

# **Investor Rights versus Human Rights: Do Bilateral Investment Treaties Tilt the Scale?\***

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## Abstract

We argue that the broad and legally enforceable protection offered to foreign investors by bilateral investment treaties (BITs) worsens the human rights practices of developing countries. BITs lock-in initial conditions attractive to investors that are linked to vertical investment flows and investment and trade competition. BITs also constrain the provision of welfare benefits or basic infrastructure. The lock-in and constraining effects are sources of popular grievance and dissent in states that host foreign investment. BIT protected investor rights, however, limit the ability of governments to back-down vis-à-vis investors, lowering the relative cost of human rights violations. Finally, we explain that democratic regimes mitigate the negative effect of BITs. Evidence from 113 developing countries from 1981 to 2009 supports our hypotheses.

Key words: Bilateral Investment Treaties; Human rights; Democracy

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The globalized economy of the past decades has seen flows of capital, people and goods, and institutions regulating these movements. With such mobility, there are concerns that gains from global governance and a more efficient allocation of resources are leveled by lower accountability to national governments and reduced welfare provision, labor standards or human rights. Foreign direct investment (FDI) is a key economic flow in the global economy and investor rights have been strongly protected since the 1960s by a large number of bilateral investment treaties (BITs).<sup>1</sup> Some view BITs as a development tool, arguing that they reduce risk and, thus, channel much needed capital to poor countries.<sup>2</sup> Indeed, recent evidence shows that countries signing more BITs see a greater inflow of FDI.<sup>3</sup> Yet, others fear that the favorable treatment given to foreign investors through BITs worsens the rights of various, less powerful, domestic constituencies.<sup>4</sup> Such concerns arise because, in contrast to strong investor protection, very few, if any, BITs mention labor or human rights.<sup>5</sup> These potential negative externalities of the “broad and asymmetrical rights”<sup>6</sup> granted through BITs received little attention. We investigate whether BITs influence developing countries’ human rights practices.

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<sup>1</sup> Currently, the United Nations Conference on Trade and Development (UNCTAD) estimates that 178 countries are involved in at least one BIT, with more than 2900 BITs signed among these countries.

<sup>2</sup> Leo 2010.

<sup>3</sup> Allee and Peinhardt 2011; Buthe and Milner 2009; Haftel 2010; Kerner 2009.

<sup>4</sup> Peterson and Gray 2003.

<sup>5</sup> Jacob 2010.

<sup>6</sup> Simmons 2014: 12.

To a great degree, developing countries sign bilateral investment treaties to attract foreign investment and do so primarily because of competitive pressures.<sup>7</sup> Recent work shows that host states may have not fully anticipated the constraining effects of investment treaties<sup>8</sup>, and recently started to push back against BIT constraints on domestic policy<sup>9</sup>. Human rights groups have directly charged that the hands of capital importing developing countries are tied by investment treaties, generating important grievances and worsening governments' human rights practices. For example, the UK – Colombia BIT was signed in 2010 but was only ratified in 2014. Human rights and anti-poverty groups<sup>10</sup> have argued that this BIT exposes the Colombian government to costly lawsuits and impacts land reform programs. Similarly, NGOs<sup>11</sup> have reservations about the ongoing negotiations on a US-India BIT, including about how the investor-state dispute mechanism undermines the domestic policy space and justice system.<sup>12</sup>

We contend that BITs contribute to a worsening of human rights practices. BITs lock in legally enforceable conditions attractive to investors and constrain the states' development and welfare policies. With BITs in place, it is costly for states to reverse such policies in response to likely popular grievance and, in some countries, repression becomes relatively attractive. More specifically, the lock-in effect of BITs incentivizes

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<sup>7</sup> Elkins et al. 2006.

<sup>8</sup> Jandhyala et al. 2011; Poulsen and Aisbett 2013.

<sup>9</sup> Haftel and Thompson 2017; Poulsen and Aisbett 2013; Simmons 2014.

<sup>10</sup> E.g., Colombian NGO Cedetrabajo or British NGO Traidcraft.

<sup>11</sup> E.g., the Indian NGO “Forum against Free Trade Agreements”, a coalition of over 75 organizations.

<sup>12</sup> In another example, human rights NGOs opposed the Multilateral Agreement on Investment negotiated in the late 1990s by the OECD (Peterson 2009).

governments to favor foreign investors even at the cost of violating the rights of their own citizenry. Retrospectively, many developing countries compete for investment and trade on issues ranging from environmental regulations to labor standards and welfare spending and tend to be destinations for vertical investment seeking cost efficiencies. BITs lock in initial favorable conditions. In addition, BIT provisions constrain future policies, from taxation and the provision of welfare benefits or basic infrastructure. Locked-in standards and constrained policy choices have fiscal and labor relations consequences and are sources of popular grievance. The literature on the causes of repression suggests that human rights violations are key responses of states to the manifested or just anticipated protest that can result from these grievances. Yet, the same literature argues that rights violations are the result of a cost benefit calculation vis-à-vis other non-violent options and the globalization literature shows that races to the bottom are not necessarily straightforward responses, even in developing countries. We argue therefore, that states' reaction to potential dissent and the negative human rights consequences of BITs are moderated by regime type.

We test our theory on a sample of 113 developing countries from 1981 to 2009. Our baseline measure of human rights practices is based on the CIRI data<sup>13</sup> and includes extra-judicial killings, disappearances, political imprisonment and torture. We find that countries ratifying a greater number of BITs have worse human rights practices and show that the effect of the cumulative number of ratified BITs is conditional on the political regime: BITs are more likely to result in human rights violations in non-democracies. Our results are robust to instrumental variable techniques, the inclusion of a large number of control variables, the exclusion of outliers, variations in sample size, alternative measures

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<sup>13</sup> Cingranelli and Richards 1999.

of human rights violations and coding BIT specific clauses<sup>14</sup> or focusing only on North-South BITs that likely govern over de facto investment flows.

Our theory also suggests causal paths that can link BITs to human rights practices. We test whether BITs limit government's ability to tax and spend, contribute to a worsening of labor relations and social mobilization. We find that BITs depress de facto labor practices with no mediating effect of democracy and reduce both fiscal spending and revenue, a negative effect that is smaller in democracies. Our theoretical expectation is that governments respond not just to observed, but also expected social mobilization. We test the effect of BITs on measurable, observed, political dissent, and several of our empirical models show that the effect of BITs is mediated by political regime: That is, BITs increase dissent, but not in democracies. Finally, BITs do not solely operate indirectly through the posited causal mechanisms, but also have a direct effect on states' human rights practices.

The paper makes several contributions. We are the first to systematically theorize and test the effect of the global investment regime on states' human rights practices. Frail domestic institutions and low credibility with investors can be a motivation for joining international treaties, including BITs. Yet the evidence in favor of a credible commitment rationale for BITs is weak, for variables ranging from political institutions (democracy or political constraints) to economic risk (property rights or law and order) (Table 1). Specifically, there is no consistent evidence that countries with bad human rights sign or ratify more BITs for credibility reasons.<sup>15</sup> Our work however shows robust evidence for an effect running from BITs to human rights violations, including evidence for plausible

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<sup>14</sup> The direct arbitration clause to the International Centre for Settlement of Investment Disputes (ICSID).

<sup>15</sup> Neumayer 2006; Vadlamannati 2008.

causal pathways. This research thus contributes to recent work on the effect of international economic treaties<sup>16</sup> or international organizations<sup>17</sup> on states' human rights practices. It also backs calls to reestablish more space for states to act in economic and social policy and protect the rights of domestic constituencies.<sup>18</sup> Finally, states may have ratified BITs within a bounded rationality framework, without being fully aware of the implications of BITs for domestic economic and social policies.<sup>19</sup> Yet it appears that host states come to better understand their BIT commitments and protect investor rights, even at the cost of violating the rights of their domestic populations.

