Strategized Exit: Sunset Clauses & Unilateral Terminations of BITs

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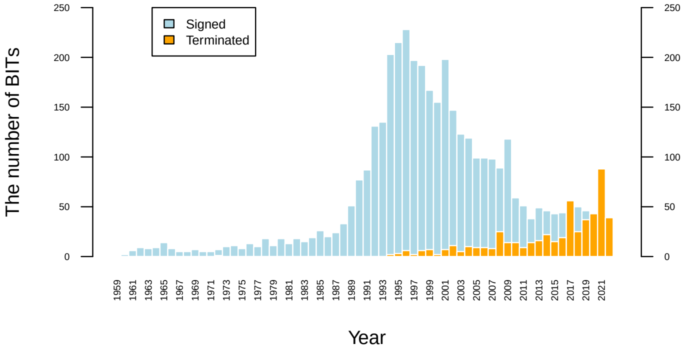
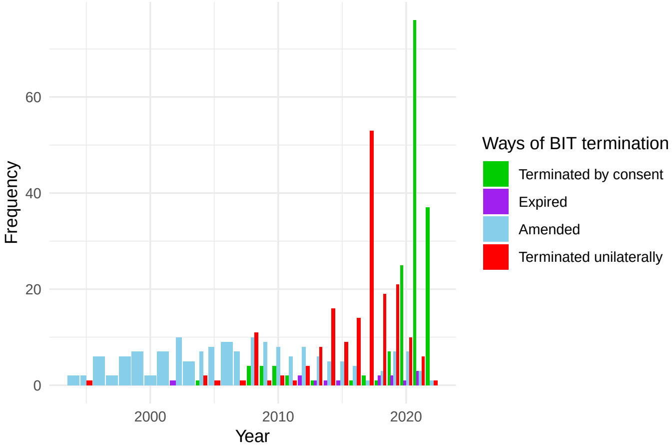
Motivations: Rising Trend of BIT Termination[1]



[1]Source: UNCTAD. Last updated in Dec. 2022

Motivations: How Have States Been Exiting BITs?[2]



[2] Source: UNCTAD. Last updated in Dec. 2022

Overview: Puzzle & Argument

The puzzle

Under what conditions would states unilaterally terminate BITs?

My argument

States may unilaterally terminate BITs to increase their leverage in bargains over future terms of investment agreements.

Overview: Approach & Findings

Empirical approach

- 473 BITs across 112 countries and 50 years
- Original data on sunset periods and BIT terminations

Findings

- Longer sunset period increases the likelihood of unilateral termination of BITs.
- Declining economic growth amplifies the effect of sunset period on the likelihood unilateral termination of BITs.

Controversy over BITs

- Criticism against BITs: exorbitant costs on host countries; privilege to foreign investors
- Some countries chose to either not join or leave the network of global investment regimes
  - Examples: The withdrawal of Venezuela and Bolivia from the ICSID Convention

Unilateral Termination as an End?

- However, many more countries have been terminating some of their BITs without completely leaving the network
  - Examples: India and Indonesia have been releasing new models of BITs and renegotiating for new BITs

$\Longrightarrow$ Unilateral termination & renegotiation are often intertwined

Policy Options to Challenge Existing BITs

The three ways to exit an active BIT

- Replacement
- Mutual termination
- Unilateral termination

Sunset clauses in BITs

- Allow existing foreign investors to continue being covered until the clauses expire.
- Sunset period varies from 5 to 20 years.

Policymakers' tradeoff

Waiting for partner country to agree with termination

$\Leftrightarrow$ being constrained by BIT obligations for a period of "sunset"

Causal Mechanism: Discriminatory Effect of Sunset Clause

- A host state can discriminate against future investors from its treaty partner
- Longer sunset clause, once invoked, can undermine bilateral investment relations to a larger extent
- An invoked sunset clause will put the host government in a better position in future negotiations with the partner country

Core Argument: A Strategized Exit

- Unilateral termination as a coercive strategy implemented by states that seek to reform their BITs
  - Longer sunset clauses provide bargaining leverage to host countries
- Countries that need this strategy most are those that have declining growth thereby decreasing bargaining leverage

Hypotheses

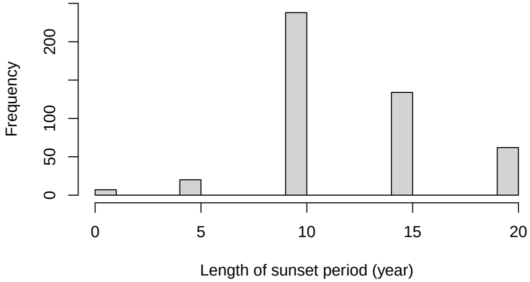
H1: The longer a BIT's sunset period, the more likely the BIT's sunset clause would be invoked.

H2: The relationship between sunset period and unilateral termination of BIT is conditioned upon economic growth. The higher the economic growth of a host country, the less the effect of sunset period on unilateral termination of BIT.

