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Working Paper

Diplomats want treaties: Diplomatic agendas and perks in the investment regime

GEG Working Paper, No. 112

Provided in Cooperation with:

University of Oxford, Global Economic Governance Programme (GEG)

Suggested Citation: Poulsen, Lauge Skovgaard; Aisbett, Emma (2015) : Diplomats want treaties: Diplomatic agendas and perks in the investment regime, GEG Working Paper, No. 112, University of Oxford, Global Economic Governance Programme (GEG), Oxford

This Version is available at:

<https://hdl.handle.net/10419/196372>

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GEG Working Paper 112
December 2015

Diplomats Want Treaties

Diplomatic Agendas and Perks in the Investment Regime

Lauge Poulsen and Emma Aisbett



GLOBAL
ECONOMIC
GOVERNANCE
PROGRAMME



Diplomats Want Treaties: Diplomatic Agendas and Perks in the Investment Regime

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Forthcoming in **Journal of International Dispute Settlement** vol. 7, no. 6, 2016
(special issue)

Abstract

Literature on the investment treaty regime has shown little interest in diplomatic interests and agendas as drivers of treaty negotiations. This contrasts with other work on international economic relations, such as the negotiation of preferential trade agreements. Our paper fills this gap through a multi-method approach. In line with other areas of economic diplomacy we show that strategic foreign policy considerations have driven some investment treaty negotiations. Secondly, we show that some diplomats have been successful in promoting investment treaties to further their own individual interests. Rooted in public choice theory, this second causal mechanism is often overlooked in literature on economic diplomacy.

The Global Economic Governance Programme is directed by Ngaire Woods and has been made possible through the generous support of Old Members of University College. Its research projects are principally funded by the Ford Foundation (New York), the International Development Research Centre (Ottawa), and the MacArthur Foundation (Chicago).

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Introduction

On 19 March, 1976, a bilateral investment treaty (BIT) was signed in London by Mr. Roy Hattersley, Minister at the British Foreign and Commonwealth Office (FCO) and Mr Ioan Patan, Deputy Prime Minister of the Socialist Republic of Romania. The agreement had not been pushed by the United Kingdom.³ Rather, it had been initiated by Romania a few years before in the expectation that it would attract British investment. Negotiations couldn't proceed, however, until the two states had settled a number of outstanding financial matters. Once settled, the Romanian Embassy in London handed over a draft text in the autumn of 1975 to which London responded a few months later. From that moment negotiations went swiftly. Bucharest was anxious to get the treaty signed at the Ministerial visit to London in March. If the UK stalled, Romanian insisted that "they would regard this as a markedly negative element in the development of closer Anglo-Romanian friendship."⁴ To London, this sounded as if "the Romanians would stall on Concorde overlying rights, the purchase of further British aircraft and the joint venture agreements that [were] in the pipeline". Romania was strong-arming the United Kingdom to enter into a BIT. Moreover, Harold Wilson, the British Prime Minister, had announced his resignation just a few days before the visit, which ruled out a meeting with the Romanian Vice Premier. This made the signing of the BIT even more important and the "Romanians were much put out that at one stage it looked as though there would be nothing for Mr. Patan to sign ...". Foreign policy agendas were not isolated to the Romanian side. While British negotiators sought to negotiate the best deal possible, FCO put pressure on them to conclude the talks in time for the visit. This was the first BIT London had negotiated with a Communist country and the first to be negotiated by any Western country with Romania. Accordingly, FCO officials found that the treaty's "significance is consequently rather more political than commercial".⁵

The 1976 UK-Romania BIT was but one of thousands of investment treaties signed over the last half a century, most of them bilateral. For most Western states, the treaties were designed and negotiated primarily to protect their investors abroad, whereas for most states in Africa, Latin America, Asia, and Eastern Europe the treaties were entered into primarily in the expectation that it would help them attract foreign investment.⁶ Commercial motives were not the only driver of investment treaty negotiations, however, and even agreements signed

We are grateful to Barbara Zarate for research assistance, Tewodros Tamiro for feedback, and the Ford Foundation for financial support

³ Poulsen 2015, 62.

⁴ FCO 59/1446.

⁵ FCO 59/1446.

⁶ Poulsen 2015.

primarily to protect or attract investments were often initiated also for political reasons – as the BIT between the UK and Romania. Yet, the interaction between diplomatic interests and BIT negotiations has received hardly any notice in the growing literature on the political economy of the investment treaty regime. This contrasts with other literatures on economic diplomacy, such as the negotiation of preferential trade agreements.

Our paper seeks to fill this gap through a multi-method approach. It will do so in two steps. The first part of the paper is quantitative and shows that the existence of a diplomatic link between countries is strongly correlated with investment treaty adoption. Quite simply: country-pairs are much more likely to sign an investment treaty if they have formal diplomatic links with each other. While some previous papers had included diplomatic links as an explanatory variable for investment treaty formation, ours is the first to demonstrate both the quantitative importance, and the statistical robustness, of this relationship.

The main contribution of the paper is the second section, where we propose theoretical explanations for the importance of diplomatic links in treaty formation, and support these with qualitative evidence. We highlight two causal mechanisms in particular. The first is that BITs are often signed partly to promote foreign policy agendas – like with the UK-Romania BIT. Rather than purely commercial agreements, BITs were often also used to promote, or tie in, diplomatic links between states. The second mechanism is the use of BITs as ‘perks’ for diplomats themselves by offering opportunities for travel, inter-governmental prestige and power, and larger budgets. This mechanism is less well understood but, we argue, crucially important for some states.

Diplomatic ties predict BIT-adoption

This first section begins from a simple observation: a number of quantitative analyses have found diplomatic representation to be correlated with investment treaty adoption between two states.⁷ Even after controlling for investment flows and other potential drivers of investment treaties, diplomatic representation between countries still remains key for their propensity to adopt BITs with each other. This is potentially important. Diplomatic representation is a core proxy for whether two countries have established, or seek to establish, political links with each other, which could have driven some BITs – as in the case of the UK and Romania for instance.

Yet, the relationship between diplomatic representation and investment treaty adoption has not been reflected upon to date. Allee and Peinhardt refer the result to a footnote with no explanation, and Elkins, Guzman, and Simmons (EGS) don't consider diplomatic representation as a substantially interesting predictor in itself either. We suspect the papers have thereby overlooked a core implication of their own results.