Table 1. Evidence that host countries with low credibility sign BITs (credibility argument)

Variable operationalizing lack of credibility in host states	Support for the credibility argument	No effect	The opposite to the credibility argument
Human rights (CIRI and PTS indexes)	<u>None</u>	Vadlamannati (2008) Neumayer (2006)	<u>None</u>
Democracy (polity2 score), and Political Constraints (Henisz 2002)	Lupu and Poast (2013) Jandhyala, Henisz, and Mansfield (2011) during 1970-1987 and 2000-2007 Rosendorff and Shin (2015)	Neumayer (2006) Jandhyala, Henisz, and Mansfield (2011) during 1988-1999 Elkins, Guzman, and Simmons (2006) Neumayer and Plumper (2010) Tobin and Busch (2010)	Neumayer, Nunnenkamp, and Roy (2014) Allee and Peinhardt (2010, 2014)
Economic risks (Institutional Investors' country credit risk index; Expropriation risk, Law and order, investment risk profile, corruption, and bureaucracy quality; Contract-intensive money; Quality of governance)	Bergstrand and Egger (2013) Lupu and Poast (2013) Swenson (2009) during 1995-1999	Allee and Peinhardt (2010, 2014) Ginsburg (2005) Swenson (2009) during 1990-1994	Vadlamannati (2008) Poulsen and Aisbett (2013) Elkins, Guzman, and Simmons (2006) Freeman (2009) Ginsburg (2005)

<sup>16</sup> Hafner-Burton (2005b, 2009), Spilker and Bohmelt (2013).

<sup>17</sup> Abouharb and Cingranelli (2006, 2007, 2009), Keith and Poe (2000).

<sup>18</sup> UNCTAD 2012; UNCTAD 2015.

<sup>19</sup> Poulsen and Aisbett 2013, Poulsen 2015.

The paper proceeds as follows: We first elaborate on the legal protection afforded by BITs to investors. We then explain how BITs may affect human rights practices and derive two hypotheses. Data and research design are discussed next, followed by our empirical findings and conclusions.

## **BITs: INVESTOR RIGHTS VS. LACK OF PROTECTION FOR DOMESTIC CONSTITUENCIES**

In the absence of multilateral institutions, BITs have been the most visible and powerful legal instruments governing the global growth of FDI. These treaties offer strong protection to foreign investors while human rights provisions in BITs are marginal, at best.

Direct investment in a foreign country implies sunk costs and BITs are designed to address concerns about the future behavior of host states.<sup>20</sup> Common policy reversals that are adverse to investors include expropriation and discriminatory changes to performance requirements, capital taxation and regulation, tariffs or social contributions. BITs then aim to guarantee investor protection, including through compensation for expropriation and fair and equitable treatment, or most favored nation treatment. Even more, investors can enforce their rights in a timely manner: Early BITs provided investor protection through state to state dispute resolution. More recent BITs grant foreign investors the right to adjudicate alleged violation of rights in international tribunals, without the need

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<sup>20</sup> Elkins et al. 2006.

to exhaust local remedies, and, in case of non-compliance with arbitration decisions, broad rights to confiscate the host government's property from around the world.<sup>21</sup>

By the late 1980s most BITs included such dispute settlement mechanisms and between 1990 and 2012 there were at least 564 international arbitrations against at least 110 host states.<sup>22</sup> These investor claims are directly related to the number of ratified BITs<sup>23</sup> and have important consequences. A first implication is for the budgets of host states: Monetary awards have been significant, as shown by decisions against the Czech Republic (\$350 million in 2001), Lebanon (\$266 million in 2005), or Ecuador (\$2.3 billion in 2012)<sup>24</sup>. Second, FDI decreases when investors allege violation of rights even at the moment of filing of an international arbitration.<sup>25</sup> Third, because arbitration is a high-risk, high-cost option, the mere threat of arbitration from investors can be effective in extracting concessions. Several examples of such threats have emerged and experts estimate that the practice is not uncommon, even if, it remains mostly confidential.<sup>26</sup>

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<sup>21</sup> BITs typically also have grandfather clauses that ensure treaty obligations apply to FDI for 10 to 15 years after a treaty expires or is abrogated by a host government.

<sup>22</sup> Wellhausen 2015a,b. Most claims are brought by investors to the International Centre for Settlement of Investment Disputes (ICSID). The next used option is arbitration by the United Nations Commission on International Trade Law (UNCITRAL).

<sup>23</sup> Simmons 2014.

<sup>24</sup> This is the largest ICSID award to an investor and a direct consequence of the US-Ecuador BIT.

<sup>25</sup> Allee and Peinhardt 2011.

<sup>26</sup> Recent examples include arbitration threats from open-pit mining companies in Indonesia and Costa Rica regarding regulation changes; telecom operators in Zimbabwe over the cancellation of their license; or an energy company in India over taxation policy. Also, Luke Eric Peterson, publisher of the Investment Law Reporter notes that "I would not be the least bit surprised if there were dozens upon dozens of such

Also, host states may be disadvantaged over investors because many developing states have limited legal capacity to counter the BIT driven investor-states claims. Evidence from actual litigations indeed shows legal asymmetry favoring foreign investors.<sup>27</sup>

In contrast to strong investor protection, very few, if any, BITs mention human rights or associated fields<sup>28</sup> and developing countries would like to see more BIT obligations for investors<sup>29</sup>. For instance, no explicit reference to human rights is included in the country model BIT of Germany (2008), France (2006) or the United States (2004). An exception is the 2007 the Norwegian model BIT which mentions human rights in preambular language. However, such preambular wording is too weak to compel compliance for either foreign investors or host states. Related provisions (labor or environmental standards) are increasingly mentioned in recent BITs or BIT templates.<sup>30</sup> This, however, is still far from the “hard” language seen in Preferential Trade Agreements (PTAs) which explicitly link material benefits to compliance with human rights standards.

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informal treaty-uses for every claim that actually gets arbitrated” (Gallagher and Shrestha 2011, 5).

<sup>27</sup> Van Harten (2012) examines jurisdiction issues that could be interpreted either way and are litigated precisely because parties cannot readily anticipate the outcome. He finds a bias towards expanding investors’ rights of interpreting jurisdictions that applies to 76 percent of the cases. Simmons (2014) finds that the poorer the state, the more likely an arbitration panel will rule expansively in investors’ favor..

<sup>28</sup> Jacob 2010.

<sup>29</sup> UNCTAD 2015.

<sup>30</sup> Article 11 of the 2004 Canadian model BIT notes that “The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from ... such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor”. Similar provisions are in the 2012 US model BIT.

The following section leverages the strong protection offered by BITs to investors against the lack of provisions in these treaties with regards to human rights. Hafner-Burton forcefully argues that “change in repressive behavior almost always requires legally binding obligations that are enforceable”<sup>31</sup>. We apply this logic in reverse to suggest that BIT sanctioned binding legal commitments can incentivize the government to favor foreign investors (versus vulnerable domestic populations), with a net result of worsening human rights practices.

## **BITs AND HUMAN RIGHTS**

Bilateral investment treaties include both provisions that guarantee investor rights and mechanisms to legally enforce such provisions.<sup>32</sup> In brief, we argue that as many developing countries predominantly attract vertical FDI and compete for investment and trade, BITs lock in the initial conditions favorable to investors.<sup>33</sup> BITs also constrain states’ future development policy choices, from the provision of basic infrastructure to land reform. The overt favoring of foreign investors and the constraints on development policies are sources of popular grievance in host states, which can lead to outright protest or an anticipation of dissent. Repression and human rights violations are key responses of states to manifested or just anticipated threats. Yet, states’ reaction to threats and economic globalization depends on domestic institutions, and, therefore, we suggest, the negative human rights consequences of BITs are likely moderated by regime type.

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<sup>31</sup> Hafner-Burton 2005b, 595.

<sup>32</sup> States still break contracts with multinational enterprises (Blake 2013, Allee and Peinhardt 2011).

<sup>33</sup> Others note the lock-in effect of BITs (Milner 2014, Simmons 2014).

