Beyond Credible Commitments: (Investment) Treaties as Focal Points

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Introduction

Why do states enter into treaties? In literature on international economic relations, the dominant answer is that treaties allow governments to make credible commitments to traders, investors, domestic actors, and other governments. This view is particularly pronounced in the growing scholarship on investment treaties, but it has difficulty accounting for the establishment of the regime itself during the Cold War. This article will show that before the 1980s capital-exporting states mainly intended investment treaties to serve as salient focal points for investment disputes, where the parties had an interest in reaching a negotiated outcome. Rather than providing judicialized dispute settlement, sanctions and penalties to make credible commitments, Western architects of the regime expected the treaties to play a standard-setting role to be used in informal bargaining with host states. The aim was coordination rather than hands-tying.

The article makes three contributions. Empirically, it uses archival resources to explore the origins of the investment treaty regime in developed countries. This contrasts with almost all political economy literature on the regime, which has focused on the adoption and effects of investment treaties in developing countries from the 1980s onwards. In addition to the two largest capital-exporting states during the Cold War - the United States and the United Kingdom – the article also focuses on Germany, as Bonn produced the first-ever bilateral investment treaty (BIT), which in turn provided the template for later European BIT programs using similar boilerplate language. In these three critical cases, drafters had very different views on the function of investment treaties than the one portrayed in literature today.

The article also makes a theoretical contribution by putting focal points at the front and centre of a literature otherwise dominated by the credible commitment narrative. This includes the extensive scholarship on trade agreements, where the coordinating role of treaty obligations is often ignored or only alluded to in passing. By contrast, focal points play a core role in other areas of liberal institutionalist scholarship (e.g. Drezner 2009; Simmons 2011; Büthe and Mattli 2011) and the concept is being embraced in recent scholarship on international law as well (e.g.

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1 A notable exception is St John (2018).
2 Some exceptions are Goldsmith and Posner 2005 (ch. 5); Jupille, Mattli, and Snidal 2013.
Ginsburg and McAdams 2003; Goldsmith and Posner 2005, ch. 1; Huth, Croco and Appel 2012; 2013). Building on these insights fill important gaps in our understanding of the investment treaty regime and are likely to do so for other areas of international economic law as well.

Finally, the findings are not just of historical and theoretical interest. Capital-exporting states are currently struggling to respond to the growing pushback against investment treaties. The core concern is the potent investor-state dispute settlement (ISDS) mechanism, which by 2019 had resulted in about 1,000 international investor claims against states - more than half brought since 2009. ISDS is as close to a credible commitment as we come in international law, yet many states are now seeking to reign in the mechanism and some have begun to question the need for it all-together. The historical context is notable here, as early drafters of investment treaties did not regard judicialised dispute settlement as a core component of the treaties and therefore excluded ISDS, or saw it as less of a priority. Perhaps modern investment treaty drafters could find inspiration from their predecessors? And beyond the realm of investment, the cases also invite comparisons with other regimes, where opposition to judicialized dispute settlement is on the rise as well, such as human rights, international criminal law, and trade.

1. Investment treaties without credibility

ISDS is enshrined in the vast majority of investment treaties and to many present-day observers, the treaties would be largely irrelevant had it not been for this procedural avenue and its potential deterrent effect on states. Yet, ISDS was not part of the early investment treaty regime (Figure 1). Ad-hoc international tribunals allowed individual claimants at least since the early 20th century, including for investment disputes, and in the late 1950s the OECD produced a draft investment convention with ISDS at its core. But rather than following this model, Western states decided to rely on inter-state dispute provisions akin to those in trade agreements (some referred to the International Court of Justice, others to arbitration). The first investment treaty to include ISDS only came in 1968 and it was not until the mid-1980s that ISDS provisions became commonplace. And even then, some treaties still included a highly-circumscribed consent to the mechanism covering only few substantive obligations or questions.

![Graph showing total number of investment treaties with and without ISDS, 1948-1989](image)

**Figure 1. Total number of investment treaties with and without ISDS, 1948-1989**

*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. Sources: UNCTAD and UN Treaty Collection. On FCNs as BITs, see e.g. Vandeveld7 2017.*
This lack of investor standing in early investment treaties made the substantive obligations less likely to be subject to judicialized dispute settlement. States are generally reluctant to file claims against each other, and whereas the trade regime relies on inter-state mechanisms, this is typically on behalf of groups of exporters rather than an individual company. As a result, early investment treaties were unlikely to function as credible commitments (see generally; Levy and Srinivasan 1996; Sykes 2005), and they hardly ever resulted in judicialized dispute settlement.

