A FUTURE WITHOUT (TREATY-BASED) ISDS: COSTS AND BENEFITS

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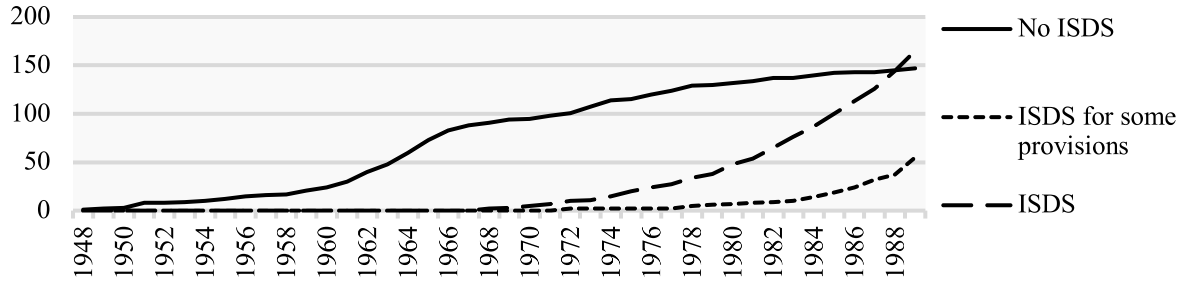
INTRODUCTION[1]

More than 1,000 investor-state dispute settlement (ISDS) claims have been brought to date based on investment treaties, most in recent years. Many of the claims challenged sensitive areas of government regulation, and some resulted in multi-billion-dollar awards. ISDS has become a posterchild for anti-globalisation groups and is increasingly considered problematic by a range of developing country governments. Yet, criticism of ISDS is not always associated with opposition to economic globalisation, multinational firms, or rules-based international order. Even a free-trade think-tank like CATO is critical of what it sees as a positive discrimination in favour of foreign investors and the German Association of Judges, a stalwart defender of the rule of law, came out against the mechanism in the Transatlantic Trade and Investment Partnership. Right or wrong, ISDS has become one of the most controversial issues in global economic governance.

It was not always thus. The first generation of investment treaties did not include ISDS (Figure 1). And when European states began incorporating it into their investment treaties in the late 1960s and 1970s it was seen as a technical procedural innovation which could perhaps add some comfort on occasion, but it was not viewed to be as practically important as the treaties' core substantive protection standards (St John 2018; Poulsen 2020). For instance, after being nudged by the World Bank, the United Kingdom included ISDS in its first model bilateral investment treaty (BIT) but early drafters did not see the mechanism as essential to their treaty practise, as they mainly saw the treaties as helpful focal points for informal dispute settlement by diplomats, not credible commitment devices backed up by potent

[1] The authors would like to thank Stephan Schill and Manfred Elsig for helpful comments and suggestions.

and enforceable investor recourse (Poulsen 2020). Investment treaty arbitration was never expected to be as frequent or as controversial as it turned out to be.



NOTES: 'Investment treaties' are understood as Bilateral Investment Treaties (BITs) as well as Foreign, Commerce, and Navigation (FCN) agreements with comprehensive investment protection provisions. Investment protection chapters in free trade agreements were very rare before the 1990s. On FCNs as BITs, see e.g. Vandevelde 2017.
SOURCE: Poulsen 2020

FIGURE 1. TOTAL NUMBER OF INVESTMENT TREATIES WITH AND WITHOUT ISDS,

Survival clauses in existing investment treaties mean that investment treaty arbitration will be here, in some form, for many years. Yet, growing calls to abandon ISDS, or to significantly curtail it, makes it helpful to think more systematically about whether a retreat from treaty-based ISDS will have negative consequences for the parties involved. That is the aim of this chapter. It is organised around the main benefits of ISDS according to its proponents: that it promotes desirable inflows of foreign investment; that it "depoliticizes" investment disputes; and that it promotes the institutionalisation of the rule of law in host states. Empirical evidence on all three questions suffers from significant data constraints and methodological challenges. Nevertheless, on the basis of a review of the evidence that does exist, we cautiously conclude that retrenchment of ISDS is unlikely to have a major negative impact on foreign investment flows, politicization of disputes, or the domestic institutionalisation of the rule of law. ISDS may have other benefits that have yet to be documented, but on these three core dimensions a world without ISDS is not to be feared even for proponents of foreign investment and a rule-based international order.

INVESTMENT FLOWS

For most developing countries the main reason for entering into investment treaties was the expectation that doing so would help them attract more foreign investment. Capital exporting states were particularly aggressive in promoting this thesis in the 1980s and 1990s (Poulsen 2015). And unlike in the earliest years of the regime, ISDS was then beginning to be recognised as a central feature of the treaties. Thomas Wälde, the eminent investment treaty scholar and practitioner and an important promoter of the treaties put it this way:

> It is the ability to access a tribunal outside the sway of the host State which is the principal advantage of a modern investment treaty. This advantage is much more significant than the applicability to the dispute of substantive international law rules. The remedy trumps in terms of practical effectiveness the definition of the right (Wälde 2005, 190).

Few claims had been brought until the 2000s and the perceived and experienced costs of investment-treaty arbitration were low. On the other hand, the benefits of signing the treaties could be speculatively portrayed as quite large, based upon theories of credible commitment and costly signalling. Those theories presented investor-state arbitration as a powerful mechanism for securing, or for demonstrating a commitment to securing, investors' property rights from state interference. Potential investors assured by access to arbitration that the state would not seize their investments would be more likely to invest. This argument about the risk-reducing and thus investment-promoting benefits of investment treaties implies that removing access to ISDS would have a serious negative impact on investment flows to developing countries (Brower and Blanchard 2014; EFILA 2015). But is this a reasonable prediction?

