

Exit Threats and Credibility: The Role of Market Reputation in BIT Renegotiations

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Abstract

What empowers states to use threats of exit in international negotiations? This paper investigates the conditions under which a state would threaten to withdraw from cooperation in the context of bilateral investment treaties (BITs). By examining 2620 BITs across 178 countries over 47 years, the study demonstrates that states are more likely to employ exit threats when their standing in global business climate indicators improves. This strengthened market reputation increases the credibility of exit threats, providing greater bargaining leverage. Additionally, the paper identifies that the likelihood of BIT renegotiations and exits is influenced by the treaties' sunset period. Specifically, a greater improvement in a capital-receiving country's investment reputation is associated with a higher likelihood of renegotiations for treaties with shorter sunset periods. Conversely, treaties with longer sunset periods are more likely to be renegotiated by capital-sending countries that have largely enhanced their investment reputation. The findings underscore the role of market perception in shaping states' strategic decisions to challenge existing international agreements, highlighting the interplay between market reputation and economic renegotiations.

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1 Introduction

International economic agreements are often expected to be beneficial to signatory states (Keohane's, 1984; Keohane and Martin, 1995), self-reinforcing (Pierson, 2004), and resilient to fundamental changes or redirections (Barnett and Finnemore, 2004). In recent years, however, the landscape of economic governance has been increasingly characterized by countries' behaviors of challenging and withdrawing from international institutions. Famous examples include the exits from international investment regimes by countries around the globe, Bolivia and Venezuela's denunciation of the International Centre for Settlement of Investment Disputes (ICSID) Convention, the United Kingdom's formal withdrawal from the European Union ("Brexit"), former U.S. President Trump's threatening to pull out of the North American Free Trade Agreement (NAFTA), Trans-Pacific Partnership (TPP), and the World Trade Organization (WTO).

Threatening exits can be a strategic choice for states that seek to renegotiate established rules and institutions (von Borzyskowski and Vabulas, 2023). However, threats may fail, and both proceeding exits and backing down from threats have consequences. How beneficial an entry is may imply how costly an exit can be. While a good record of fulfilling commitments can signal consistency in state behaviors (Downs and Jones, 2002), exit may harm the withdrawing state's reputation for reliability. When bargaining goes sour, retrieving the threat can undermine public support for political leaders (Thomson, 2016). Why would some states risk posing exit threats, despite these potential costs? In this paper, I argue that a country's market reputation can influence its strategy to challenge existing international agreements.¹ An increase in market perception can increase the prospect of gaining concessions in negotia-

¹I distinguish a country's market reputation from its political reputation. The former refers to the perception that a country holds in international markets, particularly regarding the country's consistency, transparency, and stability as an economic actor. In contrast, the latter refers to the perception of a country as a political actor in terms of its reliability, credibility, and trustworthiness by other political actors, both domestic and international.

tions and thereby incentivize the country to threaten to leave. Even if a country was initially at a disadvantage when the treaties were ratified, it may challenge its stronger counterparts in the process of institutional reform by shaping how market actors at stake perceive it.

I examine my theory by delving into scenarios where states pursue renegotiation through exit attempts, looking specifically at bilateral investment treaties (BITs). Over the past four decades, many developing countries have signed BITs with larger, advanced economies to attract foreign direct investment (FDI). More recently, antagonism toward BITs has been spilling worldwide. Some governments have started to reassess their policies regarding BITs and question the necessity and benefits of investment agreements as well as the associated dispute resolution mechanisms. In the existing stock of 3,000 BITs, there is a growing trend in treaty terminations.² The yearly number of newly signed BITs has declined ever since its peak in 1996 and was exceeded by that of terminated BITs in 2017 for the first time.³ Among the withdrawing parties, many are developing countries, and most of them even withdrew often without the consent of their treaty partners. Theoretically, the weaker parties in BITs, which are capital-poor, should be in a higher demand for foreign capital and thus would need BITs more than their wealthier counterparts. Why would countries that stand to benefit the most from BITs exit these agreements?