### *Developing countries and policies favoring investors*

Many developing countries continue to compete in trade or for foreign investment by offering cost cutting low taxes and lax labor standards, or reducing welfare spending. First, there are specific issues on which countries engage in “races to the bottom” to attract foreign investment. For example, both rich and developing countries mirror peer behavior and compete for FDI by relaxing de facto labor practices<sup>34</sup> or employment protection and regulatory standards<sup>35</sup>. Similarly, Klemm and Parys (2012) show that developing countries compete on corporate income tax rates, as well as by offering corporate income tax holidays.

Second, the nature of developing countries’ integration in the global economy provides broad evidence on the existence of competitive pressures to offer favorable treatment to investors. Our theory fits best with flows of vertical FDI<sup>36</sup>, as this type of investment is particularly interested in conditions that cut production costs and, indeed, much of the investment in developing countries is vertical. Thus, work examining country characteristics (market size, quality and quantity of labor, location, tax rates) to infer the nature of investment concludes that developing countries attract vertical FDI.<sup>37</sup> A similar conclusion is reached by UNCTAD (2004) which shows that for both manufactured goods, but also services, FDI in developing countries is increasingly vertical. In addition, Buthe and Milner (2008) find that trade flows and FDI are

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<sup>34</sup> Davies and Vadlamannati 2013.

<sup>35</sup> Olney 2013.

<sup>36</sup> FDI that establishes facilities in multiple countries, each producing different inputs for the firm's production process.

<sup>37</sup> Blonigen and Wang 2005; Hanson et al. 2003.

complements, supporting indirectly their expectation that, at least for developing countries, FDI is largely vertical, part of intra-firm, cross border transactions.

Third, the link between investment in developing countries and their trade has further implications because BITs can lock-in export promoting policies. Multi-national corporations use developing countries as part of their global production chain, by importing inputs and exporting processed goods.<sup>38</sup> Because developing countries serve as export platforms for multi-national corporations<sup>39</sup>, export promoting policies are very attractive to foreign direct investors. Moreover, under certain conditions, trade competition leads to lower environmental and labor<sup>40</sup> and trade competition induced by network position similarity<sup>41</sup> induces convergence of countries' fiscal and regulatory policies.<sup>42</sup>

In addition to locking in past investor friendly policies, BITs constrain governments' choices for sustainable development and welfare improvement. Rudra for example finds that exposure to globalization (trade openness and capital flows) lowers welfare spending

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<sup>38</sup> Buthe and Milner 2014.

<sup>39</sup> Frieden 1991; Ruane and Ugur 2006.

<sup>40</sup> Cao and Prakash 2010; Mosley and Uno 2007; Rudra 2011. The specific circumstances refer to issue areas (water or air pollution) or domestic conditions like income inequality. Greenhill et al. (2009) show that the effect of trade on labor standards is conditional on the labor standards of trade partners.

<sup>41</sup> Cao 2010, 2012.

<sup>42</sup> Our argument allows for pockets of races to the top, for particular sectors or particular countries, as long as the majority of conditions locked in by BITs reflect favorable treatment of investors in developing countries, given the type of FDI these countries are likely to receive (vertical FDI) and the type of trade they are engaged in (export platforms).

in countries where labor enjoys little bargaining power.<sup>43</sup> There are also numerous anecdotes that support the loss of sovereignty due to BITs. Blake argues that Denmark's subsidies to local firms to develop environmentally friendly technologies contravene BIT national treatment clauses.<sup>44</sup> In another example, in 2007, investors from Luxembourg and Italy brought an ICSID claim against South Africa arguing that the 2002 Mining and Petroleum Resources Development Act expropriated them because it required that mining companies be partly owned by the historically disadvantaged. After the claim's settlement in 2010, South Africa ended its BITs with Belgium and Luxembourg, arguing that they limited the government's transformative agenda. Additionally, there are pending BIT arbitrations arising from disputes over the provision of water and sewage services such as *Aguas del Tunari vs Bolivia*<sup>45</sup> or *Suez Corporation vs Argentina*<sup>46</sup>. Also, an increasing number of requests for annulment<sup>47</sup> of arbitration awards are argued by host states in relation to development and the provision of basic utilities – water, gas, electric power and infrastructure.<sup>48</sup>

*BIT clauses constrain governments' policy space*

Several BIT provisions both lock-in initial conditions and constrain governments' choices. One important standard in BITs is the national treatment clause, which prohibits

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<sup>43</sup> Rudra 2002.

<sup>44</sup> Blake 2013.

<sup>45</sup> See for example: William Finnegan, "Leasing the Rain", *The New Yorker*, April 8, 2002, 43.

<sup>46</sup> "Suez to Take US \$496MN Charge – Argentina", *Business News America*, July 1, 2002

<sup>47</sup> The tribunal decisions in BIT arbitrations are final and binding. Annulment is the only option (other than noncompliance) available to parties that disagree with the arbitration decision (Simmons 2014).

<sup>48</sup> Simmons 2014.

host governments from making negative differentiations between national and foreign investors.<sup>49</sup> Under this clause, for instance, host governments may not favor domestic firms that match their policy goals, or require foreign investors to use domestic inputs, or locate in underdeveloped regions. A related BIT standard is the fair and equitable treatment clause, which is included in most BITs and can be applied to broader instances of state arbitrary or discriminatory behavior. This clause allows a potentially expansive interpretation of fairness and has been used successfully by investors against host states.<sup>50</sup>

With direct nationalization on the decline, BIT clauses related to indirect expropriation have become prevalent. Besides guarding against weak property rights enforcement, indirect expropriation refers to less clear-cut and potentially very broad measures such as changes in taxation, revocation of licenses or denial of access to infrastructure. The vast majority of BITs include language referring to indirect expropriation and, uncertainty over the scope of this clause has the potential to deter states from taking actions that, while in the public interest, may be regarded as indirect expropriation and require significant investor compensation.<sup>51</sup>

Domestic policy autonomy is also restricted by the inclusion of stabilization clauses in investment contracts.<sup>52</sup> Such clauses aim to prevent host states from changing domestic law to the detriment of the investor and reassure foreign investors in projects that demand a large amount of investment, especially in infrastructure or natural resource exploration.

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<sup>49</sup> The majority of BITs do not include exceptions to the national treatment clause.

<sup>50</sup> UNCTAD 2012.

<sup>51</sup> Nikiema 2012.

<sup>52</sup> Amnesty International (2006) estimates that stabilization clauses are more prevalent in the contracts of poorer countries facing groups of large multi-national corporations.

Investors can invoke the stabilization clause from contracts with the host states under the “umbrella clause” of BITs and proceed directly to international arbitration. About 40% BITs include such umbrella clauses.<sup>53</sup>

*BITs, grievance and human rights violations*

All things equal, the lock-in effect of BITs can force the hand of the government to favor multi-national corporations or foreign investors even at the cost of violating the rights of their own citizenry. First BIT provisions can simply ask the government to directly intervene and physically protect multi-national companies’ investment. Second, the same conditions that were designed to be favorable to investors and attract multi-national corporations have the potential to create popular dissent or the expectation of dissent, followed by repressive counters on the side of the government.

Very directly, a common BIT obligation is to provide foreign investors with “full protection and security”. This clause commits host states to exercise “due diligence” in protecting foreign assets and can be invoked by foreign investors when they encounter protests in host countries. In a recent arbitration case<sup>54</sup>, for example, a Spanish corporation sued Mexico for failing to uphold the full protection and security clause by claiming that the authorities did not act quickly to “prevent or put an end to the adverse social demonstrations” around the investors’ hazardous-waste treatment facility<sup>55</sup>. The arbitration tribunal dismissed the claim related to the Spain-Mexico BIT’s “full protection and security” clause. Yet, it concluded that the government had to compensate

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<sup>53</sup> Gill et al. 2004. The Italian model BIT includes directly stabilization clauses as a treaty obligation.

<sup>54</sup> Técnicas Medioambientales Tecmed, S.A. v United Mexican States (ICSID Case ARB(AF)/00/2).

<sup>55</sup> Amnesty International 2006.

the company on grounds of “indirect expropriation”, because, following popular protests, the government refused to renew the Spanish company’s permit to operate the landfill.