This presents a puzzle for the standard narrative of the investment treaty regime, where the treaties are seen as part of a broader effort to craft international institutions that ‘make commitments to liberal economic policies more credible’ (Buthe and Milner 2008, 758) by imposing ex ante and ex post costs on signatories (Kerner 2009; Haftel 2010). More broadly, the absence of ISDS doesn’t fit standard expectations in rationalist literature on treaty design suggesting that states facing enforcement and commitment problems will include strong dispute resolution provisions in their treaties (Koremenos 2016). In fact, we should expect that mechanisms to provide reliable compensation in case of non-compliance would be chiefy important for any instrument intended as a credible commitment. North notes, for instance, that improving property right protections ‘means not only creating the formal rules but creating and implementing a judicial system that will impartially enforce such rules.’ (1993, 21). Yet, Western states didn’t follow this advice during most of the 20th century and even states that included ISDS provisions early on saw it as a relatively unimportant part of their treaty practice, as we shall see. This is in stark contrast to investment treaties from around the 1980s, when most states began regarding the mechanism as integral to their treaties. Many still do, as I will return to, yet even today a number of treaties have begun to exclude ISDS once again. This includes investment protection chapters in major Australian PTAs (including with the US and Japan), recent Brazilian BITs, as well as major regional investment agreements in Latin America and the Pacific.

Clearly the standard narrative of the investment treaty regime is missing part of the picture and the following sections will show that a focal point perspective is not just a theoretical solution to the puzzle of investment treaties lacking in credibility, but also corresponds more closely with the actual intent by Western states in the early years of the regime. Re-conceptualizing the treaties as focal points may even be helpful to understand many of the treaties that do include ISDS. For while these can act as credible commitments, that is not their only function.

2. The expressive power of investment treaties

Consider a stylized property right dispute between a foreign investor and a host government. Limited exit options give the investor a strong incentive to reach a negotiated settlement to avoid losing a significant share of the investment, or even all of it. The host state in this case is of a certain type that breaches its promises to foreign investors on occasion - hence the dispute - but wants to attract and retain foreign investment in the future. Following Tomz’ categorisation (2007, 16-28), this contrasts with states that attach no value to foreign investment and those that protect foreign assets at all times. Accordingly, while the state may have reneged on promises made to the investor it would also prefer a negotiated settlement as a breakdown in the relationship would send a negative signal to other foreign investors. An additional incentive to settle for the host state is to avoid conflict with the home state and international organizations (the World Bank considers uncompensated expropriation in its lending practice for instance). Finally, the home state is interested in a negotiated settlement as
well. For while it prefers an investor-friendly outcome - and may even bargain on its behalf – a breakdown in the negotiations could provoke unwanted diplomatic friction with the host state.

This may be a stylized scenario, but it is not unrealistic. During the Cold War, the focus of this article, foreign investors were subject to increased levels of government interference – particularly, but not only, in developing countries. Yet outside the Communist block only few states were outright hostile towards foreign capital. Even when foreign investment was expropriated, most states paid some compensation. Equally, while Western states typically provided some assistance to investors in distress – and occasionally used muscular diplomacy to bring about full compensation – they were often hesitant about getting dragged into ‘lowly’ investment disputes, as it could compromise broader foreign policy interests (Maurer 2013). They, too, preferred to avoid disputes escalating into diplomatic conflict in a sensitive international environment.

Table 1 provides an illustration in the context of a simple expropriation dispute with disagreement about the standard of compensation. There are four possible outcomes.\(^3\) The nature of the host state means that it prefers to pay compensation according to its own limited standard (B), but could agree to a compromise (A) or even the investor’s compensation standard (C) if that is what it takes to avoid a breakdown of negotiations (D).\(^4\) This resembles a simple hawk-dove game with the home state as an interested third party, where it is unclear which equilibrium the parties will settle on (see generally; Schelling 1960, 301-302).

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<th>Host state</th>
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<td>Settle</td>
<td>3, (1), 3</td>
<td>A: Compromise</td>
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<td>Settle</td>
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<td>B: Host state’s preferred standard</td>
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<td>4, (2), 2</td>
<td>C: Investor’s preferred standard</td>
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<td>Insist</td>
<td>-1, (-1), -1</td>
<td>D: Breakdown in investor-state negotiations</td>
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PAYOFFS: Investor, (Home state), Host state

TABLE 1. INVESTMENT DISPUTE AS HAWK-DOVE GAME WITH HOME STATE AS INTERESTED THIRD PARTY

Following Schelling (1960), this type of dispute incentivizes each party to make their preferred outcome stand out as ‘obvious’ or ‘correct’ - a focal point. One way to do this is by crafting a legal standard accepted by the parties on what constitutes cooperation and defection in the dispute. Law is not the only possible focal point, but its visibility and uniqueness often gives it a powerful expressive function that stands out as a coordination-enhancing devise – even in the absence of credible enforcement (McAdams 2015). Accordingly, if the investor and home state could make their preferred standard accepted as the applicable legal standard, they would be more likely to insist on that standard (play hawk), which in turn would increase the incentive for the host state to settle (play dove) so as to avoid a breakdown in negotiations. A similar argument can be found in work by Weingast and others on self-enforcing constitutions (Weingast 1997; Mittal and Weingast 2013). On this view, a core function of a constitution is to provide a salient focal point that citizens can coordinate around to avoid government

\(^3\) In practice negotiations would be over a continuous bargaining range, but this wouldn’t change the conclusions reached here.