Some scholars attribute BIT renegotiations to states' experience with investment dispute arbitrations (Haftel and Thompson, 2018) and find evidence that the challenging states aim toward regaining domestic authority over regulatory policies and measures (Thompson et al.,

²In this paper, I use the terms “BIT exit,” “BIT withdrawal,” and “BIT terminations” interchangeably. They describe the scenario where a BIT party terminates either with or without the consent of a treaty partner. BIT amendment and BIT replacement both imply changes in treaty content, but neither of them is referred to as “exit,” “withdrawal,” or “termination” given that they do not require a successive termination of treaties. To be noticed, the four ways of exiting BITs – amendment, replacement, mutual termination, and unilateral termination – are mutually exclusive and collectively exhaustive with each country dyad and at a given time. While the former three ways occur under the condition that both treaty parties agree with each other, the latter happens without inter-party consent.

³UNCTAD Investment Policy Hub. Source: <https://investmentpolicy.unctad.org/international-investment-agreements>.

2019). Other studies presume that countries suffering from dispute arbitrations will seek to revise their treaties only when they have the economic strength to do so (Huikuri, 2023). The discussed literature attributes treaty exits to the costs of fulfilling commitments without considering the costs of exits. Nevertheless, BIT terminations may be a part of a long process of renegotiation (Thompson et al., 2019), and it is unlikely that the treaty challenger will be able to rule out the possibility of bargaining failure beforehand. If exit threats do not achieve desirable outcomes, that is, treaty reform or at least provision change, the withdrawing state will face repercussions. While a country has to bear some costs whether it maintains or challenges the status quo, its decision would depend on how likely it expects a challenge will succeed. Rational decision-making involves calculations of costs, benefits, *and probabilities*.

I argue that an increase in a country's investment reputation can strengthen the credibility of exit threats, motivating countries to renegotiate BITs. As market perception changes, so does the market value of FDI destinations.⁴ An enhanced investment reputation increases a country's attractiveness to investors from around the globe, expanding outside options and improving the prospect of gaining concessions from a treaty partner. These countries have higher incentives to attempt renegotiations by threatening exits. When investment reputation declines, a party will lose its market value as a host destination and have fewer outside options, making its challenge to existing treaties less promising. Examining 2620 BITs across 178 countries and 47 years from 1973 to 2019, I find that BIT renegotiations are most likely to happen when at least one of the treaty parties experiences a change in investment reputation. The empirical evidence also shows a connection between an increase

⁴Destinations of foreign investment are also known as host countries, capital-receiving countries, or capital importers. In contrast, the source country of investment is referred to as a home country, capital-sending country, or capital exporter. BITs were commonly signed between economically advanced countries with abundant capital and relatively capital-poor countries. The capital-rich country typically acts as the capital exporter, while the other country often serves as the capital importer. However, the line between capital importers and exporters is becoming increasingly blurred. For example, countries like China, South Korea, and India, previously considered capital-poor, have now developed economic capacity and seen a significant increase in the volume of exported capital.

in market reputation and BIT terminations, which occur when exits are implemented rather than threatened.

This paper contributes to our understanding of international political economy in an era of institutional exits and increased cross-border connections. The landscape of economic governance has been characterized more by incremental adjustments and less by thorough structural shifts today (Carnegie and Clark, 2023). This paper depicts a path through which incremental changes in institutions can occur and highlights the agency of states in forcing institutional change. Major powers, especially the United States, shape the operations and development of international economic institutions through formal and informal means (Andersen et al., 2006; Stone, 2008; Kilby, 2009; Kersting and Kilby, 2016). Countries that lack the resources and capacities of the global powerhouses have also channeled their influence in various ways (Panke, 2012; Carnegie and Clark, 2023). This paper demonstrates that both economically strong and weak states can influence the development trajectory of economic institutions. In the contemporary landscape featured by proliferated information, market perception is a source of bargaining leverage and can affect countries' strategic calculations, catalyzing shifts in a state's status quo policies in the realm of institutional engagement.

