

Bilateral Investment Treaties (BITs): The Global Investment Regime and Income Inequality in Developing Countries

Cristina Bodea

Michigan State University

Fangjin Ye

Shanghai University of Finance and Economics

Bilateral Investment Treaties (BITs)

- Most visible and powerful legal instruments underlying the global growth of foreign direct investment (FDI)
- BITs include provisions that guarantee investor rights through clauses related to **compensation for expropriation, national treatment of foreign investors or most favored nation treatment**
- Many BITs allow investors to enforce right in timely manner through **delegation of investor-state dispute resolution to international tribunals**

Motivation

One view:

- Developing countries want FDI because it is a development tool
- International law/treaties including investment treaties promote FDI

The other view:

- Opposition to international treaties especially investment treaties
- Human rights groups/NGOs allege governments' hands are tied by investment treaties, with real consequences for constraining regulatory space and social development in developing countries.

Research Question

- Strong investor protection vs. the lack of provisions with regards to social development.
- Do bilateral investment treaties (BITs) and the asymmetric rights afforded by these treaties to investors have an impact on income inequality in developing countries?

The Argument

- Directly, BITs reduce host governments' incentive and ability to implement redistributive policies that specifically aim at reducing income inequality (e.g., 2002 MPRDA in South Africa).
 - Indirectly, BITs tend to lock-in initial favorable policies attractive to foreign investors in the fields of taxes, welfare spending, and labor practices, and constrain the future policy improvements in these fields.
 - Reduction in fiscal revenue and expenditure
 - Worsening of de facto labor rights
- ➔ Net result of increasing income inequality

Developing countries and policies favorable to investors

- BITs lock-in past favorable treatment granted to investors
 - Investment in developing country is mostly vertical, searching for cost efficiencies (Blonigen and Wang 2005, Hanson et al. 2003, UNCTAD 2004, Buthe and Milner 2008)
 - Races to the bottom on particular issues: de facto labor rights (Davies and Vadlamannati 2013); corporate income tax rates and holidays (Klemm and Parys 2012); welfare spending where domestic labor enjoys little bargaining power (Rudra 2002)
 - Developing countries serve as export platforms for multi-national corporations (Frieden 1991, Ruane and Ugur 2005) – BITs lock in export promoting policies (labor rights – Mosley and Uno 2007, fiscal and regulatory policies – Cao 2010, 2012)
- BITs constrain future choices in improving conditions in those policy areas

BITs clauses lock-in favorable policies

- National treatment clause
 - Prohibits host government to make negative differentiations between national and foreign investors
- Stabilization clauses in investment contract & the “umbrella clause” of BITs
 - Prevent host states from changing domestic law as it stands at the time of investment
- Indirect expropriation
 - But also refers to less clear-cut & potentially very broad measures such as changes in taxation, revocation of licenses or denial of access to infrastructure
- Investor-State Dispute Settlement (ISDS)

BITs, favorable policies and income inequality

1. Favorable policies attractive to foreign investment (limitations on labor rights, taxation, welfare provisions and fiscal/regulatory policies)

➔ Reduction in fiscal revenue and expenditure & worsening of labor rights

➔ Net result of increasing level of income inequality

2. Direct + Indirect impact of BITs ➔ **High level of income inequality**

Hypothesis & Mechanisms

- **Hypothesis:** BITs are associated with higher income inequality in developing countries.
- **Mechanism 1:** BITs are associated with lower fiscal revenue and expenditure in developing countries.
- **Mechanism 2:** BITs are associated with worse labor practices in developing countries.

The Data

- Panel data: 114 developing countries from 1971 to 2009
- DV: income inequality
 - Gini index from (Solt 2016)
 - Industrial pay inequality in manufacturing sectors from UTIP-UNIDO
- IVs: the cumulative number of BITs ratified by a country in a given year
 - All types of BITs
 - BITs with ICSID clause
 - North-South BITs

Empirical Model

- Controls: FDI inflow, trade openness, GDP per capita, democracy, per capita GDP growth.
- Model: OLS with fixed effect and half-decade dummies.