\(^4\) Option C prevents a fiscal transfer to the state but could still be rational if the expropriation was for non-fiscal reasons and/or resulted in private benefits for powerful government actors who don’t bear the costs of compensation.
transgressions. Although the constitution does not guarantee successful coordination and will not always provide a clear answer of ‘what the law is’, it can induce coordination through bright-line demarcations on the limits of state power – including in property right disputes (Jacobi, Mittal and Weingast 2015).

In our scenario, however, the investor and home state are unlikely to accept the domestic law of the host state – which may even be the source of the dispute in the first place - and in the post-colonial era the domestic law of the home state could not be invoked as a focal point either. An alternative is to rely on international legal standards (see generally Garrett and Weingast 1993; Huth, Croco, and Appel 2012; McAdams 2015, 67-70), yet during the Cold War the international customary law on expropriation had become unsettled and thus less helpful as a coordinating device. Since the 19th century, Western states had successfully established compensation at market value as the customary international law standard for expropriation (corresponding with outcome C in Table 1), but during the post-colonial era many developing countries began pushing back arguing that international law only required limited compensation (corresponding with outcome B). The resulting uncertainty meant that unless the investor had secured a contract with the host state specifying otherwise, only expropriation without any compensation (corresponding with outcome D) would be an undisputed violation of the host state’s international obligations.

Enter investment treaties. If the home state could get the host state to adopt an investment treaty before the dispute arose, the investor’s preferred compensation standard would now – once again - be the ‘correct’ applicable international legal standard against which the behaviour of the host state would be judged. Even in expropriation disputes with uncertainty about how the legal standard should apply, the treaty would at a minimum imply greater compensation than the standard of the host state (corresponding with compromise A). This, again, would make the host state’s preferred outcome less focal and ‘set the stage’ in favour of the investor. Beyond the specific investor-state state bargain, the treaty could serve a coordinating function for other relationships as well. It could be useful for international organisations and other home states engaging with the host government on property right questions. It could also provide a domestic law substitute for actors within the host state seeking to avoid transgressions of private rights by the executive, be they domestic investors or – more likely - branches within the host government itself. Finally, and importantly, if the treaty was part of a network of similar treaties using boilerplate language, it would further enhance its coordination function, not just in disputes with the host state but also in disputes involving third states having adopted similar treaties. Such a network effect would be even stronger if other home states also adopted treaties with similar standardized terms (Montt 2009). In the extreme, a sufficiently standardized and global network of investment treaties could help re-establish the Western standard as customary international law.

In short, an investment treaty could help resolve our stylized dispute in the investor’s favour. Even if the treaty is not expected to be used directly through judicialized dispute settlement, it could help indirectly by (re-)establishing the Western standard of compensation as the focal point in investment disputes in the presence of an unclear status-quo (customary international

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5 Following McAdams (2015), I focus on how (international) law can provide coordination-enhancing information. For a thicker description of ‘expressive international law’ highlighting also norm development and socialization, see e.g. Hathaway 2002.

6 Almost all investment treaties include the so-called “Hull standard” of ‘prompt, adequate, and effective’ compensation – or an equivalent standard - with “adequate” typically interpreted as the full value of the expropriated investment at the time of the taking plus interest.
law). Just as a Constitution can provide pre-negotiated default solutions domestically, the treaty can provide a similar function on the international plane.

This is a different conceptualisation of investment treaties than the standard narrative dominated by concerns with enforcement. But there are also theoretical overlaps (see Elkins, Guzman, and Simmons 2006, 823-4). An investment treaty is more credible when breaches risk diplomatic friction and/or reputational costs among relevant audiences (foreign investors, international organizations, other governments), yet the same risks also make treaty compliant behaviour more focal. And just as an investment treaty can help solve domestic commitment problems for host state actors wanting to tie their own hands, the same actors can also use the treaty as a coordinating focal point (e.g. as an alternative to their own domestic law). As such, investment treaties can act both as hands-tying and coordination devices by allowing state actors to credibly commit to their preferred focal point.