2 BITs and the Costs of Exit Threats

National governments seek to attract FDI due to its potential positive effects on growth. While tax incentives and regulatory policies are commonly used mechanisms within the control of sovereign states, international investment agreements serve as cooperative regimes in the international sphere. Countries concluding these agreements commit themselves to specific standards regarding the treatment of foreign investments within their territory. International investment agreements also define procedures for resolving disputes that occur

when host governments do not fulfill their commitments. BITs are one of the most prevalent and important types of international investment agreements.

Investment treaties experienced their high point in the 1990s. BITs signed between 1991 and 2000 account for over 50 percent of all BITs signed since 1959.⁵ States were enthusiastic about BITs because they believed these treaties reassured foreign investors (Büthe and Milner, 2008). As capital owners worry about the host government’s ability to protect foreign investment and enforce laws (Simmons, 2000a; Jensen, 2008; Staats and Biglaiser, 2012; Lee et al., 2014; Xu, 2020), binding institutions are preferable to “cheap talk.” By ratifying BITs, host states grant foreign investors access to international legal recourse if domestic institutions fail (Ginsburg, 2005; Büthe and Milner, 2008; Malesky and Milner, 2021). This signals the government’s commitment to fair treatment and dispute resolution. Additionally, BITs provide access to the investor-state dispute settlement (ISDS) mechanism that allows private actors to sue sovereign states in international courts, offering a powerful tool for resolving investment disputes.⁶

Despite the benefits, BITs are highly controversial, driving dissatisfied treaty parties to renegotiate. BITs were criticized for failing to block out power politics (Poulsen and Gertz, 2021). With the ISDS mechanism in place, BITs also provide foreign investors with a privilege that domestic investors do not have access to (Miller and Hicks, 2015). Facing threats of investment disputes, host countries would even reverse the policy decisions made in the public interest (Schram et al., 2018). For these reasons, countries may benefit from decreasing or even avoiding the costs of fulfilling their commitment to BITs, and many of them have responded by exiting or threatening exits. Indonesia and South Africa, both large capital importers but also emerging regional capital exporters, have publicly stated

⁵Data collected from UNCTAD Investment Policy Hub. Last updated in December 2022.

⁶The objective of establishing the ISDS mechanism is to fulfill the objective of removing investment disputes from the intergovernmental political sphere. BITs and the ISDS mechanism to which BITs provide foreign investors with access to are criticized for failing to achieve this objective (John, 2018).

that their domestic institutions have evolved to the point where existing ISDS provisions are now less relevant (Lester, 2016) and have terminated some of their BITs.

Even if countries often cite their experiences with investment arbitration to legitimize their challenges, a state's withdrawal from a BIT should not be understood simply as a way to delink from a BIT partner or the network of BITs. In the real world, terminations rarely happen without initial rounds of renegotiation and sometimes follow treaty expiration or failures in renegotiations (Trakman and Sharma, 2015). Even the most skeptical countries, such as India and Indonesia, have sought to renegotiate, designing new BITs that align better with their interests of regaining autonomy.⁷ These observable clues are consistent with governments' motivations identified by existing literature: states often challenge the BIT status quo by implementing piecemeal withdrawal (Peinhardt and Wellhausen, 2016) or pushing for reforms that help them preserve policy autonomy (Thompson et al., 2019) without breaking away from the BIT system wholesale. Lacking better options for attracting FDI, states may not permanently or completely quit the network of investment treaties. Instead, threatening to withdraw from an international institution can be useful to pressure the members to agree to reform the institution (von Borzyskowski and Vabulas, 2023). Exit and renegotiation may thus arise from a similar causal process whereby states struggle to reform BITs (Thompson et al., 2019), the design of which favors their treaty partners that enjoyed a better economic position when the treaties entered into force.

