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Learning from Brazil's bilateral investment treaties[*]

by

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The surge in FDI over the past three decades has been accompanied by a surge in bilateral investment treaties (BITs). The latter could be seen as a reaction to the former—or its cause, due to the protections that BITs offer to foreign investors. The rise in BITs has also caused a surge in the scholarly literature investigating their impact on FDI flows, which still provides mixed findings.[1] Yet, the literature has neglected the case of Brazil, a country that has attracted increased FDI flows despite not ratifying any BIT. Consequently, Brazil has been used as an example that BITs do not have any effects on FDI inflows and, hence, that countries can do without them.

Even though Latin American countries were reticent to negotiate BITs, influenced by the Calvo doctrine's underlying belief that foreign investors should receive the same treatment as domestic investors, all countries in the region eventually ratified multiple BITs. Brazil signed fourteen BITs in the early 1990s, yet the Brazilian Congress never ratified them. The opposition feared that most-favored-nation provisions jeopardize Brazil's sovereignty by offering preferred terms to foreign investors and, most importantly, that investor-state dispute settlement (ISDS) was incompatible with the constitution. Brazilian officials argued at the time that the inexistence of BITs had not affected the country's position as an important FDI destination. Brazil's stable domestic legal regime and the strength of Brazil's economy were arguably the reasons why. In the absence of a clear negative impact on FDI inflows, Brazil did not seem to have the crucial pressure other countries had when considering entering into BITs. Brazil became the example that a major host country does not need BITs to attract FDI if it has a strong economy and proper domestic protections for foreign investors.

Analyzing Brazil's BITs position on FDI inflows meets with the obstacle that there are no two countries that resemble each other in all factors that impact FDI inflows. The synthetic control method allows construction of a hypothetical version of Brazil as a weighted average of the available control units, consequently enabling a better comparative analysis.[2] The factors considered in this analysis are the main covariates used in the literature,[3] the strength of domestic institutions and the level of property-rights protection. The donor pool, i.e., the countries from which the weights are selected, is comprised of all developing countries that have received FDI before 1990 and enacted BITs after 1990. The synthetic Brazil is constructed then as the convex combination of countries in the donor pool that most closely resemble pre-1990 Brazil considering 20 years pre- and post-periods.

Importantly, this counterfactual analysis shows that Brazil would have received additional FDI inflows had it enacted BITs, i.e., it had not achieved its full potential in terms of attractiveness. This suggests that not all foreign investors were willing to trust Brazil's institutions, but if the economic determinants are right, some investors were willing to take the risk. One would need to weigh the "benefit" of that additional FDI against the related risk in terms of increased exposure to ISDS.

The fact that Brazil, an increasingly important home country, is now pursuing its own brand of BITs (Cooperation and Facilitation Investment Agreements) is an interesting change in direction. Brazil, which was swimming against the tide before by resisting the enactment of BITs, is swimming against the tide again as its BITs advocacy comes at a time when a number of countries are abrogating such treaties. Brazil is still not a member of ICSID, and its BIT model neither follows its rules nor provides for ISDS. These abrogating countries are now accepting Brazil's initial position that potential increases in FDI are not worth exposure to ISDS.[4] Yet, the fact that these countries are not necessarily rejecting BITs completely, coupled with the results of the counterfactual analysis and Brazil's late push toward investment treaties, reveal the importance to FDI inflows of protecting the property rights of foreign investors. Thus, policy-makers frustrated with the system should be careful when abrogating BITs if they want to continue attracting a maximum of foreign capital. They can pressure ICSID for change and reform the system,[5] but they should not underestimate the importance of investor protection. Or they can imitate Brazil and pursue alternatives.

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[1] For a collection of studies, see Karl P. Sauvant and Lisa Sachs, eds., *The Effect of Treaties on Foreign Direct Investment* (New York: OUP, 2009).
[2] For a detailed explanation of the method, see Alberto Abadie et al., "Synthetic control methods for comparative case studies: Estimating the effect of California's tobacco control program," *Journal of the American Statistical Association*, vol. 105 (2010), pp. 493-505.
[3] Population size, GDP per capita, GDP growth, urban population, trade openness, and population skill level.
[4] Clint Peinhardt and Rachel Wellhausen, "Withdrawing from investment treaties but protecting investment," *Global Policy*, vol. 7 (2016), pp. 571-576.
[5] Meg Kinnear, "Moving with the times: amending the ICSID rules," *Columbia FDI Perspectives,* no. 233, August 27, 2018.

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