Consider the question through the lens of political risk insurance (PRI). The link between investment treaties and PRI is a critical test-case for whether the treaties have an impact on investment flows. This is because PRI underwriters have a particularly strong incentive to carefully consider relevant factors when pricing investment risks – it is, in a sense, their only job – and the price of PRI will in turn impact the cost of investing in different jurisdictions. If the treaties are important signals about investment climates in host states and/or function as credible commitments for individual investors, PRI underwriters should incorporate the treaties' presence or absence into their pricing, which in turn would *directly* impact the bottom-line of companies seeking to invest in risky jurisdictions.

The case of Germany is routinely brought up to suggest that ISDS is critical for PRI, so let us begin there. Germany signed its first investment treaty in 1959 and its early interest in investment treaties is unsurprising given that German investors had lost almost all overseas assets after the Second World War and viewed international legal protection as essential to securing their new post-war investments from a similar fate. The absence of former colonial links did not help either (Burkhardt 1986, 99-104). Important for our purposes, Germany's investment treaty program was *legally* tied to its new investment insurance scheme. This formal linkage was in contrast to the US investment insurance programme, which was designed and administered independently from early U.S. investment (FCN) treaties.[2] This was important for some German investors. Volkswagen, for instance, encouraged the Government to finalise investment treaties early on, as it would not otherwise have access to government-backed insurance in core markets,[3] and later German officials have highlighted the importance of the link to PRI when arguing that the treaties are important for foreign investment flows (e.g. Dolzer and Stevens 1995, 156). Although a few other capital-exporting states also make links between PRI and BIT coverage, the integration of the two programs has been most comprehensive in Germany. In this way, German investment treaties had a material impact on the pricing of investment risk – which, in turn, is likely to have driven at least some investment decisions.

Note, however, that the early German investment treaty program did not include ISDS. Herman Abs, then chairman of Deutche Bank, lobbied the government extensively to include the mechanism, but the legal department within the Foreign Ministry was concerned that ISDS could result in a large number of claims and 'turn every case of expropriation into an international litigation with political relevance' (cited in Poulsen 2019). While Germany was not necessarily opposed to ISDS – it supported the ICSID Convention for instance – it was not until 1987 that it enshrined the mechanism into the German BIT model. Before then, Germany's investment treaty program was (largely) without recourse to ISDS, meaning that German investors had access to government-backed investment insurance so long as their investments were covered by BITs containing standard substantive protection provisions. This is important, as it highlights how it wasn't ISDS – the focus of this chapter – that made the difference for underwriters.

It is also difficult to identify a clear link between ISDS and PRI outside the special case of Germany. Apart from their home states, investors can access investment insurance on the private market – emerging in London from the 1970s – or from the Multilateral Investment Guarantee Agency (MIGA) established in 1988. These insurance providers or others like them may look to ISDS when considering pricing, but at least by 2010 surveys conducted independently of each other showed that neither the private PRI market or MIGA considered investment treaties critical for pricing or availability – whether the treaties had ISDS or not (Table 1). There were exceptions to this pattern with some underwriters suggesting that the treaties were more important (see also Kantor 2015), and as ISDS has become more widely used since the surveys were conducted more underwriters may have begun to take note of the treaties and their arbitration provisions. But at least up through the 1980s, 1990s, and early 2000s there is no evidence that ISDS was critical for PRI.

[2] The US Investment Guaranty Program – the precursor to the Overseas Private Investment Corporation – was initially used to protect American investors against capital controls in Europe but was expanded to developing countries in 1951; Maurer 2013, 404-406.

[3] Bundersarchiv Koblenz (BK) 102/211675.

Private PRI providers	Public PRI providers
Just as extremely few investors seem to be aware of these treaties, most private insurers don't make them part of their underwriting process.	The existence of a BIT may provide us with comfort, but they are not specifically taken into account when we are considering investment projects. (UK)
I would be very surprised if out of a sample of 10 underwriters any of them would mention BITs as being directly relevant for their risk-evaluations. ... While the treaties are part of the backdrop to the investment regime, and will be relevant if claims arise, they don't play any direct role for the ranking or pricing of investment risks.	BITs can perhaps simplify our analysis in some cases if taken as an indicator that the legal regime is favourable towards the protection of investment. But in practice they are hardly ever decisive. (Netherlands)
If it is a country, we are not that familiar with we will look if they've signed up with MIGA and OPIC regimes, but not so much BITs.	BITs do not play a great role in our work. ... In some cases, if we are dealing with a particularly risky country, we do look to BITs and their provisions. But it is very rare. (Denmark)
We do not take the treaties into account, because we are not convinced that they will have an impact on countries' willingness to pay out claims.	I could perhaps speculate that for a certain very risky economy we may want the treaty in place, but that has never actually been the case. (Finland)
They are practically never incorporated into decisions concerning the coverage and pricing of risk insurance. ... So, while they probably should be taken into account, I'm not aware that they have in fact made any difference at all.	In some rare cases we may look at BITs. But they are no precondition for getting the insurance and don't actually impact the pricing. So, while we might look at them, they don't really play a role in the underwriting process. (Austria)
Do we look at BITs? Yes, but I have never experienced a risk not taken because the investment was not covered by a BIT, and they probably don't impact pricing either.	While it is in our formal guidelines that we should look towards BITs as a risk-mitigating factor, their existence is unlikely to have had any impact on our pricing. (Sweden)
For major infrastructure investments in difficult jurisdictions, they could potentially signal that host states are willing to uphold their contractual obligations with the investor. But BITs are never a prerequisite for insurance, and I have never experienced that they have factored into an underwriting decision in any material way.	The availability and pricing of our insurance is pretty much unrelated to whether there is a BIT or not. ... We regard them simply as signals of good relations between the two countries, but they don't actually provide a safety net for us in practice. (Italy)
In theory, BITs should improve the risks, but in practice the jury is out on the actual value of these treaties, and they are certainly not a primary motivator for us.	We do not take BITs into account. Even if there is a BIT, it will not impact the premium compared to a similar country without a BIT. (Japan)
We do look at BITs occasionally. However, they are one out of so many factors we take into account and we actually don't have any real experience with them. ... So, the fact of the matter is that BITs most often don't matter much.	BITs are naturally important to our underwriting process, as we would like to know which rights we have in case of subrogation, but they are not at essential to underwrite an investment. (MIGA official I)
We have never taken a great deal of notice of them. Governments wanting to expropriate will do it irrespective of their BITs, so they are not a primary consideration at all.	While we have to look to BITs, they are not important determinants to our perception of the risk of an investment project [and] it is very rare that BITs become crucially important for us in practice. (MIGA official II)
While they should perhaps have a role to play, I would say they are likely to be considered completely irrelevant by underwriters today and thus irrelevant for the pricing of risk insurance. ... Rather than having a role in the investment decision, they are just an extra arrow in the lawyer's quiver on the occasions where disputes arise.	BITs were of marginal importance within MIGA, and of no practical importance when covering political risks… provided we can expect a country to remain committed to foreign investments and the rule of law, cancelling all its BITs would not have a substantial impact on whether, and to what extent, MIGA would be willing to underwrite investments to that country. (former senior MIGA official)
While some of the major American firms may take them into account, I think this is the exception. For underwriters, BITs would typically be very far down their checklist, and they are therefore unlikely to play a determining factor in the underwriting process.	
BITs don't effect pricing at all for me. I don't regard the process as being robust enough with enough of a successful track record.	
[BITs have] no direct influence—country risk factors may be affected a little but usually other factors driving the price...aggregate pressure, competition, prices from [public providers]. .. [They might impact pricing] less than 5%, if anything.	
Promises of arbitration and compensation not supported by realisable assets (and in most cases I suspect they are not) are not that persuasive in reducing premiums (IMO). But then I am just a cynical underwriter[.] ... the BIT is not a deciding underwriting factor in most cases and other issues … are far more important.	