That said; there are good reasons to be suspicious that the effect of diplomatic representation on BIT-adoption is driven by a range of other factors not controlled for in the calculations. As a first step for our paper, the following section will therefore show that diplomatic links are, in fact, a highly important and robust predictor of investment treaty adoption, and use a set of complementary tests with another proxy for diplomatic links to provide evidence which suggests the identified relationship is at least partially a causal one.

Diplomatic representations

As in previous papers, our proxy for diplomatic links is the indicator of formal diplomatic representation from the Correlates of War of War Diplomatic Exchange Data Set (version 2006.1). Given the benefits of diplomatic representation - such as information gathering, effective communication, international prestige, and promotion of economic and political interests⁸ - states should have an interest in opening up missions in most countries. Yet, establishing diplomatic missions is costly⁹ and there is therefore significant spatial and

⁷ Allee and Peinhardt 2010, ftn. 37; Elkins, Guzman, and Simmons 2006.

⁸ Kinne 2014; Keeley 2000.

⁹ In 2014, the United States spent \$8 billion on diplomatic and consular programs and \$2.6 billion on embassy security, construction, and maintenance; Department of State, "Congressional Budget Justification: Fiscal Year 2016". Available at:

<http://www.state.gov/documents/organization/236395.pdf>. Last accessed 4 November 2015. For the United Kingdom, it cost £3.5 million to reopen the embassy in Libya in October 2011;

temporal variation in diplomatic representation. In the period after the Second World War, only about one third of all possible country pairs (dyads) had diplomatic representation.¹⁰ Similar levels are evident in our data as can be seen in Table 1.

Table 1: Summary statistics for key variables by time period.

	Variable	Mean	Std. Dev.	Min	Max	N
1970-1987	Dyad has signed BIT	.0094	.0969	0	1	415386
	Dyad has diplomatic representation	.3800	.4854	0	1	397848
	Military personnel p/c in Source	3.390	39.29	0	550	400496
	Military personnel p/c in Host	3.390	39.29	0	550	400496
	Host has been subject to BIT claim	.0004	.0221	0	1	326284
1988-1999	Dyad has signed BIT	.0431	.2031	0	1	385242
	Dyad has diplomatic representation	.2681	.4429	0	1	353590
	Military personnel p/c in Source	2.405	29.94	0	442	373099
	Military personnel p/c in Host	2.405	29.94	0	442	373099
	Host has been subject to BIT claim	.0332	.1792	0	1	300953
2000-2007	Dyad has signed BIT	.1161	.3204	0	1	293380
	Dyad has diplomatic representation	.2483	.4320	0	1	291466
	Military personnel p/c in Source	1.82	23.82	0	370	277917
	Military personnel p/c in Host	1.825	23.82	0	370	277917
	Host has been subject to BIT claim	.2629	.4402	0	1	225381

Such variation makes the variable useful for quantitative analysis and it has been used a number of previous studies assessing the drivers and effects of diplomatic engagement.¹¹ Rather than merely counting the number of diplomatic representations, however, we use the variable to measure links *between* country dyads. Our measure is thus binary and equals one when either or both countries have diplomatic representation in the other. Note also, that whereas recent work has sought to directly assess the role of diplomatic representation for treaty making *as such*,¹² we are more comfortable merely using it as a broader proxy for diplomatic engagement between states.

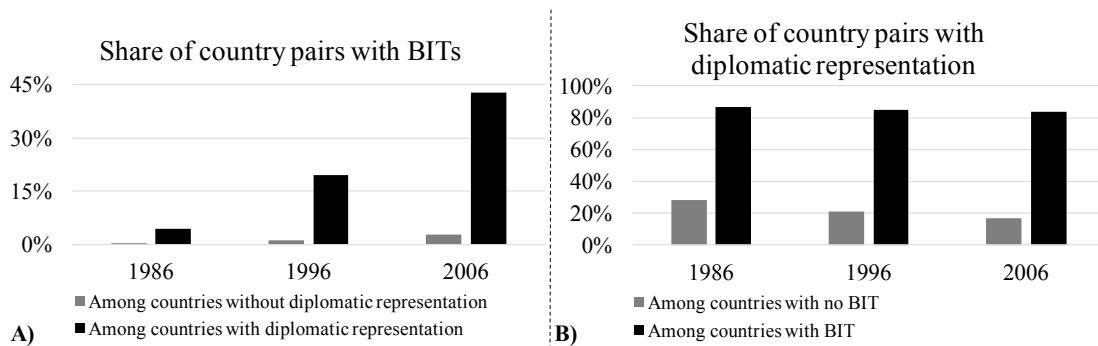
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/351563/Cost_of_reopening_the_British_Embassy_in_Tripoli_in_2011_FOI_ref_0754-14.pdf. Last accessed 4 November 2015.

¹⁰ Bayer 2006.

¹¹ E.g. Small and Singer 1973; Rose 2007; Neumayer 2008; Segura-Cayuela and Vilarrubia 2008; Maliniak and Plouffe 2011; Moons and Bergeij 2013; Kinne 2014.

¹² Plouffe and Van Dersterren 2015.

Figure 1: BITs are more much prevalent among countries with diplomatic representation.



As a starting point, Figure 1 shows the bivariate relationship between BIT-adoption and diplomatic representation for 1986, 1996, and 2006. Throughout we use the signing of BITs as our measure of BIT-adoption.¹³ Panel A shows that the share of country pairs with BITs is significantly larger among those who have diplomatic links than among those without diplomatic links. By 2006, for instance, 43% of country pairs with diplomatic representation had BITs, whereas BITs were present among only 3% of country pairs without representation. Similarly, Panel B shows that in 2006 84% of country pairs with BITs had diplomatic representation, whereas only 17% of country pairs without BITs had diplomatic representation. It seems that diplomatic representation is important for the adoption of BITs. That said; these patterns could occur because of range of factors, not least since the number of country pairs without diplomatic representation is far greater than those with representation.

To test the role of diplomatic representation for BIT-adoption, we therefore incorporate the binary variable into the dataset of the influential paper on BIT-adoption by Jandhyala, Henisz, and Mansfield (JHM).¹⁴ JHM's model of BIT adoption allowed for what they saw as three categories of drivers of BIT adoption: economic, competitive, and peer effects. The inclusion of the economic drivers is motivated by the idea that dyads with higher potential FDI flows might have more to gain by having a treaty with each other. Thus several potential drivers of bilateral FDI suggested by Markusen's knowledge-capital model¹⁵ and gravity models of FDI¹⁶ were included, namely: the difference in GDP per capita of source and host countries, the sum of the GDPs of source and host, and the square of the difference in source and host GDP, the distance between the two countries, the existence of a preferential trade agreement (PTA), and the share of trade in GDP for both source and host. JHM also argued

¹³ On the politics of BIT-*ratification*, see e.g. Haftel and Thompson 2013.