Yet, credibility is not a necessary condition for focal points to be relevant and that has important implications. Two stand out. First, third-party dispute settlement is much less important for treaties intended as focal points as the substantive obligations are expected to self-enforcing even without the shadow of international litigation. The main function of dispute resolution provisions in treaties intended as focal points is to allow for tribunals to provide more salient cues in the presence of opposing claims (Ginsburg and McAdams 2003; see generally Schelling 1960, 78). This can be an important role for vague provisions where tribunals have to ‘fill in the blanks’ - such as provisions on ‘indirect expropriation’ or ‘fair and equitable treatment’ - but it is a much more limited role than in treaties intended as credible commitments, where international dispute resolution is critical to increase the costs of non-compliance. Accordingly, the ability of ISDS to impose fiscal and sovereignty costs on the host state is the main reason why (modern) investment treaties have been portrayed overwhelmingly as credible commitments. Second, while treaties intended as credible commitments are valuable for the investor and home state wherever there is need for enforcement, treaties intended as coordination devices are valuable only with host states that want to avoid escalation of disputes.

3. The architects of the investment treaty regime: The United States, Germany, and the United Kingdom

To assess these arguments, I turn to the early investment treaty programs of the United States, the United Kingdom, and Germany. Apart from being the most important programs among Western states during the Cold War, the three cases also vary on a crucial dimension: dispute resolution. While the US and Germany excluded ISDS provisions from early investment treaties, most UK investment treaties allowed for ISDS. As the history of European investment treaty programs have been subject to less focus than the US program (Vandevelde 2009; 2017; St John 2018, ch. 7), I compiled all negotiation and investment treaty policy files made available from the German and UK lead agencies – the German Federal Foreign Office and the UK Foreign & Commonwealth Office (FCO) – in addition to a few files from other relevant agencies. This covered the vast majority of negotiations before the archival closure periods and since the two agencies also led on inter-departmental coordination it covered views from other agencies as well.

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7 Although not the subject of this paper, host states would find the treaties helpful to adopt nevertheless as long as the expected benefits (e.g. more investment) outweighed expected costs (see generally Poulsen 2015).
As we shall see, drafters in all three countries carefully drafted the treaties to provide meaningful investment protections that could be useful in certain types of host states. Yet, the relevance of the treaties was not expected to come through the threat or use of formal dispute resolution mechanisms, but rather through their standard-setting function. This is a distinctly different view of the treaties than the one portrayed in modern literature dominated by concerns with formal dispute settlement and enforcement. More broadly, it cautions against equating international property right rules solely – or even mainly - as a credible commitment device.

**United States**

Shortly before the end of the Second World War, the Roosevelt administration decided to initiate a network of bilateral trade and investment agreements. The result was so-called FCN agreements. The treaties had several motivations and were more complex and multi-faceted than BITs, but their main aim was the protection of American investment. Provisions not directly related to investment - such as trade and employment rights – were ultimately targeted towards investment as well. A former American negotiator notes, ‘[i]n a real sense … the FCN treaty as a whole is an investment treaty; not a mosaic which merely contains discrete investment segments.’ (Walker 1956b, 244). The objective was to provide international equivalents to the property right protections in the American Constitution, particularly the Takings Clause and its associated jurisprudence (Vandevelde 2017, ch. 1).

This is telling. As already mentioned, a core function of Constitutions is to provide focal points for property right violations. More specifically, the Takings Clause in the US Constitution is a prime example of a provision intended as a focal point by ‘helping to create shared expectations over what constitutes transgression by the government’ (Jacobi, Mittal, and Weingast 2016, 620). In the same way, the expectation was that FCN agreements with ‘like-minded countries … should be conducive to the development of international standards of practice, not to say the crystallization of principles of international law, with respect to the treatment of companies’ (Walker 1956a, 393). As in the US Constitution, the language was not crystal clear – that would be difficult – but the aim was to make the treaty standard focal when American investors resolved expropriation disputes abroad.

Despite being drafted to address investor-state disputes, judicialized dispute settlement played only a peripheral role in the FCN program. The compromissory clause in the 1955 treaty template noted that disputes ‘not satisfactorily adjusted by diplomacy’ should be referred by the parties to the ICJ ‘unless the Parties agree to settlement by some other pacific means.’ The clause was important for principled reasons - the US strongly supported the ICJ – and was only excluded on one occasion (with Sultanate of Muscat and Oman). But actual use of it was expected to be extremely rare as formal dispute settlement was seen as ‘all but unavailable as a practical matter’ (Vandevelde 2017, 538; see also Connell 1961, 272). Hardly any ink was spent on dispute settlement clauses in a US negotiator’s comprehensive introductions to the agreements (Walker 1957a; 1958b), and the secondary role of judicialized international dispute settlement also came through in discussions with treaty partners. The US noted to Germany, for instance, that the expectation was that the treaties ‘would operate smoothly’ without any need for third-party adjudication, and ‘any problems arising would ordinarily be reviewed and settled bilaterally through the normal process of diplomacy’ (Vandevelde 2017, 529).