SOURCES: Column one is from Poulsen (2010) and Yackee (2011); column two is from Poulsen (2010).

TABLE 1. INVESTMENT TREATIES AND POLITICAL RISK INSURANCE: FEEDBACK FROM UNDERWRITERS

This suggests that the majority of investment insurers do not place a lot of value on BITs and ISDS as investment-protection devices – at least until recently. This is relevant because PRI providers should, in theory, care a lot about BITs and ISDS if the two are really essential to protect foreign investment from significant political risk (Yackee 2014). It is also interesting because it highlights the availability of alternative strategies of risk reduction that can substitute for BITs and treaty-based arbitration. The existence of those substitutes suggests that a world without treaty-based arbitration would not necessarily be one in which states lack incentives to treat investors fairly or in which investors have no effective way to protect themselves from unfair treatment. Investors can insure against any residual risk, either literally—through PRI—or by entering into custom investment contracts with host states. Not only can investment contracts provide the same substantive protections as investment treaties, but they will often also include additional protections – such as stabilisation obligations and project specific protections. Moreover, investment contracts can include an enforceable ISDS provision when the investor is willing to negotiate for its inclusion. Although sometimes ignored, or considered unimportant, by social scientists writing about the investment regime, investor-state contracts backed up by ISDS are critical investment protection instruments, particularly for major extractive and infrastructure projects (Yackee 2008; 2008-2009).

Contracts are, of course, different in their coverage than investment treaties as they have to be negotiated on a project-by-project basis (absent model contracts offered to all foreign investors). Whether this implies that they are less helpful than investment treaties for small-and-medium sized investors is an open question, however. Because, when considering the costs of treaty-based ISDS (see Table 2 for ICSID arbitrations) it is clear that it is mainly relevant for large investors. Third-party financing can help level the playing field to some extent (e.g. Steinitz 2011), but empirical evidence suggests that by far the most compensation from treaty-based ISDS has been granted to either firms with billions in annual revenue or extremely wealthy individuals (Van Harten and Malysheuski 2016).

	Arbitration costs	Claimant legal costs	Respondent legal costs	Total Cost
Average	1.2	4.3	8.0	13.5
Median	0.5	3.2	2.7	6.4
Minimum	0.04	0.03	0.2	0.3
Maximum	20.9	24.4	218.6	263.6

NOTE: Figures are US$ million. Calculations do not include several multi-billion-dollar awards issued since 2011 (e.g. Yukos).
SOURCE: Bonnitcha, Poulsen, and Waibel 2017, Table 3.2.

TABLE 2. COSTS OF ICSID ARBITRATIONS, 1972-2011

Do our observations up to this point match up with the econometric evidence on the impact of ISDS on investment flows? A wide range of studies have been published to date, many with competing findings (for a review, see Bonnitcha, Poulsen, and Waibel 2017, ch. 6). Taken together, the econometric literature suggests that treaty-based ISDS is likely to have an impact on *some* investment decisions in *some* circumstances – depending on sector, size, and host state in particular - but it is unlikely to have a major effect on the bulk of foreign investment decisions. This is also the implication of surveys of foreign investors. Yackee, for instance, targeted in-house legal counsel in Fortune 500 companies, and responses indicated a 'low level of familiarity with BITs, a pessimistic view of their ability to protect against adverse host state actions, and a low level of influence over FDI decisions.' (Yackee 2009, 421).

Our sense that treaty-based arbitration is largely irrelevant for many (if not most) foreign investments is backed up by the observation the vast majority of the world's foreign direct investment (FDI) occurs between developed countries and is not directly covered by privately enforceable international investment law. The US, for example, is by far the world's largest source and the world's largest destination of FDI. Table 3 shows the US's largest investment relationships. Only two of these relationship – those with Canada and Mexico – are covered by treaty-based ISDS arrangements, under NAFTA's Chapter 11, which remains in force at the time of writing. (This situation is likely to change in 2020 if and when the USMCA enters into force. The USMCA provides only limited access to ISDS for Mexico and none for US-Canada.) This table shows that ISDS does not currently play a central role in governing the US's largest investment relationships.