¹⁴ Jandhyala, Henisz, and Mansfield 2012.

¹⁵ Markusen 2002.

¹⁶ The gravity model of trade predicts trade flows between countries based on their economic size and proximity.

that economic benefit of a BIT is likely also to depend on the difference in political constraint of the executive in source and host countries. This variable is also included in the category of economic drivers.

The inclusion by JHM of variables capturing potential competitive drivers of BIT adoption was motivated by the influential work of EGS who argued that host countries' participation in BITs was strongly influenced by the participation behaviour of their competitors.¹⁷ EGS identified competitive motivations with variables representing the average cumulative number of BITs signed by competitors, weighted by the extent to which they were likely to be competitors for FDI with the host (e.g. by similarity of trade profile). They contrasted these "competitive" indicators with peer learning indicators which were similar in construction, but weighted by cultural similarity (e.g. common language or coloniser).

JHM take a slightly different approach to that of EGS in identifying competition versus peer-emulation/learning effects. Competitive forces in their model are captured by weighted measures of whether similar countries have signed a BIT with the particular source in the dyad. The weighting applied is either trade similarity, commonality of major language, common coloniser, or commonality of intergovernmental organization memberships (IGOs). Due to the significant potential for collinearity among these measures, JHM include trade, language, colonial and IGO measures each in separate regressions.

Peer effects in the JHM model are captured via a weighted average of the total number of BITs signed by peers. This variable is thus analogous to the competition variable, except that it captures general propensity to participate in BITs, rather than the propensity to sign a BIT with the particular source in the dyad. Again, the weightings applied reflect either trade, language, colonial history, or IGO-membership similarity to the host. In order to ensure that these variables do not inadvertently capture the effect of the direct peer relationship between source and host, the corresponding direct bilateral measures are also included in each regression.

Finally, our specification is slightly more conservative than that of JHM. We include year dummies rather than just period dummies, dummies for both soviet and former soviet states, and we run the regression separately for each of the three periods they identify.

Table 2 shows the results of this exercise for the case of trade-related competitive and peer effects. H refers to 'host' country, and S refers to 'source' country. The first thing to note is that diplomatic representation has a robust and statistically highly significant positive effect on the rate of BIT formation in all three time periods. This cannot be said of many of the other

¹⁷ EGS 2002.

variables. The peer effects (measured by H-export-weighted peers' av. BITs) are not significant in any period, and the dyadic similarity (measured by S share in H total trade) has a consistently negative coefficient.

Table 2: Diplomatic representation variable significance and magnitude compared previously proposed determinants of BIT formation.

Time Period	1970–1987		1988–1999		Post 2000	
	Coeff. (SE)	Hazard ratio	Coeff. (SE)	Hazard ratio	Coeff. (SE)	Hazard ratio
Diplomatic representation	2.220*** (0.355)	9.20	1.867*** (0.0973)	6.46	1.682*** (0.103)	5.38
H-export-weighted peers' av. BITs	0.00824 (0.0962)	1.01	-0.0254 (0.0226)	0.96	-0.0377 (0.0272)	0.94
H-export-weighted competitors' BIT w. S	0.335*** (0.0305)	1.41	0.0768*** (0.00557)	1.33	0.0661*** (0.00411)	1.58
S share in H total trade	-1.636 (1.448)	0.94	-2.797*** (0.958)	0.92	-5.990*** (1.504)	0.84
Political constraints (S-H)	0.891*** (0.338)	1.32	-0.297*** (0.110)	0.92	0.679*** (0.135)	1.20
Log distance between S and H	-0.374*** (0.0916)	0.75	-0.340*** (0.0367)	0.78	-0.379*** (0.0392)	0.76
PTA between S and H	0.350* (0.206)	1.42	-0.120* (0.0715)	0.89	-0.110 (0.0860)	0.90
In(S_GDPpc - H_GDPpc)	0.566*** (0.115)	2.74	0.146*** (0.0235)	1.30	0.0980*** (0.0277)	1.19
In(S_GDP + H_GDP)	-1.151*** (0.426)	0.11	-0.148*** (0.0471)	0.76	-0.133** (0.0536)	0.79
In(sq(S_GDP - H_GDP))	0.414* (0.215)	6.64	0.0425** (0.0213)	1.22	0.0139 (0.0233)	1.06
S_Trade/GDP	-0.704*** (0.170)	0.67	-0.466*** (0.0489)	0.78	0.0403 (0.0621)	1.02
H_Trade/GDP	0.167 (0.145)	1.11	-0.372*** (0.0611)	0.82	-0.254*** (0.0749)	0.89
S_former soviet	.	.	0.391*** (0.0977)	1.48	-0.214* (0.120)	0.81
H_former soviet	.	.	1.264*** (0.0792)	3.54	0.469*** (0.104)	1.60
S_soviet	-12.36*** (0.262)	0.00	-13.83*** (0.162)	0.00	.	.
H_soviet	-0.468 (0.424)	0.626	1.167*** (0.296)	3.21	.	.
Year dummies	Yes		Yes		Yes	
Observations	99064		105214		80660	

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$. Hazard ratio compares instantaneous likelihood of BIT formation for 1-std. dev. increase in continuous controls, or for change from 0 to 1 for binary controls. A hazard ratio greater than one indicates an increase in the likelihood of BIT formation.

The magnitude of the predicted effects of diplomatic representation are also of note. The hazard ratio for dyads with and without diplomatic representation varies from around nine in the first period, to just over five in the final period. This means that in the first period, the rate of BIT formation was nine times higher for pairs with diplomatic representation than for those without. The only variable which had a greater effect on BIT formation in any period was if the source country was Soviet at the time and the only variables which had a similar magnitude of effect are the various constructs from combinations of host and source GDPs (whose magnitudes are likely overblown due to collinearity problems). Table 2 suggests diplomatic representation is an important and robust determinant of BIT formation.

The results are essentially unchanged regardless of the measure of competition or peer effects used. We demonstrate this robustness in Table 3 by reporting the results for diplomatic representation in regressions in which all the JHM variables are included simultaneously. We do not report the effects of the full set of controls in the interest of saving space, and because they show an erratic pattern due to collinearity with each other. The results in Table 3 show that adding more controls tends to increase the observed correlation between diplomatic ties and BIT formation.