Although the State Department wanted a wide network of FCN agreements in countries where additional investment protections could be necessary, negotiations were only initiated with friendly and like-minded states. Because if a host state did not have a genuine interest in
resolving an investment dispute through an amicable process, the treaties were regarded as largely useless (Walker 1958b, 78). But for states that occasionally posed a risk to US investors yet cared about foreign investment and friendly diplomatic relations, the treaties were expected to provide an expressive function on substantive investment protections ‘with a view to better clarity and conciseness, fewer ambiguities and qualifications’ (Walker 1958a, 79). This is exactly the strategy one should expect if the treaties were intended as focal points.

Germany

In Europe, the patterns were similar. After losing almost all their overseas assets after the Second World War, German investors were keenly aware of the importance of international property right protections and the absence of former colonial links left German investors in a weak position compared to French and British investors (Burkhardt 1986, 99-104). Germany therefore decided to initiate an investment treaty program, which was legally tied to its new investment insurance scheme – thereby making the treaties important for German firms seeking political risk insurance in countries not otherwise considered safe jurisdictions – and intended to ‘treatify’ Western investment protection standards. Not only would this be useful in individual disputes. If enough treaties could be signed, a ‘quasimultilateral treaty-system’ could re-shape the international customary law on foreign investment along Western preferences (Alenfeld 1971, 26).

The German program was developed alongside proposals for a global investment treaty backed up by ISDS. The suggestion came from Deutsche Bank’s Chairman, Herman Abs, and his German Society to Advance the Protection of Foreign Investment. Abs admonished the cautious attitude of Western states towards property right disputes abroad and saw little promise in copying American FCN agreements as they didn’t have an effective dispute resolution mechanism (Abs 1957). He wanted a more credible commitment device. By 1958, a draft Convention had been drawn up together with UK lawyers Hartley Shawcross – Shell’s Head of Legal and former attorney general – and Elihu Lauterpacht. But no states wanted to sign up and OECD’s revised convention with more limited ISDS options - mentioned above - didn’t get off the ground either. Abs also failed to convince the European Economic Community to sign joint investment protection treaties with ISDS and his own government explicitly refused to include ISDS in its bilateral agreements. Even if it could be pursued in principle, the German Ministry of Justice wanted there to at least be an exhaustion of local remedies rule – as in the European Convention of Human Rights - and 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’. This line was followed. Bonn closely followed discussions about foreign investment dispute settlement, but the German treaties – the first BITs – excluded recourse to ISDS.

The concern by the German Foreign Ministry was not unrealistic. Allowing investors to file treaty claims can come with costs for home states, as they cede control with treaty disputes (see generally; Levy and Srinivasan 1996). This will be a cost for the home state when the

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8 In practice, American investors that were refused reasonable settlements often managed to lobby the US government to impose sanctions, sometimes at the expense of core US foreign policy interests (Maurer 2013).
9 See e.g. Volkswagen’s request to finalise treaty with Romania; Bundersarchiv Koblenz (BK) 102/211675.
10 ‘Magna Charta for investment interests asked,’ American Banker, 16 October 1957. See also; BK 102/130141.
11 Politisches Archive des Auswärtigen Amts (PAAA), B56-61.
12 Meyer-Lindenberg quoted in ibid.
13 BK 106/39371-II.
preferences of the investor and home state diverge, for instance if the investor wishes to pursue legal arguments that could come back and ‘bite’ the home state in subsequent claims or initiate proceedings that risk antagonizing diplomatic relations between the home and host state. So; whereas ISDS provisions can make the commitments credible and will almost always be hailed by investors – as it was by Abs - they are not an unmitigated good from the perspective of home states. For investment treaties intended as focal points, traditional inter-state dispute settlement suffice even if it makes international litigation much less likely in practice.

Even formalized inter-state dispute settlement was not considered crucial in the early years. It rarely came up during negotiations, and in his extensive notes on the early program, a lead German negotiator spent little ink on judicial dispute settlement. The treaties’ strength mainly came from partner countries wanting ‘to avoid being accused of a breach’ of their international legal obligations, and since arbitral tribunals could produce unwanted decisions it was preferable to work towards reasonably precise rules.

A few years into the German BIT program, the World Bank sought to promote the International Centre for the Settlement of Investment Disputes (ICSID) as a forum to resolve treaty-based investment claims. By managing the majority of ISDS claims, ICSID has been the centre of the storm of recent controversies over the investment treaty regime. But during the 1960s, it was seen as largely irrelevant and while Bonn responded that the ICSID mechanism might provide a useful complement to the treaties (St John 2018, 164), it was ultimately excluded from Germany’s BIT program. Only from 1979 did Germany begin to include ISDS, and that too only inconsistently until the late 1980s. Before then, Bonn had signed two FCN agreements and more than 40 BITs without ISDS.