Rank	Country	Investment relationship covered by ISDS?
1	Luxembourg	No
2	United Kingdom	No
3	Switzerland	No
4	Canada	Yes
5	Netherlands	No
6	Japan	No
7	Germany	No
8	France	No
9	Ireland	No
10	Mexico	Yes

NOTE: This ranking is calculated by adding US outward FDI stock in the partner country (in US$ million) and US inward FDI stock from the partner country (in US$ million). Data is for 2017 or latest available. Availability of treaty-based ISDS is based on author review of all treaties currently in force.
SOURCE: Author calculations of FDI ranking based on OECD 2019a; OECD 2019b

TABLE 3. US: LARGEST INVESTMENT RELATIONSHIPS

One possible qualification to this conclusion is the practice of treaty-shopping (Baumgartner 2017). For example, UK investors considering investment in the US could route their investment via a company incorporated in Canada, and then benefit from the protection of an ISDS clause for Canadian investment in the US. If this practice were widespread, a greater fraction of foreign investment in developed economies might be covered by ISDS provisions than a formal analysis of treaty coverage implies. However, there is no evidence – either through surveys of business practice or through actual ISDS claims initiated under 'third country' treaties – that treaty-shopping is a common practice for investors in developed countries.

The situation is similar for Germany. Recall that Germany played a major role in the development of the investment treaty regime and that is has the world's largest investment treaty network. For this reason, we might expect ISDS to play a significant role in governing Germany's major investment relationships. Table 4, however, shows that this is not the case.

Rank	Country	Investment relationship covered by ISDS?
1	United States	No
2	Netherlands	No
3	Luxembourg	No
4	China	Yes
5	France	No
6	United Kingdom	No
7	Austria	No
8	Switzerland	No
9	Italy	No
10	Spain	No

NOTE: This ranking is calculated by adding German outward FDI stock in the partner country (in US$ million) and German inward FDI stock from the partner country (in US$ million). Data is for 2017 or latest available. Data on the Germany-China investment relationship does not appear in the OECD data on German investment positions, and was included after review of the data on Chinese investment positions. Availability of treaty-based ISDS is based on author review of all treaties currently in force. Availability of treaty-based ISDS ignores the protection for foreign investment in the energy sector provided by the Energy Charter Treaty.
SOURCE: Author calculations of FDI ranking based on OECD 2019a; OECD 2019b

TABLE 4. GERMANY: LARGEST INVESTMENT RELATIONSHIPS

The same picture emerges if one considers other Western European states, such as the United Kingdom, France and the Netherlands. These states are among the largest participants in international investment and are also among the architects of the investment treaty regime. ISDS does not play an important role in the major investment relationships with any of these states.

In the case of Western European states, one qualification is that the Energy Charter Treaty (ECT) does provide access to ISDS for foreign investment in the energy sector among the forty-nine state parties. For example, all of Germany's largest investment partners are parties to the ECT, with the exception of the United States and China. The ECT is important to understanding the politics of ISDS in Europe, as the majority of claims against Western European states have been initiated under that treaty. Vattenfall's claim relating to the phase-out of nuclear power in Germany and the series of disputes relating to the tariff regime for solar energy in Spain are high profile examples. Nevertheless, it is important to keep the ECT's limited scope of coverage in perspective: less than 1.5% of Germany's outward FDI stock is potentially covered by it (OECD 2019d).[4]

Finally, we consider the position of China. China has the world's second largest investment treaty network. Like Germany, it is a major source of, and destination for, foreign investment. Indeed, if inward and outward FDI is aggregated, it is the second largest participant in international investment, eclipsing Germany and other Western European states (OECD 2019c). To put these figures in perspective, China's involvement in foreign investment is a little over 20% of the equivalent figure for the EU Member States considered collectively (OECD 2019c). Similarly, while the US is China's largest investment partner, this relationship is only the twelfth largest of the US's bilateral investment relationships.

Rank	**Country**	**Investment relationship covered by ISDS?**
1	United States	No
2	Japan	Yes
3	Germany	Yes
4	Republic of Korea	Yes
5	Australia	Yes*
6	France	Yes
7	Canada	Yes
8	Sweden	No
9	Switzerland	Yes
10	Luxembourg	Yes

NOTE: This ranking is calculated by adding Chinese outward FDI stock in the partner country (in US$ million) and Chinese inward FDI stock from the partner country (in US$ million). Data is for 2017 or latest available. Availability of treaty-based ISDS is based on author review of all treaties currently in force.
* indicates partial ISDS coverage. The China-Australia BIT allows for ISDS, but only in disputes relating to the determination of compensation for expropriation. The China-Australia FTA allows for ISDS, but only in disputes relating to breach of the national treatment obligation.
SOURCE: Author calculations of FDI ranking based on OECD 2019a; OECD 2019b.

TABLE 5. CHINA: LARGEST INVESTMENT RELATIONSHIPS

[4] This figure is obtained by adding German outward investment in the OECD's statistical categories of the 'Electricity and Gas' industry with the 'Quarrying and Mining' industry, which includes petrol and gas extraction. This figure tends to overstate the percentage of German outward investment covered by the ECT, both because some projects that fall within the OECD's 'quarrying and mining' category fall outside the coverage of the ECT and because the figure refers to outward FDI to all countries, whereas only outward FDI to the forty-eight other ECT state parties is potentially covered by that treaty.