Table 3: Strong positive effect of diplomatic representation on BIT formation is robust to inclusion of all controls simultaneously.

Time Period	1970–1987		1988–1999		Post 2000	
	Coeff. (SE)	Hazard Ratio	Coeff. (SE)	Hazard Ratio	Coeff. (SE)	Hazard Ratio
Diplomatic representation S-H or H-S	2.477*** (0.687)	11.91	2.859*** (0.282)	17.44	2.365*** (0.311)	10.64
Observations	31526		28131		14722	

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$. Hazard ratio compares instantaneous likelihood of BIT formation with and without diplomatic representation. A hazard ratio greater than one indicates an increase in the likelihood of BIT formation. Results for full set of controls available on request from authors.

Despite the strength of the relationship between diplomatic representation and BIT formation, however, there remains one concern which needs to be addressed before we can claim that diplomatic ties actually cause higher rates of BIT formation in and of themselves. This concern is that economic drivers – such as source country investors wishing to access the host country – may increase both the likelihood of diplomatic representation and the probability of BIT formation. For instance, for the United Kingdom – as for many other states – one of the core responsibilities of the Foreign and Commonwealth Offices relates directly to

promoting UK exports and investment.¹⁸ This agenda could both promote diplomatic representation as well as investment treaty adoption.

Military capabilities

In order to reduce the possibility that economic motivations are driving the observed relationship, we build on the finding of Neumayer that countries are more likely to seek diplomatic representation with partners that have greater military capabilities.¹⁹ We therefore replace the diplomatic representation variable in the regressions with military personnel per capita for each member of the dyad. While no political variable is completely immune to contagion from economic drivers, military personnel per capita seems likely to capture almost purely political motivations for governments that wish to strengthen their relationship. Following a similar logic; if BITs are diplomatic tools, we would expect states to be more likely to sign them with partners that have greater military capabilities. Again, however, it is important to stress that as with the variable on diplomatic representation, we solely use this variable as an aggregate quantitative proxy to test foreign policy related drivers of BIT-formation. The actual causal mechanism will be elaborated with qualitative evidence below.

Table 4 shows that since the late eighties military personnel per capita is an important and statistically significant determinant of the rate of BIT formation. In periods 2 and 3, countries are more likely to sign BITs with partners that have greater military focus. Interestingly, the same was not true in the period up to 1988. One explanation for the lack of importance of the military variable in the first period could be that early BITs were much more likely to have been driven by economic factors as also suggested by JHM. Differences in GDP and GDP per capita were particularly strong determinants of BIT formation in the years up to 1988.

¹⁸ Foreign and Commonwealth Office, "Annual Report & Accounts: 2014-2015", 6.

¹⁹ Neumayer 2008.

Table 4: Military personnel per capita is a statistically significant predictor of BIT formation for both source and host countries post 1987.

Time Period	1970–1987		1988–1999		Post 2000	
	Coeff. (SE)	Hazard ratio	Coeff. (SE)	Hazard ratio	Coeff. (SE)	Hazard ratio
S_Military personnel pc	-0.174 (0.139)	0.68	0.0736*** (0.0164)	1.08	0.146*** (0.0369)	1.07
H_Military personnel pc	0.0125 (0.00968)	1.03	0.0722*** (0.00994)	1.07	0.0918*** (0.0210)	1.05
H-export-weighted peers' av. BITs	0.0884 (0.0913)	1.09	-0.00364 (0.0223)	0.99	-0.0550** (0.0278)	0.92
H-export-weighted competitors' BIT w. S	0.358*** (0.0312)	1.45	0.0885*** (0.00595)	1.38	0.0779*** (0.00443)	1.73
S share in H total trade	-2.206 (1.492)	0.92	-4.103*** (1.074)	0.89	-6.748*** (1.736)	0.82
Political constraints (S-H)	0.993*** (0.346)	1.3	-0.268** (0.111)	0.92	0.529*** (0.143)	1.15
Log distance between S and H	-0.621*** (0.0764)	0.62	-0.647*** (0.0347)	0.62	-0.636*** (0.0392)	0.63
PTA between S and H	0.394* (0.206)	1.48	0.0655 (0.0725)	1.07	-0.141 (0.0914)	0.87
ln(S_GDPpc - H_GDPpc)	0.589*** (0.112)	2.86	0.130*** (0.0232)	1.27	0.0974*** (0.0293)	1.19
ln(S_GDP + H_GDP)	-0.910** (0.412)	0.18	0.119** (0.0468)	1.25	0.0927* (0.0544)	1.18
ln(sq(S_GDP - H_GDP))	0.383* (0.207)	5.76	0.0101 (0.0217)	1.05	-0.0108 (0.0240)	0.95
S_Trade/GDP	-0.829*** (0.163)	0.63	-0.629*** (0.0468)	0.71	-0.103 (0.0661)	0.95
H_Trade/GDP	-0.0452 (0.135)	0.97	-0.599*** (0.0590)	0.72	-0.454*** (0.0772)	0.81
S_former soviet	.	.	0.371*** (0.0956)	1.45	-0.426*** (0.126)	0.65
H_former soviet	.	.	1.241*** (0.0804)	3.46	0.285*** (0.108)	1.323
S_soviet	-12.54*** (0.245)	0.00	-12.99*** (0.138)	0.00	.	.
H_soviet	-0.542 (0.408)	0.58	1.049*** (0.299)	2.86	.	.
Year dummies	Yes		Yes		Yes	
Observations	100227		108350		73490	

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$. Hazard ratio compares instantaneous likelihood of BIT formation for 1-std. dev. increase in continuous controls, or for change from 0 to 1 for binary controls. A hazard ratio greater than one indicates an increase in the likelihood of BIT formation.

Table 5 provides additional tests of whether the military personnel variable is truly capturing diplomatic, rather than economic, motivations for BIT formation. If military personnel per capita captures diplomatic motivations, then we would expect it to be a stronger predictor of BIT formation when diplomats are more involved, and when they have more freedom to sign BITs as they please. The first two columns in Table 5 report coefficients from estimations, which pool periods 2 & 3 (i.e. post 1987), but separate observations based on whether they have diplomatic representation. Consistent with our causal predictions, military personnel only increases the rate of BIT formation when the dyad has some sort of diplomatic representation. In other words, foreign policy considerations – proxied here by military

capabilities - seem to have been important for patterns of BIT-adoption, but only when there was diplomatic representation that gave diplomats greater opportunity to initiate negotiations.

Table 5: Variation of effect of military personnel per capita depending on availability and freedom of diplomats to follow diplomatic objectives (post 1987). Coefficients (std. error) reported.