However, BIT exits are not cost-free, and different types of exit methods are costly in similar ways. While joining an institution can signal a state's resolve to fulfill commitments (Keohane's, 1984; Fearon, 1994) and a good record of fulfilling commitments can signify consistency in its behaviors (Downs and Jones, 2002), exit may harm the withdrawing state's reputation for reliability and therefore cast a shadow over the terminating party's future of

⁷Both India and Indonesia have publicly expressed concerns over the ISDS mechanism according to (Trakman and Sharma, 2014) and have terminated a large number of BITs, as shown in Appendix A.

benefiting from international cooperation. Either with or without consent, the terminating party can gain a reputation for inconsistency. Even if a country can threaten an exit and then decide to back down, the political leader may suffer from reduced approval from the domestic audience (Thomson, 2016). In brief, attempting to exit during renegotiation can be costly because it can render the terminating party unreliable both internationally and domestically.

3 Market Reputation, Threat Credibility, and BIT Renegotiation

Since BIT exit is costly, under what conditions would states risk threatening exit for the sake of treaty changes? While the rationalist approach emphasizes the role of dispute arbitrations (Haftel and Thompson, 2018) and power constraints (Huikuri, 2023) in determining state behaviors of pursuing BIT reforms, it does not incorporate into states' calculations the exit costs and probabilities of how likely it is that benefits outweigh costs. BIT exits may have consequences on the terminating party, which are predictable and should be endogenous to the decisions of potential treaty challengers. I argue that a BIT party will use exit threats in renegotiations only when it expects bargaining success, which renders actual exits unnecessary. A state with a stronger investment reputation will be more confident to force concessions and reach new agreements, as states' economic policies are often contingent upon the beliefs of the market about what the countries are capable of (Simmons, 2000b; Mosley, 2003; Tomz, 2007).

What does a treaty party's improved reputation mean to investors and the government of a partner country? This question is essential to understanding how reputation enables states to assert themselves in bargaining situations. I theorize that an enhanced market reputation reshapes the balance of bargaining leverage between BIT parties by rendering treaty

challengers competitive as FDI destinations. A robust investment reputation can generate a positive prospect for successful bargaining. A threat will be credible and effective when the threatening party is believed to have the capacity to cause harm (Hopf, 1994), outside options for future partners (Carnegie, 2015), or legitimate reasons to conduct exits (Pelc, 2010). In the context where the treaty parties are involved in interdependent investment relationships, the challenger's potential capability to harm originates from the risk of relationship interruption that a treaty partner is exposed to. A stronger reputation in the capital market can endow a country with the leverage to generate such risk by increasing the potential pool of future foreign investors and treaty partners. It can also legitimize a country's challenge to the existing treaty, providing a credible basis for renegotiation efforts.

3.1 Market Reputation and Outside Options

The effectiveness of threats in forcing policy concessions from a target state depends on how costly the enforced threat can be to the target (Schultz, 1999). The higher the potential cost that the interruption of the relationship can impose on the target, the more likely it is that the target will surrender (Keohane, 1977). For an exit threat to work, the threatener should thus generate potential costs that investors and the government of the treaty partner will have to burden when adapting to threatened changes. The availability of fungible outside options owned by foreign investors determines how high the costs of adaption will be. A decline in the fungibility of outside options for the investors from the threatener's treaty partner would raise their costs of adapting to potential interruption of BIT protection and increase their vulnerability.

Once a state exits the treaty, investors from a partner state that intend to invest in the withdrawing party have two options: they can either proceed with their plan of entering the country's market without BIT protection or invest in an alternative destination (i.e., switch

to any fungible outside option) without having to bear the risk of failed negotiations in the future between their home country and the withdrawing party. With more fungible outside options, these investors would be less likely to suffer from the lack of protection resulting from treaty termination in the latter scenario. Only when outside options are limited – making the formal scenario ideal – would the host country’s removal of treaty protection for future investors impinge on both a treaty partner and investors from that partner country.