When Germany initially did begin to allow investors to pursue treaty claims, this was not considered critical for the treaty program (somewhat at odds with initial concerns about this possibility a few decades earlier). When Panama asked about the potential implications of an ISDS provision, for instance, the German response was that actual treaty disputes were rare and always resolved through diplomatic means. Bonn found at least a limited consent to ISDS regarding expropriation questions helpful in socialist countries, which is not surprising given their history of uncompensated expropriation, but when it was discussed with Romania, the Soviet Union, and Bulgaria it wasn’t described as a major revolution in German treaty practice. When Uruguay asked for a more limited pre-consent, this was accepted as well.

By the mid-1980s ISDS was seen as increasingly useful for Bonn but was only included in the German model by 1987.

By contrast, uniformity across the German treaty network based on the boilerplate model was an explicit aim of Bonn, particularly for core substantive provisions like the expropriation clause. When counterparties objected to the expropriation clause, or wanted it watered down, Germany was no longer interested in a treaty. Changing the core substantive standards in the

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14 An exception was negotiations with Portugal, where unresolved expropriation disputes became a critical issue; PAAA Zwischenarchiv (PAAAZ) 121355.
15 Kern in; BK 106/39371-II.
16 PAAA 121347; see also BK 102/272922.
17 BK 102/211675; BK 102/2272885; BK 102/2426576; BK 102/2239107; BK 102/380241; BK 102/380242; BK 102/272872.
18 BK 102/392304.
19 E.g. BK 102/272923.
20 PAAAZ 121375.
21 PAAA, B33/322; PAAAZ 121341; PAAA, B33/15164; BK 102/272872.
treaty would undermine their role as focal points and question German positions on customary international law on investment protection. Bonn also told Nepal it had to accept the German definition of full compensation for expropriation, as this ‘makes it easier to determine the amount of compensation and thus helps to prevent disputes later’. 22 Another core provision was the transfer clause; included to provide protections against capital controls. Whereas some compromises could be reached on how long host states could delay the transfers, 23 the provision had to be clearly drafted so as to offer clarity about the protections offered. By contrast, the vague international standard of fair and equitable treatment has proven critical after the rise of ISDS but was considered unimportant at the time and excluded from a significant number of agreements (Hepburn et al. 2019). This is as expected if the German government was more interested in provisions offering clear ‘red lines’ that could act as coordinating devices.

The United Kingdom

The same pattern emerges in the United Kingdom. Starting in the early 1970s, Whitehall was a late-comer to the investment treaty movement. It had signed a few Commercial Treaties with expropriation provisions since the 1950s, 24 but developing countries’ increased efforts to question Western expropriation standards made London initiate a more ambitious BIT program along German lines.

As in Germany, architects of the program within the FCO regarded the treaties as instruments to treatify the Western view of customary international law on investment (Denza and Brooks 1987). 25 What mattered most was a clearly drafted expropriation provision that could act as a focal point. 26 The model investment treaty, an official noted, ‘very largely seeks to restate the principles of international law to which we attach importance regarding expropriation.’ 27 And even if some negotiations would fail, which many did, the UK government saw them as useful to have clarified the UK position on compensation for expropriation. 28 Much vaguer provisions hardly came up during negotiations. This should come as no surprise. For whereas broad and vague provisions backed up by enforcement can significantly increase the value of a treaty intended as a credible commitment – as revealed by many recent ISDS claims – such provisions are much less important for treaties intended as coordinating devices. The primary purpose of the fair and equitable treatment, for instance, was to act as a sort of ‘catch-all’ that perhaps could be ‘helpful to our Missions in the event of trouble after the conclusion of an Agreement.’ 29

Unlike German BITs and US FCN agreements, however, Whitehall’s model did allow for ISDS based on ICSID rules. But although the UK had found treaty-based ISDS a helpful idea since it was floated in connection with the ICSID Convention in the early 1960s, 30 the mechanism was not regarded as critical during the actual treaty program in the 1970s. In the 1971 Whitepaper which laid the ground for the British program, the core argument for the treaties relating to dispute settlement was that: ‘The existence of an agreement would provide an extra

22 PA AA, Zwischenarchiv 121341.
23 PAAAZ 121312.
24 BT 11/2864.
25 See also; FCO 59/630; FCO 69/662.
26 See e.g. discussions with Sierra Leone, FCO 69/692.
27 FCO 59/699.
28 FCO 59/948.
30 T 312/251.
pot on which HMG might base its intervention in cases of discrimination against British investment.\textsuperscript{31} The intervention was mainly expected to be made by the government, not the investor, and it was to be informal.\textsuperscript{32} This expectation remained up through the 1970s.\textsuperscript{33} The aim was to have treaties in place that British officials abroad could use ‘when they had to make representations for the protection of UK private investment.’\textsuperscript{34} Rather than iron-clad commitments enforceable by investors themselves, investment treaties were intended as coordinating devices to be used by British diplomats.\textsuperscript{35} In fact, UK officials had only decided to include the ISDS provision into the agreement in the first place because they were urged to do so by the World Bank.\textsuperscript{36} The provision was seen as a technical innovation, not a major departure from German practice, and without the advocacy of the ICSID secretariat, it is doubtful the early British investment treaties would have even included it (St John 2018).