Data & Variables

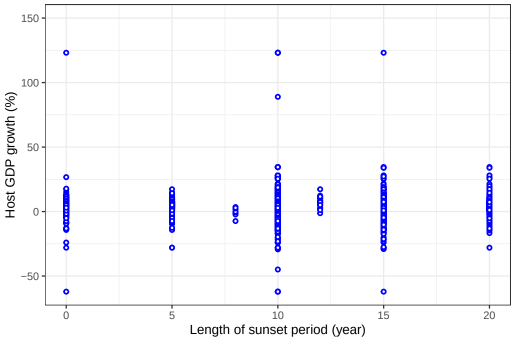
- 473 BITs across 112 countries and 50 years
- Original data on the length of sunset clauses and the ways in which BITs were terminated
- Binary dependent variable: whether the BIT was unilaterally terminated
- Two key independent variables:
  - The length of sunset period
  - Host country's annual GDP growth rate (lagged)

Dependent Variable



The frequency of sunset periods for all sunset clauses in the sample

Independent Variables



The sunset period of BITs and the annual GDP growth rate of host countries across years

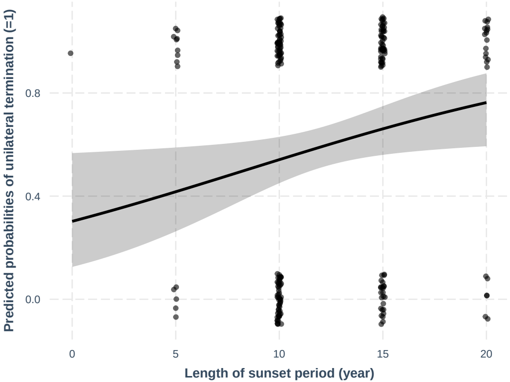
Other variables

- Control variables
  - The cumulative number of investment disputes where the host country was a respondent (logged)
  - The annual GDP growth rate of the home country (lagged)
  - The gap of economic strength between the two signatory countries of BIT (lagged)
- Confounders
  - Democratization of the host country (lagged)
  - Government stability of the host country
  - Intra-EU
  - Year (cubic polynomial)

Model

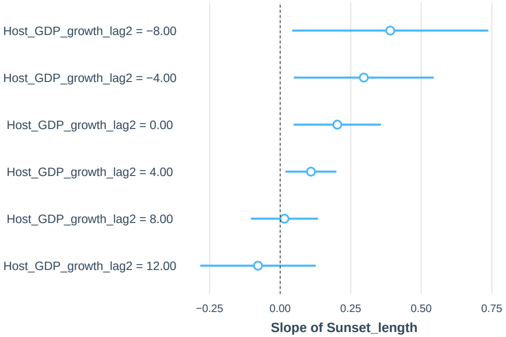
- Logistic regression model
- Standard errors are clustered by country dyad

Finding 1: The Positive Effect of Sunset Period on BIT Unilateral Termination



Finding 2: Declining Economic Power Amplifies the Effect of Sunset Period

Economic growth diminishes the effect of sunset period on BIT unilateral termination



Key Findings

- Strong, postive correlation between sunset period and BIT unilateral termination, conditioned by host economy's growth
- Longer sunset clauses provide additional negotiating leverage to host countries
- A host country experiencing negative GDP growth may exit strategically for the sake of bargaining leverage

Broader Implications of Research

- Exit may be part of a long-term renegotiation process
- States can use the ultimate bargaining chip of exit threat to push for institutional reforms
- Countries lacking channels of influence may use lock-in institutions at their advantage

Next Steps

- What explains the inclusion and settings of sunset clauses?
- Institutional design as another part of my larger project

Thank you very much!

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The Case of Indonesia-Singapore BIT

- In 2016, Indonesia unilaterally terminated the 2005 Indonesia-Singapore BIT $\rightarrow$ 10-year sunset clause
- A new BIT signed in 2018 and ratified in 2021
- Singapore has been Indonesia's top source of foreign investments

Logistic Regression Results

	Dependent variable: Unilateral termination of BIT (=1)				
	(1)	(2)	(3)	(4)	(5)
Sunset length	0.090^{**}	0.203^{**}	0.207^{**}	0.192^{**}	0.224^{**}
	(0.043)	(0.079)	(0.081)	(0.081)	(0.103)
Sunset length * Host GDP growth$_{t-2}$		-0.023^{*}	-0.023^{*}	-0.020	-0.030
		(0.013)	(0.014)	(0.014)	(0.018)
Host GDP growth$_{t-2}$	0.028	0.318^{*}	0.317^{*}	0.284^{*}	0.424^{*}
	(0.038)	(0.166)	(0.169)	(0.171)	(0.232)
Host ISDS resp cum (logged)	0.176	0.240	0.163	0.033	0.220
	(0.188)	(0.192)	(0.201)	(0.218)	(0.254)
GDP gap$_{t-2}$	0.432^{**}	0.449^{**}	0.405^{**}	0.371^{*}	0.466^{*}
	(0.181)	(0.182)	(0.186)	(0.212)	(0.254)
Home GDP growth$_{t-2}$	-0.105^{*}	-0.118^{**}	-0.122^{**}	-0.139^{**}	-0.230^{***}
	(0.055)	(0.056)	(0.058)	(0.063)	(0.077)
Host democratization$_{t-2}$			-0.545	-0.806	-0.857
			(1.707)	(1.668)	(1.734)
Host gov stabilty				-0.306^{*}	-0.355^{**}
				(0.158)	(0.171)
Intra EU					-3.845^{***}
					(0.752)
Year	0.196^{***}	0.192^{***}	0.212^{***}	0.196^{***}	0.228^{***}
	(0.039)	(0.039)	(0.042)	(0.044)	(0.049)

Note: $^{*}p < 0.1$; $^{**}p < 0.05$; $^{***}p < 0.01$.
All models are logistic regression. Standard errors are clustered by country and shown in parentheses.