackerman S. (2003). Foreign direct investment and the business environment in developing countries: The impact of bilateral investment treaties (William Davidson Institute Working Paper No. 587). Ann Arbor, Michigan: The University of Michigan Business School.

3. Banga (2003) estimated the impact of the total number of signed BITs on FDI inflows for 15 developing economies of South Asia, East Asia, and Southeast Asia. The study found that BITs with developing countries did not have a significant impact on aggregate FDI inflows but those with developed countries had a significant impact on FDI inflows[10].

Impact of BIT on FDI Evidence from India

Some argue that foreign investment inflows to India are not dependent on BITs. Two studies question this wisdom. The first, done by Rashmi Banga, examines the impact of BITs on FDI inflows in 15 Asian developing countries including India from 1980-81 to 1999-2000. The study shows that BITs signed by these 15 countries with developed countries had a strong and significant impact on FDI inflows in these 15 countries. However, BITs signed by these 15 countries with developing countries didn't have much impact on foreign investment inflows. Till the year 2000, out of the 14 BITs India signed, nine were with developed countries. Therefore, BITs had a significant impact on FDI inflows in India, which rose from $393 million in 1992-93 to $4,029 million in 2000-01. The second study, Niti Bhasin and Rinku Manocha, considers the impact of BITs FDI inflows in India from 2001-2012. This study also demonstrates that BITs signed by India contributed to rising FDI inflows in the said period by providing protection and commitment to foreign investors. The significance of BITs in attracting investment was also emphasized by Canada's Trade Minister during his recent visit to India. The Minister said that absence of an India-Canada BIT is restricting the scope and volume of investments that Canadian pension funds can make in India[11].

According to the latest edition of the World Investment Report of the United Nations Conference on Trade and Development (UNCTAD) India slipped a rank to end at tenth place in the latest ranking of top foreign direct investment receiving countries for the year 2018. According to the report India received $42 billion in FDI in 2018, a growth of 6%. China, which retained the number two position, received the highest foreign inflows among the developing countries[12].

It is nobody's case that BITs alone determines FDI inflows, but they do play a critical role in mitigating regulatory risks and

[10] Niti Bhasin and Rinku Manocha, Do Bilateral Investment Treaties Promote FDI Inflows? Evidence from India, http:// journals. sagepub. com/doi/pdf/10.1177/0256090916666681, visited on 06-11-2019.

[11] Prabhash Ranjan, Turning the Clock, The Hindu, March 28, 2017, http:// www. thehindu. com/ opinion/op-ed/ turning-the-clock-back/article17684494.ece, visited on 04-12-2019.

[12] The Economic Times, FDI flows to India grew 6% in 2018 to $42 bn UN report, Jan 2, 2019.

thus encouraging investors to invest. Several countries have managed to get more FDI than India in recent years in spite of the fact that they don't have any BITs with their partner countries. Brazil is a case in point. India needs to continue to focus on its domestic reforms and promote its various initiatives including 'Make in India' and 'Digital India' to consistently attract foreign investment[13].

Bilateral Trade Agreements with their Pros and cons

- Each agreement covers five areas. First, it eliminates tariffs and other trade taxes. This gives companies within both countries a price advantage. It works best when each country specializes in different industries.
- Second, countries agree they won't dump products at a cheap cost. Their companies do this to gain unfair market share. They drop prices below what it would sell for at home or even its cost to produce. They raise prices once they've destroyed competitors.
- Third, the governments refrain from using unfair subsidies. Many countries subsidize strategic industries, such as energy and agriculture. This lowers the costs for those producers. It gives them an unfair advantage when exporting to another nation.
- Fourth, the agreement standardizes regulations, labor standards, and environmental protections. Fewer regulations act like a subsidy. It gives the country's exporters a competitive advantage over its foreign competitors.
- Fifth, they agree to not steal the other's innovative products. They adopt each other's copyright and intellectual property laws.

Advantages

- Bilateral agreements increase trade between the two countries. They open markets to successful industries. As companies benefit, they add jobs.
- The country's consumers also benefit from lower costs. They can get exotic fruits and vegetables that can get too expensive without the agreement.
- They are easier to negotiate than multilateral trade agreements, since they only involve two countries. This means they can go into effect

[13] Geethanjali Nataraj, Will a New Model investment Treaty Boost FDI?, https:// www. brookings. edu/ opinions/ will -a-new-model-investment-treaty-boost-indias-fdi/, visited on 04-12-2019

faster, reaping trade benefits more quickly. If negotiations for a multilateral trade agreement fails, many of the nations will negotiate a series of bilateral agreements instead.