Table 5 shows that China's situation differs from other major players in the global economy. With the crucial exception of its relationship with the US, most of China's largest investment relationships are currently covered by ISDS.[5]

A simple, yet often overlooked, point emerges from the foregoing analysis. The investment treaty regime is not a genuine a multilateral regime (cf. Schill 2009). The world's largest and most important investment relationships are not currently covered by ISDS. This is particularly true of investment relationships between developed countries. In this respect, a future without ISDS would look much the same as the present. The case of China is somewhat more complex. China is not yet a high-income country (as per World Bank classifications), but the size of its economy makes it a major player in the global economy. Notwithstanding the unusually large fraction of Chinese investment covered by ISDS provisions, there are only five known cases in which Chinese foreign investors have used ISDS to sue, and only three known cases in which ISDS proceedings have been initiated against China (UNCTAD 2019). Given well-known complaints about the difficulties that foreign investors face in operating in China (e.g British Chambers of Commerce 2019), the latter figure is particularly surprising. It may be that treaty-based ISDS fails to address the practical issues relating to cybersecurity, protection of intellectual property and licensing restrictions of which investors in China sometimes complain. Or perhaps investors are particularly hesitant pursuing investor-state arbitration claims against China in particular. In any case, the infrequency with which ISDS is invoked in cases involving China suggests that dispensing with ISDS would not be a major change to the *status quo*.[6]

In summary, evidence to date implies that treaty-based ISDS is not very important in investment decision-making. Most of the world's largest investment relationships are between pairs of developed countries and most of these relationships are not now, and have never been, covered by ISDS. The implications for investment in developing countries are more complex. Bearing in mind considerable data constraints, ISDS does seem to be important for some investors, making certain types of investments, in certain types of jurisdictions. Yet, even when investing in developing countries, investors have access to other risk-mitigating instruments and strategies, and they have shown a great willingness to invest massive sums in the absence of investment treaty protections. The vast majority of foreign investment projects would likely still proceed even if the governments of the world should decide to remove ISDS from the investment regime.

POLITICIZATION OF DISPUTES

A second prominent justification for ISDS is that it serves to "depoliticize" investment disputes (Polanco 2019). This justification has its origins in what was essentially a marketing effort by high-level ICSID officials who were seeking to convince investors and states to use the Centre's services (Puig 2013; St John 2018). Given its non-academic origins, it is unsurprisingly that this thesis is more of a loose and informal collective sense than a fully worked out theory. Although the concept is invoked in very different ways (Paparinskis 2012), it typically starts from a deep suspicion of a world in which "diplomatic protection" serves as the investor's primary protection against host state malfeasance. In the absence of an independently exercisable, treaty-based private legal remedy, the foreign investor will appeal to his home state government to intervene diplomatically on his behalf. While diplomatic

[5] That said, it is important to note that according to UNCTAD's bilateral FDI database, Japan, Korea, France, Germany, and Canada were also among the most important sources of inward FDI stock to China prior to the entry into force of China's modern, enforceable investment treaties with those countries. Investors from those countries (and from the United States, the number one source of FDI stock in China in 2001) were willing to invest large amounts of FDI in China absent robust treaty protection.

[6] Hypothethically, the reason for the absence of claims could be because the treaties have been implemented fully in Chinese administrative practice. This has not been assessed in empirical work, but it would be in stark contrast from other countries, something we will return to below.

protection, as a quasi-formal system, might sometimes involve law-like procedural and substantive norms, it also obviously leaves room for political considerations, including threats of economic or other sanctions, that would be considered out of bounds in a purely legal process (Staley 1935). It might even lead to war. That extreme possibility is prominently displayed through the standard textbook practice of introducing investment treaties by contrasting the modern era with a supposed historical period in which gunboat diplomacy—armed intervention by the home state to protect foreign investors—was an ever-present threat (Yackee 2019).

Four core assumptions underlie the de-politicization thesis. First, the period before treaty-based ISDS was dominated by coercive diplomatic intervention by capital-exporting states. Second, treaty-based ISDS was introduced to fix this problem – i.e. it was a demand for de-politicization that resulted in the introduction of ISDS provisions into investment treaties. Third, treaty-based ISDS worked by effectively de-politicizing investment disputes. Fourth, and finally, politicization of investment disputes is more costly than ISDS for developing countries and even for home states, as it clashes with broader foreign policy interests. The implication is that an abandonment of ISDS threatens a return to an unprincipled and even dangerous past, in which investment disputes are settled on political rather than legal grounds, in which powerful investors can set their home state's foreign policy machinery in motion even when public intervention was not in the national interest, and in which weak investors, unable to do the same, lack effective access to justice. Reisman, for instance, notes that the 'central achievement' of ISDS is the 'insulation' of disputes from 'the caprice of sovereign-to-sovereign politics' (cite), and Schwebel concurs: '[ISDS has] proved to be a significant and successful substitute for the gunboat diplomacy of the past' (cite).

Unfortunately, the historicity of this argument has rarely been examined with any rigor. The case of the United States is an exception. Here Maurer (2017) shows – in line with the first assumption above – that the executive branch was repeatedly dragged into investment disputes involving US asset owners during the Cold War. US aid flows were frequently withheld from expropriating governments. Less research has been conducted on European capital-exporting states. But the research that *is* available suggests that the pre-BIT approach to investment protection was very different. Take the case of the United Kingdom first. Even when shifting British governments *could* use coercive diplomatic instruments to resolve investment disputes, the Foreign and Commonwealth Office took a hard line refusing to use British aid flows as an instrument of coercion (Poulsen 2015). Diplomatic involvement in investment disputes was routine, but it would hardly ever involve the type of quasi-coercive instruments used by the United States.

Yackee (2019; forthcoming) has documented a similar experience in post-independence Francophone Africa, where French investors suffered a number of initially uncompensated nationalizations. The complex interdependence between France and its foreign colonies, along with France's relatively autonomous and professional foreign policy machinery, combined to tamp down pressure on the French government to forcefully intervene. As with Whitehall in the UK, the French government's responses to nationalization were often measured and mindful of France's larger political interests in the region. Rather than engaging in "gunboat diplomacy," the French government steered its aggrieved investors and the nationalizing host states to negotiated, compromise outcomes reached over a reasonable time-period and which were sensitive to the investor's desire for reasonable compensation and to the expropriating state's often-fragile political and economic situation.