	Diplomatic representation		BIT claim against host	
	Yes	No	Yes	No
S_Military personnel pc	0.0524*** (0.0181)	-0.0648 (0.102)	-0.0148 (0.0640)	0.0706*** (0.0171)
H_Military personnel pc	0.0687*** (0.00957)	-0.0926 (0.0694)	0.317* (0.167)	0.0778*** (0.00911)
H-export-weighted peers' av. BITs	-0.00805 (0.0219)	-0.152*** (0.0357)	-0.111 (0.0757)	-0.0104 (0.0211)
H-export-weighted competitors' BIT w. S	0.0602*** (0.00367)	0.117*** (0.00820)	0.0847*** (0.00841)	0.0814*** (0.00442)
S share in H total trade	-1.781** (0.732)	5.209* (2.960)	-11.60** (5.386)	-3.984*** (0.937)
Political constraints (S-H)	0.238** (0.0948)	-0.554*** (0.179)	0.375 (0.241)	-0.159 (0.104)
Log distance between S and H	-0.124*** (0.0323)	-1.069*** (0.0551)	-0.556*** (0.0718)	-0.626*** (0.0324)
PTA between S and H	-0.149** (0.0620)	0.0546 (0.119)	-0.272* (0.159)	0.242*** (0.0690)
In(S_GDPpc - H_GDPpc)	0.107*** (0.0197)	0.123*** (0.0404)	0.0355 (0.0503)	0.139*** (0.0218)
In(S_GDP + H_GDP)	-0.166*** (0.0383)	0.147** (0.0707)	0.203** (0.0918)	0.0616 (0.0481)
In(sq(S_GDP - H_GDP))	0.0216 (0.0173)	-0.00556 (0.0310)	-0.0342 (0.0362)	0.0211 (0.0221)
S_Trade/GDP	-0.104** (0.0445)	-0.283*** (0.0999)	0.181 (0.123)	-0.538*** (0.0449)
H_Trade/GDP	-0.353*** (0.0537)	-0.0915 (0.113)	-0.605*** (0.160)	-0.518*** (0.0560)
S_former soviet	0.0582 (0.0986)	-0.00662 (0.150)	0.0279 (0.186)	0.0974 (0.0912)
H_former soviet	1.040*** (0.0810)	1.136*** (0.129)	0.0431 (0.181)	1.236*** (0.0744)
S_soviet	-13.06*** (0.228)	-13.97*** (0.217)	-13.88*** (0.714)	-13.75*** (0.161)
H_soviet	1.660*** (0.303)	-14.05*** (0.233)	. (0.321)	1.224*** (0.321)
Year dummies	Yes	Yes	Yes	Yes
Observations	49278	126963	17425	139138

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$.

Finally, the right-hand columns in Table 5 again report the results of estimations which cover both periods 2 and 3, but they differ depending on whether the host country has been subject to a BIT-claim. Poulsen and Aisbett showed that many developing countries only realised the potential costs of BITs after they experienced their first such claim.²⁰ Before governments became subject to claims, diplomats often had a carte blanche to sign BITs with few, if any, commercial justifications.²¹ Accordingly, we expect diplomats to have had less leeway to sign BITs for diplomatic purposes once a country has experienced a claim (and thus reassessed the potential economic costs of BITs). This has been documented by Poulsen for a wide range of countries,²² and is also what we observe when comparing the results in columns 3 and 4 of Table 5. For hosts who have not experienced a claim under a BIT, the military personnel per capita of the source country is a strong predictor of BIT formation. For hosts who have experienced such a claim, however, the source's military personnel per capita no longer has a statistically significant effect on BIT formation. Note also that further evidence that the effects we are identifying are causal is provided by the fact that a claim against the *host* does not decrease the importance of foreign policy motivations (measured by the host's military personnel per capita) for the *source*. Thus the host experiencing a claim does not seem to curtail the source country's tendency to use BITs for diplomatic purposes. This finding that a BIT claim against a country predominantly affects its own BIT-signing behaviour and not that of other countries is consistent with Poulsen and Aisbett's finding that countries only appear to realise the potential costs of BITs when they themselves are the respondent to an investor claim.

²⁰ Poulsen and Aisbett 2012.

²¹ Poulsen 2015, 41.

²² Poulsen 2014; Poulsen 2015, ch. 6-7.

Causal mechanisms

The core finding from the previous section is that diplomatic links and motivations are strong predictors for investment treaty adoption. Yet, our quantitative analysis says little about the actual causal mechanism underlying this correlation and previous quantitative work that identified a relationship between BIT-adoption and diplomatic links also ignored the potential drivers. The qualitative evidence in this section addresses this gap. We categorise the identified mechanisms broadly in two categories: a wish to strengthen diplomatic ties; and the desire to obtain diplomatic perks.

Diplomatic ties

The first mechanism is well-known in international relations literature. Economic agreements are not just signed for commercial reasons, but also to promote or tie in foreign policy objectives. In the trade regime, for instance, Gowa and Mansfield have shown that security alliances partly shape patterns of trade flows and preferential trade agreements (PTAs).²³ The linking of PTA-adoption to broader foreign-policy agendas has also been a theme in country-specific literature on the US²⁴ and Japan,²⁵ for instance, as well as on-going discussions of mega-regional agreements, such as the Transatlantic Trade and Investment Partnership.²⁶

The argument should not be taken too far as one can point to a range of important cases of economic diplomacy where commercial objectives trumped security and other foreign policy objectives.²⁷ Also, the parallel with BITs is not one-to-one as PTAs are less widespread but more politicized than BITs and thus more likely to be associated with significant political rewards. Nevertheless, it is undisputed that economic agreements can be driven by non-economic motives. In the context of the investment regime the following paragraphs will show that Salacuse is right to note that,

²³ Gowa and Mansfield 1993; Mansfield 1993; Gowa 1994.

²⁴ See e.g. Feinberg 2003.

²⁵ Ravenhill 2008.

²⁶ See e.g. Hamilton and Blocmans 2015.

²⁷ See e.g. Odell 2000, 43-44, 95-197. In the context of investment disputes, Maurer (2014) shows that American multinationals often managed to force the hand of the executive branch during the 20th century leading the American government into investment disputes at the expense of broader foreign policy concerns.

Investment treaties are basically instruments of international relations, and the parties to them – sovereign states, not investors – undertake them in order to further certain long-term goals that may go well beyond the domain of investment.²⁸

The United States is a case in point. To understand why, it is useful to take a step back to the predecessors to modern investment treaties, namely the Friendship, Commerce, and Navigation (FCN) agreements negotiated by Western powers from the 19th century onwards.