Disadvantages

- Any trade agreement will cause less successful companies to go out of business. They cannot compete with a more powerful industry in the foreign country. When protective tariffs are removed, they lose their price advantage. As they go out of business, workers lose jobs.
- Bilateral agreements can often trigger competing bilateral agreements between other countries. This can whittle away the advantages that the free trade agreement confers between the original two nations.

Examples

The Transatlantic Trade and Investment Partnership would remove current barriers to trade between the United States and the European Union. It would be the largest agreement so far, beating even the North American Free Trade Agreement. Negotiations were put on hold after President Trump took office. Even though the EU consists of many member countries, it can negotiate as one entity. This makes the TTIP a bilateral trade agreement.

On July 17, 2018, the world's largest bilateral agreement was signed between the EU and Japan. It reduces or ends tariffs on most of the $152 billion in goods traded. It will come into force in 2019 after ratification. The deal will hurt U.S. auto and agricultural exporters[14].

Economic Benefit of BITs

Theoretical argument

The two types of market imperfections arise in investment decisions of foreign investors, which are related to the fact that foreign investment is sunk and this may create a short run incentive for governments to change their policies towards foreign investors. Thus a credibility problem may arise which ultimately leads to an inefficiently low level of foreign investments. Whether BITs gives a remedy to this problem

Market imperfections:

There are mainly two factors that lead to market imperfections in investment decisions: adverse selection and time inconsistency. Both types deal with the

[14] Bilateral Trade Agreements with their Pros and Cons, Kimberly Amadeo, February 13, 2019, https:/ / www. thebalance. com/ what-are-bilateral-trade-agreements-pros-cons-and-list-3305911, visited on 06-01-2020

impact of the past on future investment decisions. Adverse selection arises on part of the investors and time inconsistency arises on part of (host country) governments. Information asymmetry is based on a micro-economic perspective and refers to the fact that information about the true intentions of a government may be private, i.e. "when observers lack information about the beliefs and values that are motivating a government to pursue (…)" a certain policy. When observers are domestic investors, this asymmetry may have a serious impact on their domestic investment decisions. The information asymmetry will be larger, if the government in question is a foreign government where it is more costly for the foreign investor to obtain information, especially when dealing with countries that lack credible institutions, e.g. some developing countries. Due to the information asymmetry investor's expectations will be based on their experience with past policies and this will inter alia determine their future investment decisions. This argument holds independently of the motivation of the policy change. For example, a host country government may have lowered its taxes in the past to attract FDI or in order to maximize the probability of re-election; or a host country government may have raised its taxes in the past due to external pressures for budget consolidation.

The time inconsistency argument has originally been developed with regard to macro-economic policies but can be applied to micro-based policies as well In the context of foreign investment the time inconsistency problem is of relevance, if the short-term incentives for host country governments are more important than the long-term incentives and thus lead to changes in its behavior against the foreign investor. "In other words, time inconsistency is said to arise if, though nothing has changed, these choices are not equal. Consequently, the existence of these two types of market failures may serve as an economic justification for government intervention in the area of foreign investment.

Incentives for governments to change investment policies

The market imperfections described are not only important from an investor's point of view, but they create a very serious problem for governments designing their investment policies, because FDI is sunk costs: "Once a firm undertakes a foreign direct investment, some bargaining power shifts to the host country government, which has an incentive to change the terms of the investment to reap a greater share of the benefits." This has been termed the "obsolescing bargain". While at first glance, strengthened bargaining power sounds positive from a host country government's view, it bears potentially unpleasant implications. The importance of the incentive to change the investment policy is related to the two types of market failure. First, it depends on the extent to which past information asymmetry on part of the actual investors (i.e. the experience of investors with past policies of the host country) impacts on current investment decisions. Countries with a younger history of FDI (some developing countries, transformation countries) will thus have more room to change investment policies than countries, which have hosted FDI for a long time.