Second, BIT clauses preserve the incentives offered to attract investors. The consequence is limits on governments’ ability to tax and spend, as well as provide welfare and basic infrastructure development. In addition, governments have no incentives to improve labor law, but, rather, undermine labor standards by slacking on the implementation of labor law and reducing the de facto collective action capabilities of labor groups. Such locked-in conditions can create enormous dissatisfaction or straight out disapproval in the form of protest. In turn, the government’s response to popular grievance may turn violent or abusive.<sup>56</sup> For example, in 1997, India saw peaceful protests against the social and environmental consequences of a power-plant built by the Dabhol power company, a joint venture of three US multinationals. The protests were met with harassment, arbitrary arrest and preventive detention.<sup>57</sup>

The grievance that results from policies favoring investors can lead to overt social mobilization or the expectation, on the part of governments, of future dissent. Dissent in the form of protest or the expectation of dissent as a consequence of popular grievance increase the perceived threat for governments seeking to preserve the status quo and generate motivation to employ repressive measures. Empirically, actual protest or

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<sup>56</sup> Abouharb and Cingranelli (2009).

<sup>57</sup> <http://www.refworld.org/docid/3ae6a9884.html>; Peterson and Gray (2003). In 1997, the US did not have a BIT with India, but India’s other BITs gave US investors (Bechtel, Enron, GE) protection via treaty shopping (Van Os and Knottnerus 2011). These US companies channeled their investment through the Netherlands and Mauritius, and brought cases to the International Chamber of Commerce (ICC) against India under India’s BITs with these countries. The ICC decided against India in 2005 (Bettauer 2009).

potential dissent are key determinants of states' use of coercive measures against their own citizens.<sup>58</sup>

The use of state repression in response to manifested or anticipated dissent is the result of authorities' assessment of the costs and benefits of rights violations versus other tools at their disposal.<sup>59</sup> Repression is thus not an automatic response. We explore the variation in the costs of repression in the next subsection. Here we argue that, *ceteris paribus*, when the government's hands are tied by BITs, it becomes relatively expensive to address the root causes of popular grievance by taking measures against the legally protected investors. In addition, not only are investors' rights legally protected, but these rights limit severely some of the non-repressive options that governments normally use to buy off the potential opposition, including increasing social benefits, cheap access to infrastructure services like water or electricity or providing side payments through domestic companies.

Our first hypothesis follows this discussion: *BITs are associated with a worsening of human rights practices* (Hypothesis H1).

#### *The mitigating effect of political regime*

We emphasize the key point of the repression literature that rights violation is the result of a cost-benefit analysis, and, therefore, domestic conditions can mitigate the incentives of host states to use repression. We focus on democracies, because democratic institutions are a key consistent variable that raises the cost of human rights violations.<sup>60</sup>

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<sup>58</sup> Davenport 1995; Davenport and Armstrong 2004; Moore 1998; Nordas and Davenport 2013.

<sup>59</sup> Davenport 1995; Nordas and Davenport 2013.

<sup>60</sup> Davenport and Armstrong 2004.

In addition, democracies filter the effect of globalization. Races to the bottom are thus not necessarily a straightforward response and domestic institutions condition the effect of globalization on states' welfare policy, labor standards or pension reform.<sup>61</sup> Democracies may also be less likely to offer favorable initial conditions to foreign investors. Thus, Li finds that countries with better rule of law, which tend to be democracies, offer lower levels of tax incentives.<sup>62</sup> Also, favorable trade policies are valued by investors who use developing countries as export platforms and Cao and Prakash find that countries with low political constraints, which tend to be non-democracies, respond to trade pressures with lower standards for air pollution.<sup>63</sup>

Moreover, while BITs tie the hands of all governments in a similar fashion, we argue that democracies and dictatorships vary in two key dimensions that affect states' calculus of the costs and benefits of repression. First, democratic leaders and dictators are likely to have different assessments of the level of threat to their rule posed by popular grievance and dissent. All else equal, the greater the perceived threat to their rule, the more likely that governments will make use of repression.<sup>64</sup> It is likely, however, that the level of perceived threat emerging from conflict between the interests of multi-national corporations and domestic groups is higher in dictatorships. Protest or mass

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<sup>61</sup> Brooks 2002; Mosley 2008; Rudra 2002.

<sup>62</sup> Li 2006. Li and Resnick (2003) also argue that democratic accountability reduces the ability of governments to offer 'sweet bargains', which, in turn, reduces the incentives to pick democracies as investment locations.

<sup>63</sup> Cao and Prakash 2012. Further evidence exists that democracies are associated both with better environmental outcomes (Li and Reuveny 2006) and environmental institutions (Neumayer 2002).

<sup>64</sup> Davenport 1995, Nordas and Davenport 2013.

demonstrations, either manifested or just expected, are more likely to be seen challenges to regimes that severely limit citizens' freedom of speech and association, or voting for the political competition as outlets to express grievance.

Second, democracies and dictatorships face different levels of accountability. In their review of the literature, Davenport and Armstrong note that “in democracies political leaders who use repression against their citizens can be removed from office through the popular vote and...these governments contain numerous institutional checks and balances on government activity”<sup>65</sup>. Thus, in political regimes that face real political opposition and a free media, episodes of human rights abuses can be expected to be quickly and widely acknowledged, raising the political and electoral costs of repression. In democracies both mechanisms – a low threat perception and high accountability – are likely to balance the favorable treatment afforded to investors by BITs with a high cost of repression.

We propose therefore a second hypothesis: *The negative impact of BITs on governments' respect for human rights is mitigated in democracies* (Hypothesis H2).

## **DATA, MEASUREMENT AND RESEARCH DESIGN**

We test our hypotheses using data for 113 developing countries from 1981 to 2009.<sup>66</sup> The start year is dictated by the availability of the key dependent variable. The sample includes only developing countries because rich countries have a different position in the

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<sup>65</sup> Davenport and Armstrong 2004, 538.

<sup>66</sup> Similar to Poulsen and Aisbett (2013), these are countries that the World Bank does not classify as high-income for the majority of our sample period. A list of countries is available in the Online Appendix.

global economy and are both sources of FDI and FDI recipients. Human rights practices also tend to be better in rich countries, making it likely that the causal process and government's trade-offs are different in the developing world.

#### *Dependent variable*

The dependent variable is the Cingranelli and Richards measure of government's respect for physical integrity rights (CIRI updated to 2012)<sup>67</sup>. The CIRI data explicitly captures governments' human rights practices while other data only captures overall human rights conditions.<sup>68</sup> CIRI codes the violation of four physical integrity rights: the use of torture, disappearance, extrajudicial killing, and political imprisonment. Our variable is an index ranging from 0 (no respect for any of the four physical integrity rights) to 8 (full respect for all four physical integrity rights), coded based on both Amnesty International's Annual Report and the U.S. State Department's annual Country Reports on Human Rights Practices. The index sums the coding for each of the four physical integrity rights where 0 codes frequent violations (50 or more), 1 codes some violations (1-49) and 2 signals no violations. In our sample the most frequent violation of rights is torture, followed by incidences of political imprisonment. About 90% of the sample, respectively 70%, experiences some violations or frequent violation of rights in the form of torture, respectively political imprisonment.

#### *Independent variables*

To test hypothesis one we use the total cumulative number of BITs ratified by a country in a given year. This makes sense because our focus is on the total leverage that foreign

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<sup>67</sup> Cingranelli and Richards 1999.

<sup>68</sup> Cingranelli and Filippov 2010; Cingranelli and Richards 2010; Richards et al. 2001.

investor interests have on the host states through BITs. The greater the number of BITs a host state ratifies, the greater the potential for popular grievance and repressive tactics on the side of the government. We use ratified BITs because merely signed BITs are not legally binding.<sup>69</sup> This variable is constructed using the International Investment Agreements database (UNCTAD website). In our sample, the variable ranges from 0 to 104 and developing countries were on average subject to about 11 BITs.