Although historical research remains limited, these experiences highlight the capabilities of politicized dispute settlement, while presenting a more realistic and less alarmist understanding of its limitations. In practice, it consisted of a mixture of investor self-help and diplomatic tools and strategies of influence far removed from actual "gunboats." It is also worth recalling that investors were not powerless in the absence of treaty-based arbitration. They could threaten bothersome domestic legal action. They could often threaten to invoke contract-based international arbitration. They could threaten to interfere with the nationalizing state's ability to market the products produced from nationalized facilities. Notably, this was the case also for investors from home states with fewer diplomatic levers than the major powers.[7] In addition, the nationalizing host states' reputational interest in attracting more private investment in the future often encouraged them, sooner or later, to come to the negotiating table. At a minimum, this suggests that the first assumption of the de-politicization argument is more nuanced than sometimes portrayed in the pro-ISDS literature.

The second assumption – that ISDS was introduced to solve the politicization problem – finds even less support in the archives. Whereas one of the core justifications for ISDS made by the World Bank was the need for de-politicization, it was in practice mostly the World Bank *itself* that wanted to disentangle itself from foreign investment disputes (St John 2018). It was already mentioned above that early German drafters explicitly rejected ISDS with the argument that it would *politicise* investment disputes and when ISDS was later added to German treaties up through the 1980s de-politicization doesn't feature as a core driver (Poulsen 2020). In the case of the United Kingdom, ISDS was included in the 1971 BIT model but nothing in the archives suggest this was because of a need for de-politicization (Poulsen 2020). That lack of evidence is unsurprising given, as noted above, that UK foreign policy was not held hostage to investor demands for intervention.[8] Even in the case of the United States there is only limited archival evidence that de-politicization was a core driver for the BIT program in the 1980s (Gertz – review; St John xx).

The third assumption – that ISDS has fixed the problem of politicization – has been subject to hardly any empirical testing. The main exception is Gertz, Jandhyala, and Poulsen (2017), who show that the U.S. government in recent years has routinely intervened diplomatically in foreign investment disputes involving U.S. investors even when the investments are covered by a U.S. investment treaty. Yet, coercive policy responses – such as threatening withdrawal of aid – are rarely invoked in modern US investment diplomacy. Moreover, when coercive diplomacy is threatened, the threat does not correlate with whether an American investment dispute is protected by ISDS or not. This suggests that ISDS does not replace diplomatic protection but exists in concert with it (just as it coexisted with contract-based arbitration in an earlier era). The fact of continued coexistence is important because the depoliticization thesis sometimes suggests that the point of ISDS is to save home state governments the costs of maintaining the diplomatic capacity to intervene on behalf of their investors. The idea is that the home state government, approached by an investor demanding intervention, can steer the investor toward ISDS while firmly declining to become involved itself. But ISDS doesn't save diplomatic resources if governments actually *want* to intervene diplomatically, which at least in the case of the US has often been the case after the end of the Cold War (Gertz 2016).

Finally, there is very limited empirical evidence on the fourth assumption – that politicization of investment disputes is inherently *costly* for host and home states compared to ISDS. While the U.S. case suggests that the absence of ISDS allowed investors to interfere with broader U.S. foreign policy objectives (a "cost"), the cases of the U.K. and France tell a different story. They might even suggest that diplomacy and investor self-help (whether legal or otherwise) can be mutually supporting, not just in terms of helping the investor to recover, but also in terms of helping to dissuade the investor from taking excessive action or making excessive demands that could cause political or financial instability in the host state. This point is rarely made in the existing literature, but it is an important one: "politicization" of an investment dispute does not necessarily entail the home state pressuring the host

[7] As a caveat, it is important to stress that there is again very limited historical work on this question, so we don't know whether investors from 'powerful' home states (e.g. France and the UK) could expect more favourable treatment by host states than otherwise similar investors from 'weaker' home states (e.g. Denmark and Luxembourg).

[8] Equally, when members of the European Communities and the Arab League negotiated a 'mega-regional' investment treaty up through the 1970s and 1980s, nothing in the negotiation files suggest that the inclusion of ISDS was linked to the need for de-politicisation among the parties (Denza and Poulsen 2020).

state to give the investor whatever he wants. It can also entail the home state pressuring *its investors* to behave in reasonable ways.

Politicized dispute settlement can lead to more holistic and mutually beneficial and acceptable solutions that are not always possible through excessively cabined, overly legalistic proceedings that may inhibit settlement, heighten tension and conflict, and destroy future opportunities to cooperate for mutual benefit (Salacuse 2007). In fact, a long line of research in the law-and-society tradition warns against exaggerating the conceptual and practical utility of a bright-line distinction between law and politics and encourages us to be suspicious of claims of the inherent superiority or relevance of formal legal rules and processes for the regulation of many kinds of disputes. In that spirit investment law scholars have recently begun urging the architects of the investment treaty system to incorporate greater opportunities for mediation as an alternative to legalized arbitration (Franck 2007; Welsh & Schneider 2013).

Finally, it is worth considering whether, by granting wide classes of investors generous substantive rights coupled with guaranteed access to international arbitration, ISDS may actually increase the volume of disputes (and the costs of resolving them) while also occasionally provoking arbitrations that raise highly sensitive issues that can cause substantial controversy. Rather than tamping down "politics", widespread access to ISDS may produce highly politically salient disputes that, in the absence of ISDS, would have been quietly resolved behind the scenes or which would never have crystalized, the investor realizing that the lumps he takes are an unrecoverable cost of doing business. Recall, the German government's concerns with ISDS in the 1950s: salient investor-state claims could force the government to get involved in disputes it would rather stay clear off or not be brought at all (Poulsen 2019). This, of course, is the *opposite* of the de-politicization thesis.