A better reputation can make a party more confident in achieving negotiations by intensifying the competition among foreign investors from different home countries that seek a satisfactory host market. Treaty exits may infringe on the prospect of cooperation unevenly among all possible future partners since the challenger’s partner will suffer directly from treaty termination (Schmidt, 2023). After the BIT is terminated, the investors that have not yet entered the host market will remain unprotected by investment agreements until a new BIT is signed between the two treaty parties. If there are fewer paralleled outside options and more competition over the market entry opportunities, these foreign investors will face increasing opportunity costs of not choosing the withdrawing party’s market. This thereby increases the necessity of the home government of these investors to shorten the period during which future investors are not covered by treaty protections, and an evident solution would be to turn to the negotiation table and reach a new agreement sooner with the challenger government. In this way, a better reputation makes BIT withdrawal a credible exit threat, improving the prospect of bargaining success and thus encouraging attempts to renegotiate treaties.

Correspondingly, the costs of interrupted investment relationships are essential to the viability and effectiveness of BIT exits. Having fungible outside options can reduce the vulnerability of the threatening party to a threat that will be actualized once the threat fails its purpose (Fearon, 1994). As investors and countries around the globe are educated by the country performance indicators, the countries that have an improved status identified by the

published indicators would be popular FDI destinations that do not lack candidates from the global pool of investors. Warmer attitudes among foreign investors provide a host country with more outside options for future treaty partners. Since outside options make its exit threat credible to the threatened partner (Carnegie, 2015), and the political reputation for inconsistency is not always a priority if it contradicts immediate strategic interests (Press, 2005), an improved reputation can increase a country's bargaining leverage by attenuating the negative impact of the potential loss of political reputation resulting from actual exits on the prospect of cooperation.

3.2 Market Reputation and Revisionist Demands

A better investment reputation would make the country an attractive FDI destination, helping legitimize a revisionist appeal of reforming BITs. The effectiveness of exit threats can be impacted by a lack of legitimacy, as it shapes the attitudes of both the international community and the domestic public.⁸ First, threat legitimacy influences the attitudes of the international community. If a status-quo challenger fails to convince others that its actions are not intended to undermine liberal principles, those actions may be deemed illegitimate and unacceptable to other states (Kim, 2012), thereby limiting future opportunities for cooperation (Simmons, 2000a; Tomz, 2007; Kydd, 2005). Second, the low legitimacy of a financial policy can weaken a country's influence in the international financial order by eroding domestic support (Seabrooke, 2006). When a BIT party's behavior contradicts the domestic constituents' beliefs about how a government should act to benefit the country, there could be a public backlash, diminishing the credibility of the threatening party's resolve and thus the effectiveness of the threat (Martin, 1993; Fearon, 1994, 1997). Empirical evidence also supports that an illegitimate threat can stigmatize the threatening party and is less likely

⁸Legitimacy stands for a non-material power of norms (?).

to succeed (Pelc, 2010). This means the legitimacy of the challenger’s appeal in the eyes of both its domestic audience and other countries affects whether treaty exit could effectively force the other treaty party to agree to reform BITs.

To some extent, a strong market reputation and a BIT serve similar purposes, which provides a good reason for treaty challengers to demand changes to existing investment agreements. Signing international treaties can demonstrate a country’s intentions to cooperate and comply (Simmons, 2000a; Büthe and Milner, 2008). Particularly, BITs help host countries to assure investors that foreign investments will be protected and treated fairly even when there lacks a favorable domestic institutional environment (Malesky and Milner, 2021; Betz and Kerner, 2016). With an improved reputation in the financial market, a country can legitimize its challenge to BITs by claiming that existing treaties have already accomplished their role in complementing the flawed domestic legal institutions and that treaty reform is what it deserves. As a result, a country will increase its expectation of success in challenging the existing treaty if its market reputation is so improved that BITs become “obsolete.” In sum, reputational power can legitimize a BIT party’s demand to reform BITs. A better investment reputation, therefore, increases countries’ bargaining leverage and empowers them to apply treaty termination as an exit threat.