For the American government, FCN agreements were primarily used as investment treaties from the 1950s to 1970s. They included a range of the same provisions and formulations found in later-day American BITs (with the notable exception of direct investor recourse to arbitration).²⁹ Moreover, 20th century FCN agreements were predecessors to BITs not just in substance, but also in their political drivers. The key is in the F: the treaties were intended to regulate economic activities – primarily investment - but also to show the world that the parties were on *friendly* diplomatic terms.

FCN treaties were used as part of Truman's Point Four program, where the fourth policy objective was to promote economic development in the developing world.³⁰ Investment promotion was a core pillar of this plan, something FCN agreements could assist with. In this way, the negotiation of the treaties would serve the interest of American business community but also help the American government win the hearts and minds of developing country governments during the Cold War. When American business groups suggested that other states should be coerced into signing FCN agreements, the State Department refused.³¹ This was partly because it would increase the chances of non-compliance, but also because it would promote “antagonistic reactions abroad which are difficult to overcome.”³² While the treaties’ language calling for perpetual peace and friendship may have been a formality,³³ the treaty program itself served a core function for American diplomacy beyond the protection and promotion of commercial interests.

This was the case with American BITs as well. A core driver to adopt American investment treaties with former Socialist states during the early 1990s, for instance, was to show that they were now fully on-board with the Washington Consensus and on friendly diplomatic terms with the American government.³⁴ For instance, when President Bush welcomed Polish Prime Minister Mazowiecki to Washington in 1990, the visit raised a range of political

²⁸ Salacuse 2013, 359.

²⁹ Vandeveld 2012. See also; Alschner 2013.

³⁰ Vandeveld 2012.

³¹ Ibid., 110-113, 130-132, 180, 326, 376.

³² Ibid., 326.

³³ Ibid., 100.

³⁴ Vandeveld 2009.

questions and the signing of one treaty: a BIT. According to the *Washington Post*, the treaty was an effort on the part of the Bush government to “welcome Poland as a full partner in the community of nations.”³⁵ Similarly, during talks about a nuclear arms deal with Kazakhstan, Bush and Nazarbayev signed a BIT which was described by the *Post* as a “symbolic show of U.S. regard for Kazakhstan”.³⁶ During the signing ceremony, Bush noted that “The United States supports your independence … We believe your security, Kazakhstan’s security, is important for stability in Europe and in Asia.” While the treaty was about investment protection, it was linked to broader diplomatic and security interests.

Similar justifications are found in other regions. The 1991 US agreement with Argentina, for instance, was again reported as signalling Washington’s satisfaction not only with Argentina’s economic reforms, but also President “Menem’s new political stature in the international community.”³⁷ In Grenada, as well, the 1985 BIT was initiated soon after the American invasion in 1983 and concluded after one hour of ‘negotiations’ during a hospital visit to Washington by the Grenadian prime minister. According to Ken Vandevelde, a former American BIT-negotiator, the “treaty seemed quite clearly an attempt to signal that the U.S. invasion had been a success and that conditions for foreign investments in Grenada now were favourable.”³⁸ In short, Washington’s policy was not just to adopt BITs to protect American capital abroad, but also “to accomplish political objectives.”³⁹ Chilton has thus also found that economic factors were relatively unimportant to predict US BIT adoption compared to political motivations.⁴⁰

American BITs were not the only treaties used for strategic political purposes. In Denmark, for instance, several BITs were also explicitly framed as part of broader foreign policy goals. As an example, the 1991 agreement with Czechoslovakia was not just initiated to promote commercial links but also part of “the broader Danish initiatives to support the reform process in central- and eastern European countries”.⁴¹ Equally, when the agreement with Albania was signed in 1995 – upon Albania’s suggestion – it was presented at the ceremony not “only as an economic instrument but certainly as an indicator of our wish to further strengthen the ties

³⁵ “Bush Says ‘Poland Must Have a Voice’,” *Washington Post*, Mar 22, 1990.

³⁶ “Kazakhstan Agrees To Give Up A-Arms: START Treaty Roadblock is Cleared,” *Washington Post*, May 20, 1992.

³⁷ “Menem Signs ‘Revolutionary’ Treaty With U.S. to Protect Investments,” *Washington Post*, Nov 15, 1991.

³⁸ Vandevelde 1992, 635.

³⁹ Ibid.

⁴⁰ Chilton 2015. Using quantitative analyses, Chilton further contents that US BIT partners reciprocated the ‘favour’ by being more likely to vote similarly to the United States in the United Nations than countries without US BITs.

⁴¹ 400.E.9/Tjekkoslovakiet/12: EF/Tjekkoslovakiet: Investeringsbeskyttelsesaftalen. Own translation.

of friendship and mutual understanding between our countries and peoples.”⁴² An agreement was agreed around the same time with Bulgaria, even though the Danish government realised “there was no pressure from Danish business, which don’t see Bulgaria as one of the important markets in Eastern Europe”.⁴³ In Iran, as well, the Danes initiated negotiations in the late 1990s partly because Maersk – the shipping multinational – was planning to make investments there in the future, and partly because “it was expected that an expression of Danish interest in an agreement would be considered a good-will gesture.”⁴⁴

Diplomatic relationships were also brought into play during negotiations. In negotiations with Turkey, several Danish authorities objected to the initial deal negotiated by the Danish Foreign Ministry.⁴⁵ The Central Bank and the Economic Council found the transfer clause objectionable as the Turks wanted exceptions for balance-of-payments difficulties. After this was settled in a new draft the Danish Foreign ministry was ready to sign, yet new objections came in from the Ministry of Industry, who now objected to the dispute settlement clause. The fork-in-the-road provision included a one-year waiting period, to which the Ministry objected (despite the fact that Danish industrial groups had said Danish firms never raised ICSID claims anyway and that it therefore probably didn’t matter in practise). In response, the Danish Foreign ministry responded in internal files that any further delay would be unfortunate “due to the broader relationship with Turkey”.⁴⁶ While a ‘stronger’ dispute settlement clause could maybe have been negotiated, the political relationship was more important to keep in mind. That settled the matter and the draft passed.