The Finding

- A greater number of BITs ratified by a country increases the level of income inequality in developing countries.

Table 1: The impact of BITs on income inequality in developing countries

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9
All BITs	0.0622* (0.033)			0.0726** (0.035)			0.0006** (0.000)		
BITs with ICSID		0.0313 (0.040)			0.0340 (0.043)			0.0008* (0.000)	
Adjust N-S BITs			0.1358** (0.061)			0.1645*** (0.059)			0.0012** (0.001)
R^2	0.127	0.113	0.134	0.110	0.094	0.119	0.165	0.166	0.170
Countries	114	114	114	114	114	114	97	97	97
N	2,131	2,131	2,131	2,131	2,131	2,131	1,802	1,802	1,802

Note: All models are OLS with fixed effect, intercepts, and half-decade dummies. Models 1-3 use post-tax, post-transfer income inequality (Solt 2015), models 4-6 use pre-tax, pre-transfer inequality (Solt 2015), and models 7-9 use industrial pay inequality in manufacturing sectors from UTIP-UNIDO as dependent variables. Numbers in parentheses are country clustered standard error. All independent variables are lagged one year. *** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$

Not shown: Controls & time and country dummy variables

Table 2: The impact of BITs on fiscal revenue and expenditure, and tax revenue

	Model 10	Model 11	Model 12	Model 13	Model 14	Model 15	Model 16	Model 17	Model 18
All BITs	-0.0444 (0.0192)**			-0.0411 (0.0215)*			-0.0428 (0.0182)**		
BITs with ICSID		-0.0566 (0.0221)**			-0.0185 (0.0247)			-0.0526 (0.0205)**	
Adjust N-S BITs			-0.0754 (0.0333)**			-0.0630 (0.0382)*			-0.0802 (0.0319)**
R^2	0.78	0.78	0.78	0.71	0.71	0.71	0.82	0.82	0.82
Countries	104	104	104	104	104	104	103	103	103
N	2,335	2,335	2,335	2,335	2,335	2,335	1,124	1,124	1,124

Note: All models are OLS with panel corrected standard errors and AR (1), intercepts, country and half-decade fixed effects. Models 10-12 use fiscal revenue, models 13-15 use fiscal expenditure, and models 16-18 use tax revenue as dependent variables. Numbers in parentheses are standard error. All independent variables are lagged one year. *** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$

Not shown: Controls & time and country dummy variables

Table 3: The impact of BITs on collective labor practices

	Model 19	Model 20	Model 21
All BITs	-0.0399 (0.0134)***		
BITs with ICSID		-0.0440 (0.0203)**	
Adjust N-S BITs			-0.0648 (0.0207)***
R^2	0.58	0.58	0.58
Countries	120	120	120
N	1,791	1,791	1,791

Note: All models are OLS with panel corrected standard errors and AR (1), intercepts, country and half-decade fixed effects. Numbers in parentheses are standard error. All independent variables are lagged one year. *** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$

Not shown: Controls & time and country dummy variables

Implications

- Counter recent research: States ratify BITs within a bounded rationality framework & do not appreciate the degree to which their hands are tied (Poulsen and Aisbett 2013)
- Our study draws attention to the unintended externalities of concluding BITs –increasing income inequality in developing countries
- Our findings also back calls from UNCTAD to restore states' control of their regulatory space (UNCTAD 2012), as well as the recent move to incorporate clauses related to social development in the content of BITs.