3.3 Investment Reputation Gains and BIT Renegotiations: Testable Hypotheses

Being aware that its reputation improves over time among both the general public and foreign investors, a host country seeking to challenge BITs would expect more foreign investors to

show continuous interest in developing business on its soil.⁹ Therefore, a better reputation in the capital market would boost a country's confidence in itself as a more popular FDI destination for investors from a partner country and thereby make its government more inclined to pursue BIT reforms and threaten exits. The greater a country's improvement in investment reputation, the more confident it becomes in forcing renegotiation efforts to be effective, and the more incentives it has to revise the BIT and implement an exit threat. The hypothesis is as follows:

H1: The more a country improves its investment reputation, the more likely it should be to renegotiate the BIT.

The bargaining leverage provided by an enhanced reputation, however, may not be equivalent for all country dyads. The effect of market reputation on threat credibility should be contingent upon how immediately the treaty at stake will unbind the threatening party. When one treaty party insists on withdrawing without the other party granting consent, "sunset clauses" (sometimes also referred to as survival clauses), a lock-in mechanism embedded in BITs, will be automatically invoked and bind signatory parties with treaty obligations for an extended period. These clauses serve to render the BITs resilient to change or termination, and most BITs include them in the provisions. Once triggered, sunset clauses guarantee that all investments made before treaty termination continue to be protected during the sunset period which starts from treaty termination and ends when the sunset clause concludes. Sunset periods range from 5 to 20 years, as shown in Figure 1.¹⁰

What does sunset clause invocation mean to both treaty parties? With sunset clauses

⁹To be noticed, a country's reputation would affect mostly future investors. Existing investors would not be primarily subject to the rank or status of a host country identified by business climate indicators, since they are already within the market and have developed insider knowledge about how the host country performs in rule-making and policy implementation.

¹⁰A zero-year sunset period means that the treaty does not include a specified sunset clause.

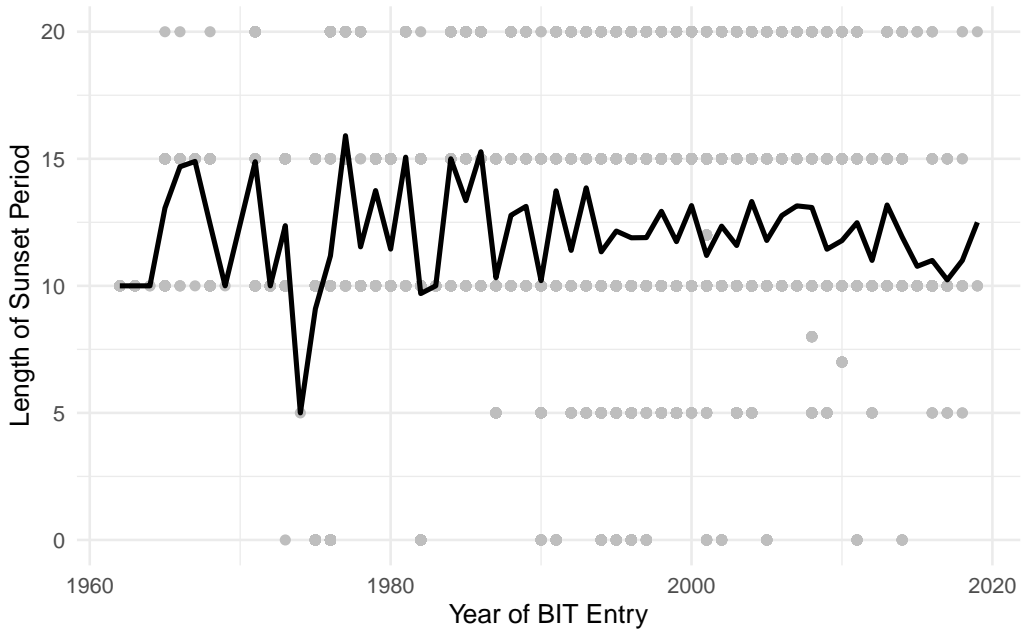


Figure 1: *Sunset period lengths of BITs over the years between 1962 and 2021*

being embedded in BITs, unilateral termination locks in signatory parties with their treaty responsibilities to existing investors. The investors who entered the host market from a partner country before treaty termination can continue to file legal claims or make threats of claims against the host government until the conclusion of the sunset clause. A state thus will stick with treaty responsibilities for longer if the BIT has a longer sunset period and the treaty partner does not agree to terminate the treaty. In contrast, a shorter sunset period can quickly free the challenging party from treaty commitments, making the threat more imminent and credible. The hypothesis is as follows:

H2: When a BIT has a shorter sunset period, a country that improves its investment reputation should be more likely to renegotiate the treaty.