In other cases, the diplomatic dimension was even more explicit, most notably for the numerous investment treaties signed merely as ‘photo-ops’ with little, if any, commercial justification. A former Austrian negotiator notes:

sometimes a state visit was under preparation and occasionally a BIT was suggested just for this reason alone. We would get a request from the office of president that a DTT [double taxation treaty, ed.] or BIT should be concluded. It was trivial diplomacy.⁴⁷

Poulsen documents that such ‘trivial diplomacy’ was also routinely the driver among a wide range of developing countries when signing BITs.⁴⁸ Pakistan is a case in point, where officials themselves and government files admit that “BITs were initially instruments that were

⁴² 400/E/9/Albanien/12: EU/Albanien: Investeringsbeskyttelsesaftaler.

⁴³ 400/E/9/Bulgarien/12:EF-Bulgarien: investeringsbeskyttelsesaftaler. Own translation.

⁴⁴ 400.E.11.Iran.12: EU/Iran: Investeringsbeskyttelsesaftaler. Own translation.

⁴⁵ 400.E.5/Tyrkiet/12: EF-Tyrkiet: Investeringsbeskyttelsesaftalen.

⁴⁶ Own translation.

⁴⁷ Quoted in Bonnitcha, Poulsen, and Waibel forth.

⁴⁸ Poulsen 2015, ch. 5-7.

signed during visits of high level delegations to provide for photo opportunities.”⁴⁹ BITs were useful to signal friendly diplomatic relations. In the case of Thailand, as well, diplomats routinely pushed for treaties whenever the prime minister went abroad – “there was a need for a treaty” – and BITs were easy to adopt in order to “intensify relations” with other countries.⁵⁰

Equally, in Latin America a former negotiator notes that: “Governments want to display co-operation, and one way to do that is to sign promotion treaties that sound nice.”⁵¹ In Chile, for instance, BITs signed during the early 1990s were part of “a political policy to put the name of Chile among the international community coming back from Dictatorship. We wanted to renew relationships with a lot of countries, where we didn’t have political relationships before. So BITs were part of that bigger picture.”⁵²

Poulsen and Aisbett similarly report how the American government interpreted Libya’s approach to investment treaties. With respect to the 2007 Libya-Spain BIT, the Qadhafi’ government had indicated before a state visit that:

it wished to quickly finalize language for an education and culture agreement, a defence cooperation agreement, a bilateral legal cooperation and extradition treaty, an investment security agreement and a double taxation- exemption agreement. ... [A Spanish official, ed.] lamented that the rush to finalize agreements for signature in time for Qadhafi’s visit had precluded meaningful bilateral discussions of what the two sides’ understanding of those accords would mean and how they would be implemented.⁵³

Finally, another case in point is described by Vandevelde:

Just prior to a State visit to Washington in early 1990, the Congolese government notified the United States that it would be interested in concluding a BIT. Negotiations were complete during the State visit and an agreement signed at the conclusion of the visit. The final agreement was identical to the 1987 model negotiating text. ... the almost unavoidable inference is that the value of the BITs as political symbols was an important factor in their negotiation.⁵⁴

Again – treaties were initiated primarily because diplomats and their agencies liked to sign treaties. Although BITs may not have attracted many headlines during the 1980s and 1990s

⁴⁹ Ibid., xv. See also; Poulsen and Aisbett 2012; Poulsen and Vis-Dunbar 2009.

⁵⁰ Poulsen 2015, 127.

⁵¹ Quoted in ibid., 148.

⁵² Interview with former Chilean BIT negotiator, February 6, 2012.

⁵³ Poulsen and Aisbett 2012, p. 283; see also Poulsen 2015, pp.154-155.

⁵⁴ Vandevelde 1992, 635-636.

compared with free trade agreements,⁵⁵ they were nevertheless useful for diplomats to display international co-operation and goodwill. Using BITs as “photo-ops” is of course a much more haphazard approach to investment treaty negotiations than the American “grand strategy”, but the aim was similar: sign investment treaties to promote, or cement, diplomatic ties.

Diplomatic perks

Our second causal mechanism relates to individual incentives for diplomats. This is an understudied area of international economic negotiations. While most work on economic diplomacy draws heavily on classic works in economics and public policy dealing with interest formation and aggregation,⁵⁶ surprisingly little scholarship engages with insights from public choice literature on how bureaucrats seek to maximise their own individual welfare.⁵⁷ Abbott, for instance, notes that officials may use international governance frameworks to “enhance their power and budgets at home”, but lament the absence of literature on this question.⁵⁸ Yet, any understanding of international economic agreements is incomplete without appreciating the incentives of the bureaucrats and regulators negotiating them.

In the context of the investment treaty regime, a bureaucratic-politics perspective would suggest that diplomats’ own interests in promoting investment treaties could be important and partly explain our quantitative findings.⁵⁹ In addition to our general findings on the importance of diplomatic links, it could also explain why diplomatic representation was already a significant predictor of BIT formation prior to 1988 – at a time when we do not find evidence that traditional diplomatic motives (measured by military personnel per capita) were a driver of BITs.

Private diplomatic interests should have been a particularly important driver for developing countries. Gray, for instance, find that international organizations provide patronage opportunities for bureaucrats in member states, but mostly in those that are corrupt and have few opportunities for career advancement.⁶⁰ Equally, the extent to which bureaucratic ‘agency-slack’ takes place in international negotiations should vary depending on whether principals of economic diplomats (politicians at home) allow treaties to be used as perks or

⁵⁵ See comparison in Poulsen 2015, figure 1.4.

⁵⁶ E.g. Olson 1965.

⁵⁷ See generally; Niskanen 1971, Stigler 1971, and Buchanan and Tullock 1962. This is in stark contrast to literature on the European Union for instance; Vaubel 1994. The only two notable exceptions we are aware off are in international legal scholarship; Macey and Colambatto 1996; Abbott 2008.

⁵⁸ Abbott 2007, 28.

⁵⁹ Poulsen 2015.

⁶⁰ Gray 2015.

fail to realise the implications of the treaties. Although some American diplomats and policy-makers may also have an interest in promoting treaty negotiations for their own reasons, for instance, they are not free to sign them right, left, and centre. That is a stark contrast to many developing countries during the 1990s, where most governments expected BITs to have significant impact on investment inflows without any substantial costs. In that context, officials had much greater leeway to successfully promote treaties to promote their own interests.