Thank you

Table 1: The impact of BITs on income inequality in developing countries

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9
All BITs	0.0622* (0.033)			0.0726** (0.035)			0.0006** (0.000)		
BITs with ICSID		0.0313 (0.040)			0.0340 (0.043)			0.0008* (0.000)	
Adjust N-S BITs			0.1358** (0.061)			0.1645*** (0.059)			0.0012** (0.001)
Polity2	-0.1428** (0.062)	-0.1566** (0.064)	-0.1383** (0.061)	-0.1499** (0.071)	-0.1665** (0.073)	-0.1436** (0.070)	0.0000 (0.000)	0.0000 (0.000)	0.0000 (0.000)
FDI inflow/GDP	0.0447 (0.052)	0.0509 (0.052)	0.0502 (0.052)	0.0425 (0.066)	0.0499 (0.066)	0.0489 (0.067)	0.0003 (0.000)	0.0004 (0.000)	0.0004 (0.000)
Trade openness	2.1448*** (0.703)	2.5114*** (0.847)	2.0602*** (0.689)	2.3978*** (0.790)	2.8416*** (0.911)	2.2701*** (0.774)	0.0032 (0.009)	0.0030 (0.008)	0.0024 (0.008)
GDP per capita	0.8850 (1.533)	1.8291 (2.095)	0.5145 (1.335)	0.8302 (1.534)	1.9495 (2.061)	0.3295 (1.371)	-0.0325** (0.014)	-0.0293** (0.014)	-0.0346** (0.016)
Growth	0.0084 (0.031)	0.0095 (0.031)	0.0109 (0.030)	0.0108 (0.038)	0.0120 (0.038)	0.0139 (0.038)	-0.0000 (0.000)	0.0000 (0.000)	-0.0000 (0.000)
R ²	0.127	0.113	0.134	0.110	0.094	0.119	0.165	0.166	0.170
Countries	114	114	114	114	114	114	97	97	97
N	2,131	2,131	2,131	2,131	2,131	2,131	1,802	1,802	1,802

Note: All models are OLS with fixed effect, intercepts, and half-decade dummies. Models 1-3 use post-tax, post-transfer income inequality (Solt 2015), models 4-6 use pre-tax, pre-transfer inequality (Solt 2015), and models 7-9 use industrial pay inequality in manufacturing sectors from UTIP-UNIDO as dependent variables. Numbers in parentheses are country clustered standard error. All independent variables are lagged one year. *** p <= 0.01; ** p <= 0.05; *p <= 0.1

BITs & Fiscal revenue/expenditure

- Panel data: 105 developing countries from 1971 to 2009
- DV: (i) fiscal revenue and expenditure (Bodea and Higashijima forthcoming); (ii) tax revenue as percentage of GDP (WDI).
- Controls: FDI inflow, trade openness, GDP per capita, democracy, per capita GDP growth, Population, Oil rent, Capital openness
- Model: OLS with PCSE, AR(1), country and half-decade fixed.