In brief, market reputation can empower countries to pursue treaty renegotiation in three ways. First, by making these economies more attractive, a better reputation in the capital

market can increase a country's outside options for future treaty partners. Second and correspondingly, when alternative FDI destinations are less comparable, foreign investors from the other treaty party face higher opportunity costs of turning to alternative host destinations. Third, a better investment reputation can legitimize a country's appeal of challenging the treaty status quo. The following sections will discuss how the hypotheses are tested.

4 Empirical Approach

I construct a sample of 2620 BITs across 178 countries and 47 years from 1973 to 2019.¹¹ Among the 2620 BITs within the full sample, 225 were changed through either amendment or replacement.¹² Additionally, 141 BITs were unilaterally terminated, representing over 97 percent of the terminated BITs (see Figure 2). As I add covariates, the sample drops to 66 countries, less than 300 BITs, and 7 years. I test my theory using a rare-event logistic regression model with country-fixed effects.¹³ Standard errors are clustered by country dyad.

The dataset is built upon the UNCTAD IIA database,¹⁴ which provides information on the status of BITs. The unit of analysis is treaty-year. Each country dyad in the dataset can

¹¹My sample does not include the BITs of which both treaty parties are member states of the European Union (EU). These BITs were found incompatible with the EU law and thus mutually terminated. (Source: https://finance.ec.europa.eu/publications/eu-member-states-sign-agreement-termination-intra-eu-bilateral-investment-treaties_en.) Given that the mutual terminations caused by this important legal change among European countries are out of the scope of my research focus, I exclude all intra-EU BITs.

¹²When BITs are being replaced, treaty parties sign a new treaty often without formally terminating the old treaty. By the time when the new treaty comes into force, the old treaty automatically terminates. A replacement within the sampled years thus signifies that two BITs, both old and new, will be recorded under the same treaty parties but for different years of signing. That differs from amendment which occurs when treaty parties modify an existing treaty without signing a new one.

¹³Since the occasions of BIT deviation are rare, I amplified the weight of cases where deviation occurs by 20, and cases of exits by 30.

¹⁴These data are available thanks to a collaborative effort by UNCTAD and over 45 universities to map the content of UNCTAD's IIA database. The IIA mapping project: <https://investmentpolicy.unctad.org/international-investment-agreements/iaa-mapping>.