Second, it depends on the conduct of democratic governments who need to pass elections from time to time have a tendency to discount the long-term too much in favor of the short-term. This may be aggravated in developing countries. Aim of policy changes is to shift the division of surplus from the foreign investment in favor of the government.

There are many ways how the host country government may shift the distribution of surplus / profit from the investor to the host state: raising tax levels, raising tariff levels, changes in regulation, fees, selective law enforcement, imposing new labor requirements etc. The most extreme form is expropriation.

Against this view, one may hold that governments will have enough incentives not to exploit their increased bargaining power, once the investment is sunk. The argument usually put forward is that governments may resist the temptation to seize assets today in order to create or maintain a reputation that will attract future investment. Yet, self-control of the government is unlikely to work in many cases and governments may adjust their investment policies frequently. Yet, investor memories and expectations place restrictions on such policy decisions.

The credibility problem

Viewed from the foreign investor's perspective, no conduct of the government can be credible, when government collects incentives. This is based on a more common reason for market failure. Given the incentives for governments arising from the obsolescing bargain to re-optimize their investment policy, such policies may have a credibility problem. An investor will not undertake an investment or be able to enter into an efficient agreement with the host country. As a consequence of the lack of credibility, an efficient investment, which would otherwise have taken place, may not be carried out at all or be carried out in a non-optimal way.

Policy intervention as remedy to the credibility problem?

Among the policy options to remedy the credibility problem in foreign investment policies, governments have chosen BITs in the overwhelming majority of cases and more recently regional agreements. BITs address the adverse selection problem via their signalling function and the time-inconsistency problem via their protection function. How does a BIT remedy the credibility problem and generate a credible expectation? There are two economic functions of BITs: First, BITs create ex-ante costs (signals) and second, BITs create ex-post costs (commitments)[15].

a. The signalling function of BITs

States enter into formal agreements such as treaties in part to make commitments more visible. Such ex-ante information about international agreements, especially when it makes the nature and specific provisions of the commitment known, facilitates detecting violations of the commitment and in turn should allow for swifter punishment.

The conclusion of negotiations for a BIT, the signing of the BIT and the ratification of a BIT are usually publicized in government press releases and often undertaken in public ceremonies reported in the media. Such initial publicity should provide at least some information about the nature of the commitments undertaken.

In addition, governments (particularly governments of regular FDI 'Home' countries) may provide information about the country's BITs on an ongoing basis. Moreover, the information provisions is not restricted to the two signatory countries. BITs are covered by the UN requirement to notify all treaties to the UN and UNCTAD has for a number of years by now made the full text of most BITs available on the website[16].

b. Ex post information and BITs

After the initial publicity subsides, BITs continue to generate information that facilitates identifying and punishing those who renege on their commitments. Such information is most likely to be generated by the aggrieved investor him/herself through the dispute settlement process. Investment treaties tend to include provisions for binding arbitration of any disputes under the treaty and increasingly specify the World Bank's International Centre for Settlement of

Investment Disputes (ICSID) as the arbitrator before which private investors may bring a dispute directly against the FDI host government. Arbitration before an ICSID panel makes the host government's alleged violation of its commitment a matter of

[15] Christian Bellak, Economic Impact of Investment Agreements, Department of Economics Working Paper No. 200, August 2015.

[16] Tim Buthe and Helen V. Milner, Bilateral Investment Treaties and Foreign Direct Investment: A Political Analysis, Ed., Karl P. Sauvant and Lisa E. Sachs, The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows, Oxford University Press.

public record: Pending cases as well as decisions are published on the World Bank website and in the ICSID newsletter.

In addition, governments and private actors are more likely to provide information about noncompliance with commitments under a BIT than about noncompliance with commitments that have not been institutionalized internationally. A government's compliance with its treaty obligations is often monitored by the other governments that are parties to the international agreements more closely and continually than policy commitments that a government may undertake domestically or via individual investors[17].

Conclusion

An individual host countries BITs cannot be judged by analysing few variables. It depends upon the country's political, economical and environmental factors. Only by having analysis on these wide areas we can analyse the impact of BIT on FDI. Especially the economic aspects of BITs always depends upon the Market imperfections, incentives of the government and also on the credibility problems of the country. So poor countries cannot go in aggressive hard work for improving their own domestic environment for investment. For the improvement of BIT vehicle, the smooth functioning of FDI is needed.

[17] Ibid