We further explore the heterogeneity of BITs to get at the causal mechanism in our theoretical explanation. First, we emphasize the strength of investors' legal protection. To explore the stringency of BITs, this variable codes exclusively the BITs for which the International Centre for Settlement of Investment Disputes (ICSID) is the only option for dispute arbitration. This means that investors can use the ICSID for dispute settlements directly, without exhausting local remedies. The ICSID has leverage over developing countries because of its status as an international convention affiliated with the World Bank, because it provides for very limited grounds for appeal and its awards have the same effect as national courts judgments. The measure is based on Allee and Peinhardt and our original coding of 420 additional BITs, with a range from 0 to 24 and an average of 4.<sup>70</sup> Second, we want to capture those BITs that regulate de facto investment, such that it is plausible that grievance in host countries comes from favorable conditions granted to real investors. It is very likely that the BITs between developed countries and developing nations capture an investment relationship characterized by de facto flows of capital to the capital poor developing nation. We use as a second measure only North- South BITs, as well as the BITs of major capital exporting developing countries: Brazil, Russia, South

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<sup>69</sup> Haftel 2010.

<sup>70</sup> Allee and Peinhardt 2010.

Africa, China, Argentina, Panama, Mexico, Malaysia, Saudi Arabia, Indonesia, Hungary, Chile, and India.<sup>71</sup> The variable ranges from 0 to 66, with an average of 7.<sup>72</sup>

To test our second hypothesis, we use the polity2 score from the Polity IV dataset (-10 to 10, with larger values indicating higher levels of democracy). We include an interaction term between the polity2 score and the cumulative ratified BITs to test the conditional effect of investment treaties.

### *Control variables*

We use a baseline empirical specification with variables from Hafner-Burton.<sup>73</sup> Specifically, our controls include: (i) foreign investment measured as the net FDI inflows as percentage of GDP (UNCTAD)<sup>74</sup>; (ii) the sum of a state's total exports and imports as a share of gross domestic product (logged) (World Bank World Development Indicators - WDI); (iii) GDP per capita in constant US dollars (logged) (WDI); (iv) regime durability measured as the number of years since a state has undergone a structural regime transition, defined as a movement on the Polity scale of three points or more (Polity IV); (v) population per squared kilometer of land area (WDI); and, from Spilker and Bohmelt<sup>75</sup>, (vi) international human rights agreements capture whether countries have ratified the International Covenant on Civil and Political Rights and the Convention Against Torture; (vii) soft Preferential Trade Agreements measures whether a state

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<sup>71</sup> Poulsen and Aisbett 2013.

<sup>72</sup> Our results are substantively the same when we code those BITs for which ICSID is the only option or one of the options, or, alternatively only North- South BITs.

<sup>73</sup> Hafner-Burton 2005b.

<sup>74</sup> Using log (FDI in millions) our own results are robust in all model specifications. However, the FDI variable is only statistically significant and positive in the instrumental variable models.

<sup>75</sup> Spilker and Bohmelt 2013.

belongs to any PTAs with soft human rights standards; (viii) hard PTAs is a dummy variable that takes a value of 1 if a state belongs to any PTAs with hard human rights standards. In addition to this baseline specification, we also include key covariates from the repression literature: Two dummy variables code ongoing civil war and interstate war (Armed Conflict Dataset). Also, following Nordas and Davenport<sup>76</sup> we include political dissent coded as the sum of antigovernment protest, riots, and general strikes.<sup>77</sup>

Additional variables are discussed in the robustness checks.

### *Model specification*

We use an OLS regression with panel-corrected standard errors<sup>78</sup> and an AR(1) process<sup>79</sup>, as well as instrumental variable techniques. All models include country dummies to capture country-specific unobserved heterogeneity. We also include half-decade period dummy variables to account for time-specific shocks or time trends that may influence both human rights violations and BIT ratification. All independent variables are lagged one year. The empirical model takes the following form:

$$CIRI_{i,t} = \gamma_1 + \gamma_2 BITs_{i,t} + \gamma_3 Polity_{i,t} + \gamma_4 BITs_{i,t} * Polity_{i,t} + [Controls] + v_{i,t} + y_i + \sim_t$$

We expect that  $\gamma_2$  is negative indicating that BITs work to worsen countries' human rights practices.  $\gamma_4$  should be positive, indicating that democracies mitigate the negative

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<sup>76</sup> Nordas and Davenport 2013.

<sup>77</sup> Banks CNTS.

<sup>78</sup> Beck and Katz 1995.

<sup>79</sup> The results are similar when autocorrelation is corrected by (i) using a panel-specific AR1 autocorrelation structure; (ii) adding a lagged dependent variable to our estimations (Online Appendix).

effect of BITs. Finally, based on the literature on repression  $\Gamma_3$  should be positive:

Democracies tend to have better human rights.

## **RESULTS AND DISCUSSION**

Table 2 presents our results. Models 1 and 2 use the cumulative number of all BITs as the key independent variable. Models 3 and 4 use an instrumental variable approach to estimate the effect of BITs on human rights practices. Models 5 to 8, on the other hand, use our alternative measures for relevant BITs, based on the ability of investors to litigate at the ICSID (BITs with ICSID; Models 5 and 6) and the likely existence of actual investment flows (Adjusted North-South BITs; Models 7 and 8). The empirical estimations support our two hypotheses. Models 1, 3, 5 and 7 include the un-interacted cumulative number of BITs and the polity2 score. Across all the models, as expected, the coefficient on the cumulative number of investment treaties is negative and statistically significant. A greater number of BITs ratified by a country reduces the CIRI index, showing a worsening of human rights conditions. Models 2,4, 6 and 8 include an interaction term between the cumulative number of ratified BITs and the polity2 score. The coefficient on the cumulative number of investment treaties continues to be negative and statistically significant, but the interaction term is positive and statistically significant. This supports our second hypothesis: Democracy mitigates the negative effect of BITs on host government's respect for human rights.

Very important, the relationship between BITs and human rights violations is open to the charge of endogeneity. It may be that states with low level of respect for human rights are in a greater need for the credibility afforded by ratifying BITs in the first place.

Although there is no clear evidence in the literature that states with high level of human right violation ratify more BITs<sup>80</sup>, Models 3 and 4 show instrumental variable estimations to address the potential endogeneity problem. We use two instruments for our key independent variable, the cumulative number of ratified BITs: The first instrument measures the average of the total ratified BITs in neighboring states in a given year. We define neighboring countries using the Correlates of War coding for type 1 or 2 contiguity which includes countries that share a land border or are separated by 12 miles of water or less.<sup>81</sup> This instrument aims to capture the competitive nature of BITs signing<sup>82</sup> and the correlation of the instrument with our independent variable is 0.69. The second instrument uses the three year lagged total of new BITs ratified in other countries in the world. This instrument intends to capture the trend of BITs ratification and the opportunities of concluding BITs and its correlation with the key independent variable is 0.29. We use Stata command `xtivreg2` and the results in Table 2 (Models 3 and 4) continue to support our hypotheses. The chosen instruments perform well: The Hansen test of over-identifying restrictions tests the overall validity of the instruments (including the choice of exogenous variables) and failure to reject the null hypothesis gives support for the model. For Models 3 and 4, the Hansen J statistic Chi-sq(2) p-value is 0.38 and, respectively, 0.54, so we cannot reject the null hypothesis. In instrumental variable models, while chosen instruments may be exogenous they may be weak, biasing the estimated coefficients. For both Models 3 and 4, the weak identification Kleibergen-Paap

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<sup>80</sup> Neumayer 2006, Vadlamannati 2008.

<sup>81</sup> Kerner 2009.

<sup>82</sup> Elkins et al. 2006.