ISDS rarely came up during negotiations during the 1970s, and when Romania objected to ISDS Whitehall agreed to exclude the arbitration provision ‘bearing in mind that the UK model regards the provision for reference to [ICSID] as desirable but not essential.’\textsuperscript{37} The UK also excluded the ISDS provision from a later agreement with Thailand and agreed to China’s highly circumscribed ISDS provision.

For the UK, therefore, the aim with its early investment treaty program was not to allow for potent investor claims, but rather to set substantive standards that could help facilitate interstate deliberations. A focal point perspective also explains Whitehall’s choice of treaty partners. The UK approached states where investment was at risk – so as to benefit ‘the interests of UK investors’\textsuperscript{38} - but stayed largely clear of developing countries with ‘uncompensated expropriation disputes’ or ‘where the country did not welcome foreign investment’.\textsuperscript{39} This was not just because they were unlikely to agree to the agreements in the first place, but also because the treaties were not seen as sufficiently costly for partner countries intent on going after UK assets.\textsuperscript{40} Instead, they were primarily intended to serve an expressive function by ‘giving precision to the standards to be observed’ (Denza and Brooks 1986, 913).

In short; just as American architects of FCN agreements did not conceive of the treaties as credible commitments, neither did European architects of BITs. Rather; the substantive treaty standards were primarily intended as salient focal points to be invoked through informal dispute settlement. Even when enforceable ISDS provisions were included, they were seen as relatively unimportant. This clashes with the standard narrative of investment treaties as credible commitment devices and re-directs our attention to the treaties’ coordinating role.

4. Beyond focal points

ISDS increased in importance for Western drafters around the 1980s. When the US renewed its moribund FCN program in the early 1980s Washington enshrined ISDS into its new model
BIT, and European BITs also increasingly incorporated ISDS at this time. Germany added ISDS to its model in 1987 and although open to significant limitations the mechanism was now seen as important.41 This new-found preference for ISDS started before any treaty-based ISDS claims had been brought and private investors hadn’t begun lobbying for ISDS on a grand scale either (Poulsen 2015). The nature of investment disputes - and thus the underlying cooperation problem - also remained the same as before. If anything, investment disputes had become less concerning as the post-colonial wave of expropriation had ended by the mid-1980s. And whereas some later US BITs were mainly intended to lock in domestic reforms in partner states, a commitment problem, this only began in the early 1990s (Vandevelde 2009). Finally, the archives don’t suggest that Western drafters were disappointed in the effectiveness of agreements lacking ISDS. As long as partner states remained committed to foreign investment and upholding treaty commitments, the treaties were seen as useful for informal dispute settlement.42 US officials continue to rely on FCN agreements when engaging with host states to this day, and former German and British officials note that even later BITs with ISDS were mainly used as points of reference in informal dispute settlement up through the 1990s.43 Why, then, did ISDS become a critical part of treaty programs already in the 1980s? Neither existing literature nor the archives offer a clear answer,44 so while it is beyond this article to assess, a few concluding considerations can set the stage for future work.

Two plausible reasons are rooted in diffusion mechanisms. The first is learning. While the ICSID Convention did not invent ISDS, it did make it a more readily available institutional option, and the World Bank spent considerable effort during the 1970s persuading governments to enshrine ISDS (based on ICSID) into their investment treaties, including through model treaty clauses (St John 2018). Also, while the first treaty-based ISDS claim was not brought until 1987 and there were few awards until the early 2000s, it is often overlooked that the 1980s actually saw the emergence of ISDS on a grand scale; namely through the Iran-US Claims Tribunal set up in 1981 to resolve around 1,000 investor-state claims after the Iranian revolution. This political and legal experiment had a significant impact on international investment law and became a posterchild for ISDS as de-politicized dispute settlement.45 Apart from the general lessons derived from the tribunal, future work could consider whether the many leading practitioners and law firms involved may have helped ‘sell’ the idea of ISDS up through the 1980s.46

*Competition* could have played a role as well. Just as developing countries competed for capital when adopting BITs, developed countries ‘competed for protection’. The US initiated its BIT program to match the spread of European treaties (Vandevelde 2009) and European states themselves also began BIT negotiations to keep track with other countries’ BIT networks to