The first private incentive to promote BITs relates to travelling. Like other international agreements, BITs provide opportunities for bureaucrats to travel abroad for negotiations, participate in inter-governmental meetings, training-sessions, etcetera. This is particularly important in some developing countries where foreign travel is often a luxury limited to only few government officials. As noted by Rose-Ackerman and Truex, travelling to “attractive locations can be a kind of perk”.⁶¹ This could be important for investment treaty adoption. UNCTAD, for instance, hosted a range of BIT negotiating sessions during the early 2000s. The first of these was based at the four-star Hotel Victoria on the shores of Lake Geneva.⁶² A luxurious setting that the participating officials from Egypt, Indonesia, India, Jamaica, Malaysia, Sri Lanka, and Zimbabwe are unlikely to have been able to afford on their own. To the extent bilateral visits also generate attractive travel opportunities for bureaucrats, this could be yet another driver of our quantitative findings. For instance, a Pakistani investment official notes that: “when there is ever a proposal for an international agreement to be negotiated everyone says yes, because you get a free trip out of it.”⁶³

In addition to leisure, another reason travelling is attractive for developing country bureaucrats is that per diem rates can provide a significant increase in their real income.⁶⁴ As noted by Nkamleu and Kamgnia, “Given the low salaries, travel per diems are sometimes the only way some civil servants can make more money.”⁶⁵ In Ethiopia, for instance, per diem rates for foreign travel go much beyond what is needed to compensate for additional costs. In addition, the pay-offs are increased even more through an informal practice of inflating the reported number of days that bureaucrats travel abroad.⁶⁶ Similar dynamics are likely to have driven at least some investment treaty initiatives. A former Ethiopian official notes that:

⁶¹ Rose-Ackerman and Truex 2012.

⁶² Poulsen 2015, 92.

⁶³ Ibid., 129.

⁶⁴ Søreide, Tostensen, and Skage 2012.

⁶⁵ Nkamleu and Kamgnia 2014.

⁶⁶ Søreide, Tostensen, and Skage 2012, 72. As noted by one high-level government official, “When I was working in the Supreme Court, if the USAID invited me, I would be much more willing to go there rather than to a government activity.”, 78.

In most cases Government-sponsored foreign travels, be it for negotiation of treaties or other matters, are seen as opportunities for government officials as avenues to obtain personal benefits in terms of travel allowances and visit rather than related to the purpose and subject matter of the travel. Such travels are mostly preceded by internal “fights” among officials and among officials and their subordinates. Hence, it is not unusual to see political appointees rather than experts in meetings, workshops, conferences or negotiation forums. Sometimes top officials of the government having a power to sign treaties may end up signing BITs the negotiations of which has still been underway without assuming any responsibility or accountability for their acts.⁶⁷

Another set of bureaucratic actors gaining private benefits from investment treaties are embassies and embassy staff. In South Africa, one official notes about the BIT-adoption strategy of the 1990s and early 2000s that: “The ambassadors used them as a possible achievement during their tenure, so we had requests from embassies all the time to sign these agreements.”⁶⁸ Another official concurs that embassies: “like photo-sessions and smiles, so they love to have a minister to come and sign an agreement, no matter how small the country”⁶⁹ In Ghana, as well, new ambassadors were always briefed on BITs and DTTs as instruments of economic diplomacy and according to the architect of Ghana’s BIT program, the ambassadors “used this information and saw the treaties as an indicator of their performance.”⁷⁰ These dynamics are not isolated to Africa. In Ecuador, for instance, some Ambassadors are reported to have initiated the treaties at the end of their posting to “finish with a bang.”⁷¹ Occasionally, developed country parties would even tell Ecuadorian embassies that they didn’t find any justification for the Ecuadorian initiative to negotiate BITs.⁷² Another Latin American bureaucrat notes that if your job is related to economic diplomacy and international negotiations, “you need to justify your work, so you will push for these treaties no matter how redundant they may appear.”⁷³

This feedback suggests that one of the drivers of our quantitative findings relates to the individual incentives of diplomats to push for BITs. That said; it is important to stress that just as some countries are more likely to have used BITs for diplomatic perks than others, there is also bound to be variation over time. After the rise of investment arbitration, there is a growing realization among governments in the developing world that investment treaties can involve significant costs and it has therefore become more difficult for diplomats to push for

⁶⁷ Correspondence with former Ethiopian BIT-negotiator, October 19, 2015.

⁶⁸ Quoted in Poulsen 2015, 184.

⁶⁹ Ibid.

⁷⁰ Quoted in ibid., 102.

⁷¹ Quoted in ibid., 121.

⁷² This happened in Denmark for instance; ibid., 148.

⁷³ Interview with former Mexican BIT negotiator, May 26, 2010.

the agreements in recent years.⁷⁴ This may explain why our quantitative analysis found that the influence of diplomatic representation on BIT-signing drops in the final period (since 1999) as this coincides with the rise of investment treaty arbitration. As mentioned, it could also explain why the influence of our other proxy for purely diplomatic drivers – military spending – disappears for host states after they have been subject to claims.

⁷⁴ Poulsen 2015.

Conclusion

This paper has assessed the importance of diplomatic considerations for the investment treaty regime. Both quantitative evidence at the macro-level and qualitative evidence at the micro-level suggests that this is an important, and overlooked, driver of BIT-adoption.

Our first causal mechanism is well-known from other literatures: foreign policy considerations drive treaty-making. We have shown this mechanism was at work in the investment treaty regime. Our second mechanism is novel, since it focuses on the individual incentives of diplomats. We suspect this finding could be important also for other areas of international economic relations. Buchanan once noted that political scientists need to replace “romantic and illusory set of notions about the workings of governments and the behaviour of persons who govern [with] notions that embody more scepticism.”⁷⁵ Our paper offers an illustration that perhaps a healthy degree of scepticism about the interests of economic diplomats could be useful to better understand the design and effects of global economic regimes.

We have not touched on a third causal mechanism that could be important, namely the role of diplomatic socialisation.⁷⁶ Among OECD countries, bureaucrats routinely meet in Paris to coordinate and discuss investment treaty policy-making, whereas the primary forum for developing countries is UNCTAD in Geneva. The extent to which these and other forums have impacted the investment treaty regime through diplomatic mimicking, social influence, and persuasion could be an important subject for future studies.

⁷⁵ Buchanan 1979.

⁷⁶ See generally Johnston 2001.

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The Global Economic Governance Programme was established in 2003 to foster research and debate into how global markets and institutions can better serve the needs of people in developing countries. The program is co-hosted by University College and the Blavatnik School of Government.

The three core objectives of the Programme are:

- ◊ to conduct and foster research into international organizations and markets as well as new public-private governance regimes
- ◊ to create and develop a network of scholars and policy-makers working on these issues
- ◊ to influence debate and policy in both the public and the private sector in developed and developing countries