Table 2. Effect of BITs on human rights in developing countries 1981-2009

	All BITs		IV		BITs with ICSID		Adjusted North-South BITs	
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
BITs	-0.0161 (0.0038)***	-0.0194 (0.0040)***	-0.0501 (0.0095)***	-0.0614 (0.0108)***	-0.0596 (0.0154)***	-0.0741 (0.0169)***	-0.0322 (0.0076)***	-0.0348 (0.0078)***
Polity2	0.0777 (0.0093)***	0.0702 (0.0098)***	0.0824 (0.0101)***	0.0696 (0.0114)***	0.0790 (0.0093)***	0.0724 (0.0100)***	0.0783 (0.0093)***	0.0724 (0.0098)***
BITs * Polity2		0.0011 (0.0004)***		0.0017 (0.0005)***		0.0034 (0.0018)*		0.0013 (0.0007)*
HR treaty	-0.1488 (0.0684)**	-0.1365 (0.0682)**	-0.1564 (0.0640)**	-0.1437 (0.0647)**	-0.1337 (0.0680)**	-0.1292 (0.0678)*	-0.1491 (0.0684)**	-0.1396 (0.0687)**
Soft PTA	-0.4514 (0.1563)***	-0.4608 (0.1556)***	-0.4954 (0.1246)***	-0.5197 (0.1248)***	-0.4492 (0.1565)***	-0.4507 (0.1556)***	-0.4603 (0.1566)***	-0.4661 (0.1562)***
Hard PTA	0.0634 (0.1620)	0.0749 (0.1623)	0.0629 (0.1326)	0.0772 (0.1324)	0.0736 (0.1621)	0.0950 (0.1623)	0.0510 (0.1623)	0.0610 (0.1625)
FDI inflow	0.0166 (0.0076)**	0.0162 (0.0076)**	0.0208 (0.0096)**	0.0205 (0.0096)**	0.0158 (0.0076)**	0.0158 (0.0076)**	0.0162 (0.0076)**	0.0160 (0.0076)**
Trade openness	0.7095 (0.1306)***	0.7009 (0.1322)***	0.8598 (0.1386)***	0.8686 (0.1396)***	0.6666 (0.1285)***	0.6647 (0.1290)***	0.7153 (0.1298)***	0.7080 (0.1312)***
GDP per capita	0.2596 (0.1881)	0.3301 (0.1898)*	0.7649 (0.2198)***	0.9854 (0.2466)***	0.1669 (0.1935)	0.1826 (0.1922)	0.2887 (0.1897)	0.3397 (0.1927)*
Durability	0.0061 (0.0044)	0.0051 (0.0045)	0.0068 (0.0037)*	0.0052 (0.0038)	0.0061 (0.0044)	0.0058 (0.0044)	0.0064 (0.0044)	0.0056 (0.0046)
Population	-0.0123 (0.0014)***	-0.0124 (0.0014)***	-0.0132 (0.0013)***	-0.0134 (0.0013)***	-0.0114 (0.0014)***	-0.0113 (0.0015)***	-0.0121 (0.0014)***	-0.0121 (0.0014)***
Interstate war	0.0443 (0.1962)	0.0170 (0.1940)	-0.1828 (0.2000)	-0.2738 (0.2110)	0.0885 (0.1992)	0.0856 (0.1981)	0.0448 (0.1949)	0.0274 (0.1935)
Civil war	-0.9653 (0.1279)***	-0.9633 (0.1278)***	-1.3888 (0.1095)***	-1.3874 (0.1102)***	-0.9655 (0.1285)***	-0.9690 (0.1287)***	-0.9574 (0.1279)***	-0.9564 (0.1278)***
Political dissent	-0.0371 (0.0091)***	-0.0345 (0.0092)***	-0.0545 (0.0100)***	-0.0492 (0.0102)***	-0.0343 (0.0090)***	-0.0329 (0.0090)***	-0.0359 (0.0090)***	-0.0342 (0.0091)***
R <sup>2</sup>	0.55	0.55	0.17	0.17	0.55	0.55	0.55	0.55
Countries	113	113	113	113	113	113	113	113
N	2,679	2,679	2,677	2,677	2,679	2,679	2,679	2,679
Kleibergen-Paap rk Wald F statistic			79.6	42.1				
Kleibergen-Paap rk Wald F statistic interaction term				159.1				
Hansen J p-value			0.38	0.54				

Note: All model except 3&4 are OLS with panel corrected standard error along with AR (1), intercepts, country and half-decade fixed effects. Model 3 and 4 are instrumental variable models (Stata command xtivreg2). The numbers in parentheses are standard errors. All independent variables are lagged one year. \*\*\* p <= 0.01; \*\* p <= 0.05; \*p<=0.1

rk Wald F statistic is above 42. This value easily passes the “rule of thumb”<sup>83</sup> that the F statistic should be at least 10 for weak identification not to be considered a problem.<sup>84</sup> In

<sup>83</sup> Staiger and Stock 1997.

addition, we use similar instrumental variables for the modified independent variables (BITs with ICSID and Adjusted North-South BITs) and the results shown in Table 2 (Models 5-8) are largely robust (Online Appendix).

A related, broader concern is that the effect of BITs reflects the preferences of actors involved in the bargaining over the BIT. We perform the following two tests to address such concerns: (i) we include in Table 2 models a variable that captures the competition for capital among developing countries, which emerges as the key factor that drives countries to sign BITs<sup>85</sup>; (ii) we exclude from our BITs count those treaties that were ratified less than 5 years prior, under the assumption that for older BITs, the coalition of interests that allowed for ratification is much less likely to matter directly and the effect we identify belongs to the BIT. Our results maintain (Online appendix).

For interactive models inference should be done with meaningful marginal effects and standard errors to determine the conditions under which the variable of interest has a statistically significant effect.<sup>86</sup> Figures 1(a, b, c, d) show the marginal impact of BITs on governments' respect for human rights conditional on the level of democracy. Figures are based on Model 2, 4, 6 and 8, respectively. The marginal effect of cumulative BITs is negative and highly statistically significant in less democratic states, whereas in democracies the effect is much smaller and only marginally statistically significant. Very

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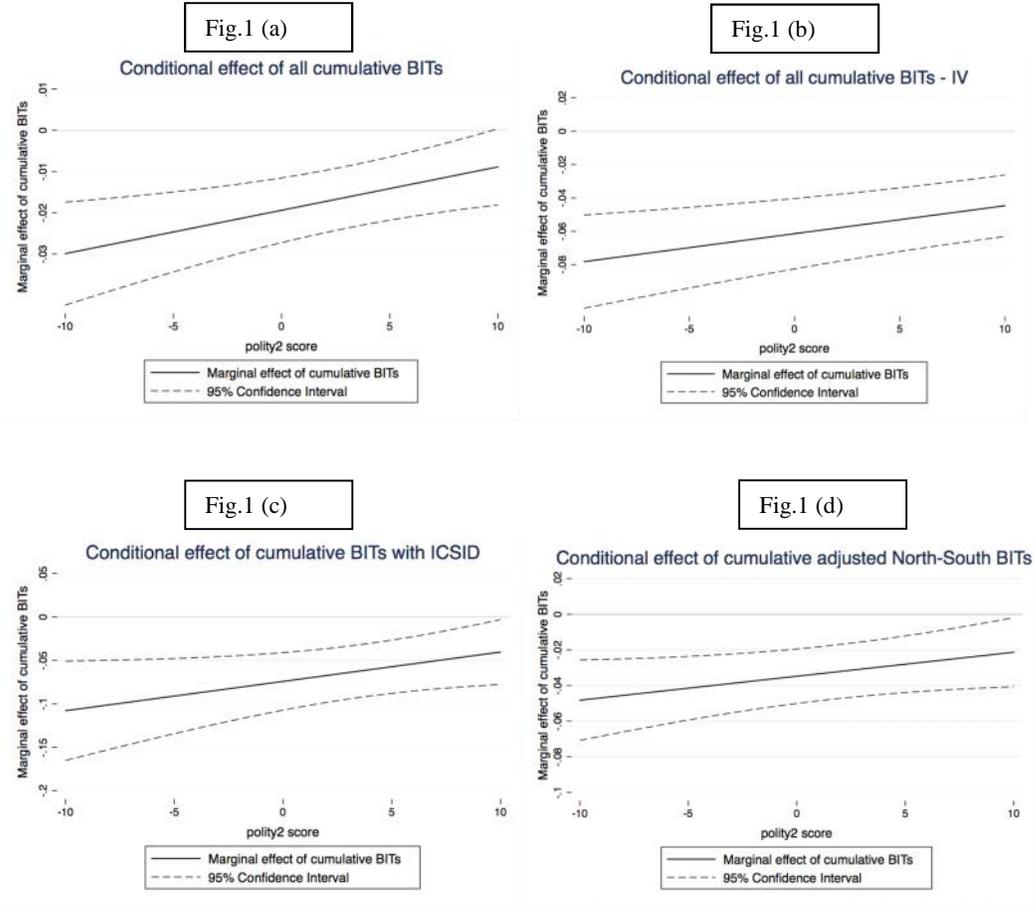
<sup>84</sup> Our results are robust to using a third instrument (Buthe and Milner 2008): Based on Jandhyala et al. (2011)'s dyadic dataset of BIT signing, we calculate for each dyad-year the probability that the two countries will become members of a BIT in that year. We then add up the predicted probabilities for each country and year and divide that (monadic) sum by the number of possible BIT partners the country could have had for the given year.