Philip Morris's costly and widely criticized challenges to anti-smoking regulations in Australia and Uruguay provide an obvious example of disputes that should never have been litigated at the international level, but there are other examples of disputes that, even if entailing potential wrongs (in a generic sense) to affected investors, would probably have been better-settled through a primarily diplomatic process. We can think, for example, of Vattenfall's challenge to Germany's phaseout of nuclear reactors; the decade-plus saga ignited by Argentina's 2001 currency crisis; or the crushing volume of recent and ongoing arbitration against post-Khaddaffi Libya, a fragile state whose collapse would pose a grave humanitarian and regional crisis. Those examples highlight how political investment disputes can be even when the process for resolving those disputes is highly legalized, and they show how important interests beyond those of the foreign investor are sometimes in play in ways which are difficult to incorporate into or to reconcile with a purely legal dispute-settlement method. Although empirical literature on this question remains in its infancy, existing evidence does suggest that the involvement of home states in investment disputes, including but not only through the exercise of diplomatic protection, may provide a reasonable and cost-effective way of steering such disputes to more balanced and mutually acceptable outcomes.

RULE OF LAW

A third core question is the implications of a future without ISDS for the rule of law. There is little disagreement that 'the rule of law' is desirable as an abstract proposition. But the concept of the rule of law is invoked by legal scholars in a wide variety of different contexts in debates about investment treaties. These different usages are not always consistent. For this reason, we begin by distinguishing four different ways in which the concept is used and clarify how our analysis relates to these debates.

A first usage treats the rule of law as synonymous with the resolution of disputes through legal adjudication. Vandevelde invokes the rule of law in this sense when he argues that 'the rule of law triumphs when sovereign governments commit themselves to legal process and honor those processes.'

(Vandevelde 2010, 119). Debate about the relationship between ISDS and the rule of law, understood in this sense, raises essentially the same issues as the discussion of depoliticization in the previous section (e.g. Paulsson 2005, 2). We do not engage further in this debate here, save to observe that, even in the absence of ISDS, there is no legal vacuum. Foreign investment is governed in the first instance by the law of the host state (Živković 2019, 535). Foreign investors have a range of adjudicative options for resolving disputes – including litigation in national courts and any contractually agreed mechanisms – aside from treaty-based ISDS.

A second usage links the rule of law to a set of desirable characteristics of courts and tribunals. Van Harten invokes the rule of law in this sense, when he criticizes ISDS on the grounds that arbitrators fail to satisfy requirements of independence and impartiality that would be expected of domestic judges (van Harten 2010, 639). These criticisms have been influential. They are reflected in proposals to reform the ISDS mechanism, such as the EU's proposal for a Multilateral Investment Court. But debates about reform of the ISDS mechanism presuppose that there is a rationale for retaining ISDS in some form or other. Our analysis calls this presupposition into question by evaluating the likely consequences of moving to a world without ISDS. For this reason, we do not engage further in debates about whether ISDS as an adjudicative mechanism is, itself, consistent with the rule of law.

A third usage characterizes the rule of law as a set of desirable constraints on the exercise of public power. Schill invokes the rule of law in this sense when he argues that ISDS tribunals have interpreted investment treaties' substantive provisions in ways that reflect various sub-elements of the rule of law, such as the principle that administrative action should be proportionate to the objective thereby pursued (Schill 2010, 181). One complication with such claims is that the rule of law is, of course, a highly contested concept (in the context of ISDS; see Calamita 2015); scholars disagree about both the nature and extent of constraints on public power implied by the rule of law (Craig 1997). Although this debate is not the focus of our inquiry, it does problematise conceptions of institutional 'quality' that underpin any attempt to evaluate the effects of investment treaties on the rule of law. Another challenge with the third usage of the rule of law is that it can encourage scholars to focus on legal doctrine as the object of inquiry. In contrast, our focus is on the effects of the ISDS mechanism. (The contours of legal doctrine may be relevant to understanding the effects of the ISDS mechanism, but it is a serious category error to assert that, because an administrator's failure to act proportionately can constitute a breach of an investment treaty by a state, ISDS encourages administrators to act proportionately. The former is a claim about legal doctrine, whereas the latter is an empirical claim that must be substantiated by evidence.)

This bring us to a fourth usage, which links the rule of law to the quality of governance in states that are bound by ISDS-enforced investment treaties. This argument necessarily draws on a normative conception of the rule of law of the sort invoked in the second or third usages. But this argument is distinctive in that it is focused on the *effects* of investment treaties, rather than on whether various system-internal features of the investment treaty regime are aligned with conceptions of the rule of law. We focus below on the implications of ISDS for the rule of law in this sense, bearing in mind that there is room for disagreement about which institutional configurations best reflect a commitment to the rule of law.

Supporters of investment treaties argue that the risk of financial liability associated with ISDS encourages states to reform their systems of domestic governance in order to ensure compliance with the treaties (Echandi 2011). According to this argument, ISDS encourages states to ensure that their judicial systems are independent and that their administrative systems are efficient and accountable. These reforms create 'spillover' benefits – i.e. benefits to constituencies other than investors themselves.

While this argument is intuitively plausible, there is little evidence to support it. Let's begin, again, with a case where we should expect to find such evidence: Myanmar.[9] Myanmar is a least developed country that ranks poorly on the World Bank's rule of law and regulatory quality metrics (World Bank 2019). And among least developed states, there are several reasons to suppose that Myanmar would be among the most likely for ISDS to have had a positive impact on the rule of law. First, since the transition to nominally civilian rule in 2011, attracting new foreign investment has been a key priority for the Myanmar government. Second, during the same period foreign development assistance to Myanmar has dramatically increased (OECD 2019e, 7), much of it focused on economic reform and the domestic business environment. This combination of high-level political support for reforms to encourage foreign investment and the availability of international development assistance eases two significant constraints on reform. Third, Myanmar had a relatively early experience as a respondent in ISDS, an experience which often triggers reflection within government on the implications of participation in the investment treaty regime (Poulsen 2015).

Nevertheless, the picture that emerges is one of profound disconnection between investment governance in Myanmar and the domestic judicial system (Bonnitcha 2019). There are efforts underway to reform the judicial system in Myanmar, but these have nothing to do with investment treaties. In interviews, government officials acknowledged the weakness of the domestic court system but even those with the most knowledge of investment treaties did not identify this weakness as a potential risk of liability in ISDS proceedings. Insofar as the investment policy community in Myanmar sought to build institutions to resolve investor-state disputes, these efforts have been focused entirely on strengthening institutions than can substitute for the Myanmar court system, such as the development of an Investor Assistance Committee within the executive branch of government.