41 See e.g. BK 102/380241; BK 102/380242; BK 102/29578.
42 E.g. FCO 59/1444; Memo from Hansell and Katz, August 10, 1977, US 2788553 (St John 2018b).
43 Interviews with former US, German and UK negotiators, July and August 2017.
44 ISDS doesn’t feature prominently in preparatory works on the US BIT program, for instance, and St John notes how contractual ICSID claims pursued by US investors infuriated the State Department just a few years before the program began (2018, ch. 7).
45 It was not an entirely peaceful mechanism; the tribunal almost shut down after a Swedish judge was physically assaulted by two Iranian arbitrators in 1984.
46 A number of US legal officials involved in IUSCT later became part of the small elite circle of ISDS practitioners (e.g. Price, Clodfelter, Reed, Alvarez, Salans). Notable European lawyers were involved as well; such as Bethlehem (later chief legal advisor to the FCO), Lloyd-Jones (later UK Supreme-Court Justice), Bockstiegel (later President of the German Association of International Law (Bockstiegel), and Dolzer (later BIT negotiator and Director-General of the Office of the Chancellor). I am grateful to JusMundi for data on IUSCT arbitrators and counsel.
ensure a level playing field. A similar dynamic took place with treaty design – the question here – as drafters routinely assessed BITs signed by other capital-exporting states when considering the ‘strength’ of their own agreements. So, once some countries began enshrining ISDS provisions into their BITs, the perceived costs of excluding the mechanism would have increased for other capital-exporting states. For the US, for instance, the presence of ISDS in some European programs meant a strong US investment treaty had to have it as well. Even if treaty drafters could not appreciate just how potent the mechanism would turn out to be, a ‘competition for protection’ would explain why ISDS gradually changed from a mere technical innovation to a critical feature.

Finally, norms almost surely played a role. This article has offered a ‘partial equilibrium’ analysis of investment treaties and bracketed broader developments in international law. Yet, the emergence of enforceable dispute settlement mechanisms was part of a broader phenomenon in international law during the 1980s, and it was also around this time a number of other regimes began allowing private actors to pursue international claims. Equally, part of the recent opposition towards ISDS may be partially rooted in an emerging scepticism towards international courts and tribunals. Accordingly, future work should clarify how domestic political preferences towards investment treaties and their design relate to underlying norms towards judicialised dispute settlement in international law.

**Conclusion**

Work on both credible commitments and focal points goes back to Thomas Schelling. But whereas major research programmes on the politics of international economic law (IEL) are rooted in the first idea, we know less about how IEL can induce coordination in the presence of distributional conflict and lacking enforcement. This article helps fill this gap by showing how one of the usual suspects in the credible commitment literature, investment treaties, were mainly seen as coordination-enhancing focal points for decades and drafters designed them accordingly. Future work may reveal different approaches among other capital-exporting states than those covered here - or at least provide important nuances – but the early investment treaty practice of the US, Germany, and the UK raises broader questions about how IEL scholars could benefit from paying closer attention to Schelling’s second big idea.

Focusing on trade and investment law, four questions stand out. First, is IEL more likely to induce coordination within certain issue areas or among certain actors? What is the role of regime complexity, for instance, if competing focal points exist within an issue area (Drezner 2009)? Second, what can states do to enhance treaties’ coordinating role? Are more precise obligations more conducive for coordination, and what is the role of dispute settlement mechanisms? In the trade regime, for instance, institutionalised mechanisms for informal dispute settlement (e.g. the WTO committee structure) have received little attention in empirical scholarship even though trade agreements often exclude important disciplines from third-party dispute settlement or fail to specify enforcement mechanisms in case of non-compliance, thereby reducing credibility.

Third, when is bringing economic disputes to international adjudication about imposing ex post costs on non-compliance, and when is the aim to rely on tribunals’ ‘expressive function’ to assist with coordination and avoid conflict (see generally; Ginsburg and McAdams 2004).

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47 E.g. FCO 59/943; FCO 50/1196.
48 E.g. BK 102/272921; US 2788553 (St John 2018b); FCO 59/630.
49 Correspondence with former US BIT negotiator, April 2019.
Empirical work has only begun to ask these questions in recent years (Davis and Morse 2018; Wellhausen 2019). Finally, how do functions of IEL vary over time, and what does this mean for treaty design and politics? This article has shown how the function of investment treaties has shifted over the last 70 years – from focal points towards credible commitments and for some important treaties now back again. But trade agreements are changing too. As more tariff lines approach zero, the battleground of trade policy becomes less about locking in market access and more about competing regulatory standards. This makes the politics of coordination more relevant than ever.

Finally, the findings are not just of theoretical and historical curiosity but could have important practical implications. The controversy surrounding ISDS has made it ever-more difficult to conclude new investment treaties. The paper offers no insights on whether this development or ISDS in general is normatively desirable, but it does suggest that a way forward could be to re-think the role of the treaties as focal points. In practice, this would mean going beyond just ‘patching up’ substantive provisions – as in most renegotiations (Thompson, Broude, and Haftel 2019) – to also exclude, or materially limit, recourse to ISDS. The standard credible commitment narrative implies that this would make the treaties largely irrelevant for investor-state relations in practise, but the early foundations of the investment treaty regime remind us that treaties can play a coordinating role for international economic disputes even in the absence of credible legal enforcement.
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