Table 2: The impact of BITs on fiscal revenue and expenditure, and tax revenue

	Model 10	Model 11	Model 12	Model 13	Model 14	Model 15	Model 16	Model 17	Model 18
Fiscal expen.	0.2218 (0.0262)***	0.2238 (0.0262)***	0.2240 (0.0262)***						
Fiscal Revenue				0.4130 (0.0382)***	0.4170 (0.0382)***	0.4145 (0.0382)***			
All BITs	-0.0444 (0.0192)**			-0.0411 (0.0215)*			-0.0428 (0.0182)**		
BITs with ICSID		-0.0566 (0.0221)**			-0.0185 (0.0247)			-0.0526 (0.0205)**	
Adjust N-S BITs			-0.0754 (0.0333)**			-0.0630 (0.0382)*			-0.0802 (0.0319)**
Polity2	0.0955 (0.0298)***	0.0949 (0.0298)***	0.0956 (0.0298)***	-0.0570 (0.0392)	-0.0562 (0.0391)	-0.0569 (0.0392)	0.0258 (0.0321)	0.0264 (0.0321)	0.0282 (0.0319)
GDP per capita	1.0469 (0.9250)	0.9907 (0.9046)	0.9841 (0.9176)	-0.4420 (0.8192)	-0.7459 (0.7973)	-0.5368 (0.8121)	2.0114 (1.2599)	1.8440 (1.2253)	1.9953 (1.2199)
Population	0.0024 (0.0051)	0.0027 (0.0051)	0.0031 (0.0051)	0.0200 (0.0067)***	0.0201 (0.0067)***	0.0207 (0.0067)***	-0.0146 (0.0080)*	-0.0126 (0.0079)	-0.0138 (0.0079)*
Oil rent	0.1527 (0.0313)***	0.1526 (0.0313)***	0.1536 (0.0312)***	0.0185 (0.0300)	0.0203 (0.0300)	0.0192 (0.0300)	0.0586 (0.0413)	0.0557 (0.0418)	0.0565 (0.0414)
FDI/GDP	0.0284 (0.0343)	0.0273 (0.0344)	0.0267 (0.0345)	-0.0678 (0.0442)	-0.0703 (0.0443)	-0.0698 (0.0443)	0.0356 (0.0349)	0.0342 (0.0349)	0.0338 (0.0349)
Capital open	-0.3460 (0.4647)	-0.3285 (0.4647)	-0.3638 (0.4611)	-1.0675 (0.6415)*	-1.1291 (0.6425)*	-1.0926 (0.6401)*	-0.3210 (0.5272)	-0.3331 (0.5197)	-0.3630 (0.5219)
Trade open	2.6864 (0.4426)***	2.7249 (0.4452)***	2.6749 (0.4421)***	1.4296 (0.5340)***	1.3546 (0.5373)**	1.4056 (0.5326)***	2.2491 (0.4998)***	2.2747 (0.5055)***	2.2751 (0.5010)***
Growth	0.0882 (0.0346)**	0.0877 (0.0346)**	0.0883 (0.0346)**	-0.0040 (0.0379)	-0.0035 (0.0379)	-0.0045 (0.0379)	0.0303 (0.0296)	0.0309 (0.0298)	0.0284 (0.0297)
R ²	0.78	0.78	0.78	0.71	0.71	0.71	0.82	0.82	0.82
Countries	104	104	104	104	104	104	103	103	103
N	2,335	2,335	2,335	2,335	2,335	2,335	1,124	1,124	1,124

Note: All models are OLS with panel corrected standard errors and AR (1), intercepts, country and half-decade fixed effects. Models 10-12 use fiscal revenue, models 13-15 use fiscal expenditure, and models 16-18 use tax revenue as dependent variables. Numbers in parentheses are standard error. All independent variables are lagged one year. *** p <= 0.01; ** p <= 0.05; *p <= 0.1

BITs & Labor practices

- Panel data: 120 developing countries from 1985 to 2002
- DV: (i) labor practices (Mosley 2011)
- Controls: FDI inflow, trade openness, GDP per capita, democracy, per capita GDP growth, Population, Civil war, and International labor organization
- Model: OLS with PCSE, AR(1), country and half-decade fixed.

Table 3: The impact of BITs on collective labor practices

	Model 19	Model 20	Model 21
All BITs	-0.0399 (0.0134)***		
BITs with ICSID		-0.0440 (0.0203)**	
Adjust N-S BITs			-0.0648 (0.0207)***
Polity2	0.0501 (0.0248)**	0.0514 (0.0250)**	0.0508 (0.0247)**
Trade open	-0.6872 (0.3543)*	-0.7039 (0.3566)**	-0.6912 (0.3532)*
FDI/GDP	-0.0127 (0.0131)	-0.0126 (0.0129)	-0.0130 (0.0131)
GDP per capita	0.2444 (0.4676)	0.1284 (0.4556)	0.2290 (0.4730)
Growth	0.0044 (0.0088)	0.0040 (0.0089)	0.0042 (0.0088)
Civil war	-0.5721 (0.2849)**	-0.5713 (0.2841)**	-0.5674 (0.2845)**
Population	-0.0210 (0.0054)***	-0.0209 (0.0055)***	-0.0203 (0.0055)***
ILO	0.1096 (0.3159)	0.1253 (0.3154)	0.1046 (0.3151)
R^2	0.58	0.58	0.58
Countries	120	120	120
N	1,791	1,791	1,791

Note: All models are OLS with panel corrected standard errors and AR (1), intercepts, country and half-decade fixed effects. Numbers in parentheses are standard error. All independent variables are lagged one year. *** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$