<sup>85</sup> Elkins et al. 2006.

<sup>86</sup> Brambor et al. (2006).

relevant for our argument, the size of the marginal effect from Figure 1(a) is smaller than that in Figures 1(c & d). This means that the effect of BITs with ICSID is about three times as large as the effect of all BITs, while the effect of adjusted North-South BITs is about 1.3 as large.<sup>87</sup> This is consistent with our story that governments react to the legal protection of investors in international tribunals and that the effect of BITs should be larger as BITs actually regulate de facto inflows of capital to developing countries.

Figure 1. The marginal effect of BITs on human rights conditional on regime type



Note: Figure 1 (a) is based on Model 2, Figure 1 (b) is based on Model 4, Figure 1 (c) is based on Model 6, Figure 1 (d) is based on Model 8.

<sup>87</sup> When use North-South BITs rather than the adjusted North-South BITs, the marginal effect is more than three times larger than in Model 2.

Further, we investigate the substantive impact of BITs. We use Models 2, 6 and 8 to predict human rights violations as we vary the cumulative number of BITs and the level of the Polity democracy score (Table 3). We vary the cumulative number of all BITs, BITs with an ICSID clause and the adjusted North-South BITs, as well as the Polity 2 score one standard deviation above and below the mean. All other variables are held at mean values. In non-democracies, varying the number of BITs by one standard deviation around the mean accounts for about 8% of the variation in the CIRI dependent variable. For example, for BITs with the ICSID clause, moving from no BITs to 7 BITs that include the restrictive clause on investment arbitrations reduces the predicted level of physical integrity rights from 3.94 to 3.28, or about 8% of the 0 to 8 range of the dependent variable. For democracies, on the other hand, the same variation in the number of BITs has a smaller effect of about 4% of the variation in the CIRI dependent variable.

Table 3. Predicted human rights conditions: Vary BITs and Democracy

		<b><u>Democracies</u></b>	<b><u>Non-Democracies</u></b>
		Polity2 score 1 SD above mean (8)	Polity2 score 1 SD below mean (-6)
Model 2 – all BITs	BIT count 1 SD above mean (25 BITs)	4.68	3.33
	BIT count 1 SD below mean (0 BITs)	4.96	3.98
	Column Difference	-0.27 (-0.48, -0.064)	-0.64 (-0.90, -0.39)
Model 6 – BITs with the ICSID clause	BIT count 1 SD above mean (7 BITs)	4.62	3.28
	BIT count 1 SD below mean (0 BITs)	4.95	3.94
	Column Difference	-0.33 (-0.57, -0.094)	-0.66 (-0.98, -0.34)
Model 8 – Adjusted North-South BITs	BIT count 1 SD above mean (15 BITs)	4.64	3.34
	BIT count 1 SD below mean (0 BITs)	5.00	3.98
	Column Difference	-0.36 (-0.63, -0.095)	-0.64 (-0.92, -0.36)

Note: Predictions are calculated using Stata command margins. The numbers in parentheses are 95 percent confidence intervals.

The differences in predictions are statistically significant at the 95% confidence level and, for non-democracies in particular, the size of this effect is important. For comparison, we compute the effect on the human right conditions of democracy, the key determinant of human rights in the repression literature. A move of one standard deviation above and below the mean in the Polity2 score (keeping BITs at mean value), accounts for about 13% of the 0 to 8 range of the dependent variable (from 4.86 to 3.75).

We also explore the idea that treaties may have different effects depending on who is the partner country in the BIT and break down the total number of BITs in two categories: BITs with advanced democracies and BITs with the rest of the world. Arguably, BITs with advanced democracies protect the rights of investors and, at the same time, could “export” the human rights standards of such advanced democracies to the investment host countries (or at a minimum not hurt human rights).<sup>88</sup> Despite the expectation that BITs with advanced democracies may have a different effect, our results maintain: A greater number of treaties with advanced democracies or with the rest of the world worsens the human rights practices of developing countries (Online Appendix).

Finally, regarding our control variables, we find that: soft PTAs may increase repression levels, while hard PTAs have no impact; ratification of human right treaties is associated with worse practices across our models; the level of democracy, trade openness, GDP per capita, population density, civil war, and political dissent are all significant predictors of human rights practices and take on expected signs. Importantly,

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<sup>88</sup> This is similar to Greenhill et al. (2009) showing that labor institutions in importing countries affect the labor laws of exporting countries (although they affect less labor practice) or Cao et al. (2013) who show that importer countries with good human rights records can diffuse good behavior to the exporter countries.

we find that net FDI inflows are associated with better human rights. This effect, and the results supporting our hypotheses, maintain when we use the ten-year lagged moving average of FDI inflows to mitigate the potential endogeneity between FDI and human rights practices.

By including in our models both the cumulative number of BITs and FDI inflows, we unpack the causal mechanisms through which FDI may affect human rights. Our models allow for a residual effect of FDI inflows which appears to aid human rights.<sup>89</sup> This likely occurs via economic development and growth.<sup>90</sup> FDI has, however, been linked to human rights through opposing arguments. Work that traces itself to dependency theories argues that foreign investors co-opt local elites and extract local resources<sup>91</sup> or, alternatively, use exit threats as leverage for tax breaks, favorable labor policies, and fewer welfare programs<sup>92</sup>. To sustain such investor-friendly policies governments in developing countries arguably need to control the masses, including through curtailment of political or human rights<sup>93</sup>. These opposing arguments are unlikely to be captured by the variables commonly used in the literature measuring the stock or flows of FDI. Our focus on BITs can thus capture directly the preferential treatment<sup>94</sup> that many multinationals enjoy in developing countries and that is locked in by BITs. Empirically, then the measures of FDI

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<sup>89</sup> Similar to Sorens and Ruger (2012), however, we find no effect for the stock of FDI.

<sup>90</sup> Alfaro 2003; Alfaro et al. 2004; Apodaca 2001; Li and Liu 2005; Richards et al. 2001.

<sup>91</sup> Bhattacharya et al. 1997.

<sup>92</sup> Haggard and Maxfield 1996.

<sup>93</sup> Meyer 1996.

<sup>94</sup> Simmons (2014), Van Harten (2012).

included in our estimations, should capture the residual effect of direct investment through channels like economic development and improved living standards.

### *Causal mechanisms*

Our theory suggests that there are several causal paths that can link BITs to human rights violations. The effect likely goes through (i) increased grievance because of limitations on government's ability to tax and spend on subsidies or other measures to reduce poverty; (ii) increased grievance from a worsening of labor relations and conditions for workers; and (iii) social mobilization and state's response to actual and anticipated protest. To understand the empirical support for these causal paths, we first test the effect of BITs on labor practices<sup>95</sup>, fiscal revenue and fiscal expenditure (percent of GDP<sup>96</sup>) and observed political dissent (antigovernment protest, riots, and general strikes). Because we argue for an effect of globalization that is mediated by domestic institutions, these models include the interaction term of BITs and the Polity2 democracy score. Second, we aim to understand whether BITs influence human rights practices directly, as well as indirectly through the posited causal pathways. Thus, we also test the effect of BITs on human rights violations when the intervening variables are included in our models.<sup>97</sup>

All models and the detailed empirical specifications are included in the Online Appendix. The results suggest that BITs depress de facto labor practices with no mediating effect of democracy and, also, that BITs reduce both fiscal spending and revenue, but this negative effect is smaller in democracies. Our theoretical expectation is

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<sup>95</sup> Mosley 2011.