The impacts of investment treaties on domestic administrative practice in Myanmar are more nuanced, but equally pessimistic. As of 2018, no diagnostic exercise had ever been conducted to ascertain whether the practices of government agencies that deal regularly with foreign investment are consistent with investment treaties, still less any program to reform those practices in light of the risks of ISDS. Indeed, even within the investment agency, knowledge of, and engagement with, investment treaties was confined to those directly involved in the negotiation of the treaties. One official notes,

> The majority of government officials they pay little attention to investment treaties. Except for within our Department [of the investment agency], the other Departments are not very familiar with investment treaties (cited in Bonnitcha 2019).

Myanmar is, of course, only one case. So how does it match up with evidence collected across other states? In the most comprehensive study to date, Sattorova interviewed government officials in Kazakhstan, Nigeria, Turkey, Ukraine and Uzbekistan on their knowledge of investment treaties and measures in their countries that had been taken to implement the treaties. Although these are not least-developed states, the picture that emerges is very similar to the case of Myanmar. There was some limited knowledge of investment treaties among those with direct responsibility for managing ISDS claims, but little or no wider awareness of the treaties across government and the judiciary (Sattorova 2018, 65-70). Tellingly, her research did not identify any examples of situations where concerns about ISDS had triggered wider dynamics of institutional reform that might plausibly lead to improvements in judicial or administrative quality. In those situations where the experience of ISDS did trigger a domestic institutional response, that response was focused on avoiding and managing investment disputes:

[9] The following sections are based on Bonnitcha 2019. In this study, the author benefited from an unusual level of access to relevant government officials, allowing for a more granular account of the impact of investment treaties on domestic governance than any other published study to date.

> Rather than embarking on comprehensive and systemic reforms of governance institutions and practices, some host governments—in particular in developing countries—appear to opt for short-term and localised solutions aimed solely at safeguarding the special treatment of foreign investors and optimising the defence of state interests in investment arbitration disputes (Sattorova 2018, 85).

Cross-country quantitative studies are also consistent with this view. Ginsburg (2005) found that investment treaties with ISDS provision have a slight *negative* impact on a state's rating on the World Bank's 'rule of law' governance indicator. Sasse (2011) reaches similar conclusions. These findings should be interpreted with caution, both because of concerns about the composition of the World Bank's 'rule of law' indicator and the challenges in identifying and controlling for other potentially relevant variables (Bonnitcha, Poulsen and Waibel 2017, 171). Nevertheless, the failure of quantitative studies to find any positive impact of ISDS on various metrics of national governance supports Sattorova's conclusions.

Overall, although the evidence to date is limited, it suggests that the risk of ISDS claims has not led to meaningful improvement in the rule of law in developing countries. There are well-known examples of states that have responded to the risk of ISDS by establishing institutions to manage and avoid investment disputes – Peru, for instance – but not of states that have responded to that risk through comprehensive processes of reform. In our view, this suggests that a future without ISDS is unlikely to have meaningful implications, whether positive or negative, for the rule of law 'on the ground' in developing countries.

CONCLUSION

What would a future without treaty-based ISDS look like? There would be obvious changes arising directly from the demise of the mechanism. Lawyers and arbitrators who work within the existing system would need to find something else to do, although many could presumably find gainful employment in other areas of investment governance. Government resources currently devoted to managing and defending ISDS claims could be repurposed, although some of these resources would need to be redirected to other methods of managing and resolving investment disputes. Scholars of the investment treaty regime, such as ourselves, would need to find something else to write about. These are among the most obvious changes a world without ISDS would bring about, but they are not changes we find particularly interesting.

Instead, we have organised this chapter around the three main benefits of treaty-based ISDS, according to its proponents: that it promotes desirable inflows of foreign investment; that it depoliticizes disputes; and that it promotes the institutionalisation of the rule of law in host states. To assess the implications of a future without ISDS in terms of these supposed benefits, we have drawn on two bodies of evidence: empirical studies of the effects of treaty-based ISDS; and evidence of how foreign investment is actually governed beyond the coverage of the existing regime of treaty-based ISDS. We acknowledge that both bodies of evidence have considerable limitations, something we've discussed at length elsewhere (e.g. Bonnitcha, Poulsen and Waibel 2017), and there is much more work to be done.

Nevertheless, evidence to date suggests that there are unlikely to be significant negative consequences associated with the retrenchment of ISDS. It is an uncontentious, but often-overlooked, fact that the world's largest and most important investment relationships are not currently covered by ISDS. In this respect, a future without ISDS looks much the same as the present. Insofar as investment in developing countries is concerned, the absence of treaty-based ISDS is likely to have some impact on some types of investment projects in some contexts. But the vast majority of foreign investment projects would likely still proceed in the absence of ISDS. Secondly, politicized forms of investor-state dispute settlement that pre-date treaty-based ISDS could be more effective and fair than proponents of ISDS assume. Moreover, the subsequent development of treaty-based ISDS does not appear to have displaced home state involvement in foreign investment disputes but, rather, has created a parallel mechanism that can be pursued simultaneously. In fact, this was the main intent of early Western founders of the regime: establishing treaties with substantive investment protections that could be used as focal points in informal diplomatic bargaining (Poulsen 2020). For both reasons, we do not see a future without ISDS as involving problematic re-politicisation of investment disputes. At a minimum, arguments to the contrary should be backed up with convincing evidence, evidence which is currently lacking. Finally, there is little indication that the risk of ISDS claims has led to improvements in the institutionalisation of the rule of law in developing countries. Here, again, it is important to stress that very little empirical evidence is available, but the evidence that does exist does not support the view that ISDS is critical, whether positive or negative, for the rule of law on the ground in developing countries.

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