<sup>96</sup> Bodea and Higashijima 2017.

<sup>97</sup> These two steps amount to mediation analysis (James and Brett 1984, Baron and Kenny 1986).

that governments respond not just to observed, but also expected social mobilization. Here, however, we can only measure observed political dissent, and several of our empirical models show that the effect of BITs is mediated by the political regime: That is, BITs increase dissent, but not in democracies.

The empirical models also show that BITs influence human rights directly, as well as through the posited causal mechanisms. Political dissent is already included in our baseline models in Table 2. However, fiscal spending and revenue or labor rights both reduce our sample size and are not usually part of baseline models of human rights violations. We include therefore the variables operationalizing the causal mechanisms one at a time in our Table 2 models. We find that political dissent worsens human rights conditions, while more fiscal revenue and spending, as well as better de facto labor practices are associated with improved human rights. In addition, in all the empirical models, BITs continue to have a negative effect on human rights, mediated by democracy.

#### *Additional robustness*

We verify the robustness of the empirical results against additional threats to inference. These include the timing of when BITs started to give investors access to international arbitration without the requirement to exhaust local remedies; the operationalization of the dependent variable; and, the presence of outliers and the effect of additional variables.

First, we restrict our sample to begin in 1990 because it was not until the late 1980s that BITs began to give investors access to investor-state arbitration without first having to exhaust local remedies. This strategy is similar to Poulsen and Aisbett<sup>98</sup>, who note that, after 1990, the vast majority of BITs include a binding consent to investor-state

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<sup>98</sup> Poulsen and Aisbett 2013.

arbitration. Our theory centers on the leverage of multinational corporations have on host states and therefore the magnitude of lock-in effect of initial policies. Focusing on BITs with access to investor-state arbitration may be therefore a more appropriate way to capture the foreign investors leverage through BITs. We thus restrict our sample to BITs ratified after 1990 and show that our results are robust (Online Appendix).

Second, we use alternative measures of rights violations, including: (i) the average Political Terror Scale (PTS)<sup>99</sup>; (ii) from the CIRI dataset, we only add the scores for the two most frequent incidences of rights infringements, i.e. torture and political imprisonment (range 0 to 4); and (iii) from the CIRI dataset, we use an additive index of freedom infringements, including freedom of foreign and domestic movement, freedom of speech, freedom of assembly & association, and freedom of religion (range 0 to 10)<sup>100</sup>. The results are in the Online Appendix and show that our findings remain substantively the same when we use these alternative measures of rights violations.

Finally, we exclude potential outliers and include additional control variables. Our results are substantively similar if we exclude: countries that are above the 99<sup>th</sup> percentile in terms of cumulative BITs ratified (China, Romania, the Czech Republic) or above the

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<sup>99</sup> Gibney et al. 2012. The PTS data has two indexes that we average: one based on US State Department Country Reports and another based on Amnesty International's Annual Report. Each index is an ordinal five category (1-5) variable that captures personal integrity rights, with larger values indicating higher levels of repression. To be consistent with the interpretation of CIRI data used in the main analysis, we invert the average PTS index so that a larger value reflects a higher respect of human rights.

<sup>100</sup> We exclude from this index Workers' Rights and Electoral Self-Determination (which make up CIRI's Empowerment Rights Index), because we look at worker's right distinctly in the causal mechanisms section and electoral procedures are included in the coding of the Polity score itself.

95<sup>th</sup> percentile (China, Romania, the Czech Republic, Turkey, India, Egypt); one decade at a time from our estimation sample<sup>101</sup>; major capital exporting developing countries: Brazil, Russia, South Africa, China, Argentina, Panama, Mexico, Malaysia, Saudi Arabia, Indonesia, Hungary, Chile, and India. We also test the robustness of our hypotheses by including additional control variables: (i) Simmons<sup>102</sup> finds that states are more likely to sign restrictive BITs during economic downturns. Economic crisis may also induce governments to repress social unrest. We control for the 3 year lagged average economic growth (WDI). (ii) Abouharb and Cingranelli<sup>103</sup> find that IMF or World Bank adjustment programs tend to worsen human rights in loan receiving countries. We control for the number of years that countries are under either IMF or WB programs. (iii) The “shaming” activities of human rights international NGOs may also improve states’ human rights practices. We control for this by using a new dataset of shaming events of more than 400 human rights NGOs<sup>104</sup>. (iv) More corrupt governments could sign more BITs to substitute for poor respect of property rights. We control for corruption in our models (International Country Risk Guide) and our results maintain, while we show that less corruption is associated with better human rights. The Online Appendix shows that our results are largely robust to these additional estimations.

## CONCLUSION

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<sup>101</sup> When we drop the 2000s from our sample, the moderating effect of democracy is less consistent, while the negative effect of BITs on human rights practices maintains.

<sup>102</sup> Simmons 2014.

<sup>103</sup> Abouharb and Cingranelli 2006, 2007, 2009.

<sup>104</sup> Murdie and Davis 2012.

This paper is a first theoretical and empirical investigation into whether and how the global investment regime, and, in particular the ratification of BITs, affects human rights in developing countries. In these countries, we argue that BITs have the potential to worsen human rights practices because they lock in initial conditions attractive to investors, both retrospectively and into the future. Retrospectively, many developing countries are destinations of vertical investment and still compete for investment and trade on issues ranging from environmental regulations, taxes, labor standards, and welfare spending and BITs lock in these initial favorable conditions. In addition, BITs provisions can constrain the future policy choices of states for sustainable development, from the provision of basic infrastructure to investment in environmentally friendly technologies. Low de facto labor rights and constraints on development and social policies can be important sources of popular grievance. Often, repression and human rights violations are key responses of states to the manifested or just anticipated protest and dissent that can result from such grievances. We argue however, that states' reaction to threats and the negative human rights consequences of BITs will be moderated by regime type. Democracies are less likely to offer investors more initially favorable conditions, as seen in tax incentive policies or de facto environmental standards. Also, relatively low perceived threat of protest or dissent to the regime stability and a high level of political accountability in democracies increase the cost of state repression and are more likely to balance the favorable treatment afforded to investors by BITs.

Using a sample of 113 developing countries from 1981 to 2009, we find support for our theoretical arguments. Countries with a higher number of ratified BITs have worse human rights practices. This effect holds and is larger when we restrict our BITs count to

only those treaties that have stringent arbitration clauses (ICSID arbitration) or are likely to govern over actual investment flows (North-South BITs). In addition, we find that the effect of the cumulative number of ratified BITs is conditional on political regime: BITs are more likely to result in human rights violations in non-democracies. Our analysis of the likely causal mechanisms shows that BITs constrain developing countries' ability to tax and spend, worsen labor practices and contribute to political dissent, with BITs having both a direct effect on human rights and an indirect one through the posited causal mechanisms.

Our research draws attention to the unintended externalities of concluding BITs. Investment treaties were drafted to facilitate cross-border capital flows and promote development through foreign investment. Yet we bring robust evidence that ratifying BITs tends to worsen the human rights practices of developing countries, very likely because they tie the hands of governments. Our findings thus back calls from UNCTAD to restore states' control of their regulatory space and to protect the rights of domestic constituencies.<sup>105</sup> They also support the recent move to incorporate human rights standards in the content of BITs, either by explicitly referencing human rights<sup>106</sup> or by including related provisions with regards to labor standards or environmental protection.<sup>107</sup>

## References

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<sup>105</sup> UNCTAD 2012, 2015.

<sup>106</sup> 2007 Norwegian model BIT mentions human rights practices in *preambular* language (Jacob 2010).

<sup>107</sup> See 2004 Canadian model BIT, 2004 US model BIT.

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