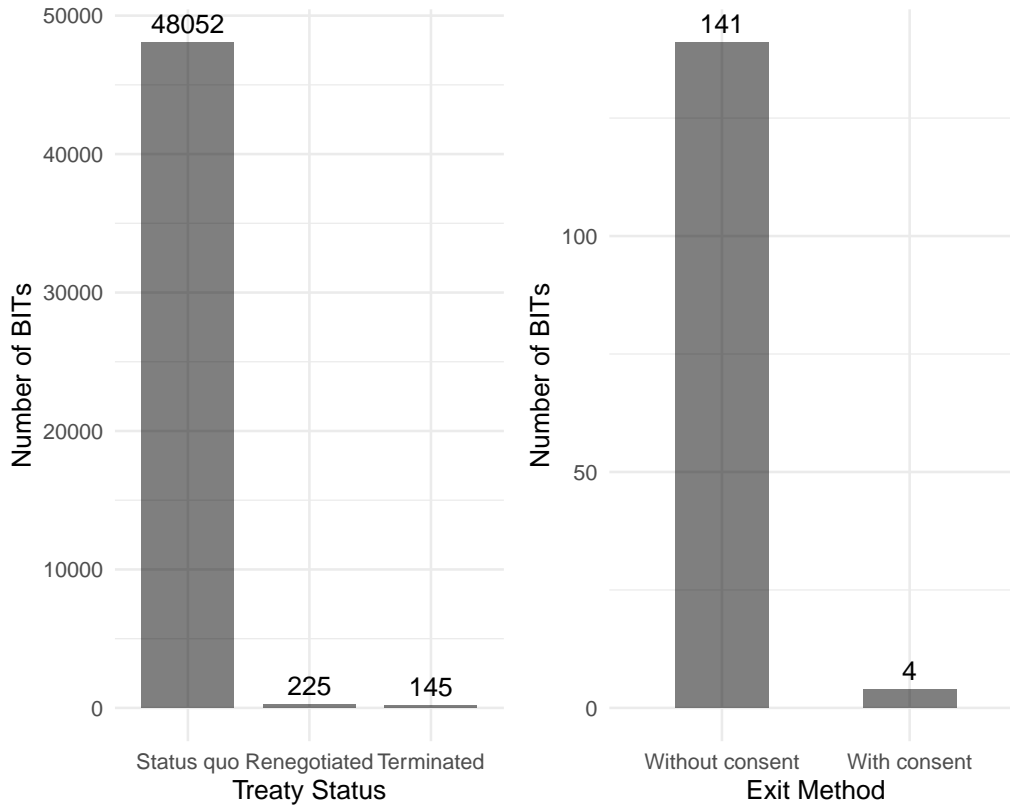


Figure 2: *Treaty status and exit methods (as of 2019)*

have more than one treaty due to BIT replacements or re-entries.¹⁵ For example, Russia-China BIT (1991) and Russia-China BIT (2009) are included as separate treaties which belong to the same dyad of Russia-China. Each BIT has observations from its ratification – i.e., the year when the treaty entered into force – until the year it gets terminated or amended, or until 2023 in case the BIT does not experience either event.

Given the asymmetric origins of the BIT regime, the treaties disproportionately favor the signatory parties that were initially stronger and able to push for their favored treaty terms (Alschner and Skougarevskiy, 2016). To reflect the reputational leverage and bargaining position of treaty parties in the initial negotiation of BITs, I follow the coding rule in Huikuri (2023)’s data to identify the state with larger FDI exports in the year of BIT signature as the

¹⁵A BIT re-entry refers to a country’s policy of signing a new BIT with another country after terminating an old BIT either unilaterally or bilaterally with the same partner country.

capital-rich, more advanced economy. If the state with smaller exports is a member of the Organization for Economic Cooperation and Development (OECD), it is coded as economically stronger to reflect its advantage in technical knowledge and correspondingly market reputation. This accounts for 90% of dyads. For remaining treaties ratified between an European Union (EU) member and a non-EU country, the EU member is considered a home party. If still unresolved, the state with a higher GDP is coded as the capital-rich country.¹⁶

4.1 Dependent Variables

The phenomenon of interest is the initiations of BIT renegotiation which are, unfortunately, rarely observable systematically. What is observable are often the cases where renegotiation attempts yield outcomes that are either successful changes to treaties or treaty terminations. I thus test my hypotheses with a binary dependent variable, *BIT deviation*. I score 1 for the onset of change in BIT status regardless of the type of change, whether it is being terminated, replaced, or amended.

Admittedly, BIT deviation does not perfectly proxy countries' attempts to revise the treaties but represents the outcome of renegotiation attempts. There is a lack of information regarding the renegotiations that were initiated but have not yet produced results and the countries that backed down from exit threats, which let my empirical testing fall prey to selection bias. Given this difficulty, I run empirical tests on a second dependent variable, *BIT exit*, to test the robustness of my results. Theoretically, a treaty party's bargaining efforts fail if it ultimately actualizes withdrawal after the threat is made. If the empirical results remain significant for only observable scenarios where bargaining fails, they may even underestimate the effects of my explanatory variable on countries' attempts to renegotiate

¹⁶The indicator of GDP is not perfect but the most commonly used proxy for economic strength. Its data availability for all countries at all times also provides the best coverage for coding the treaty dyads.

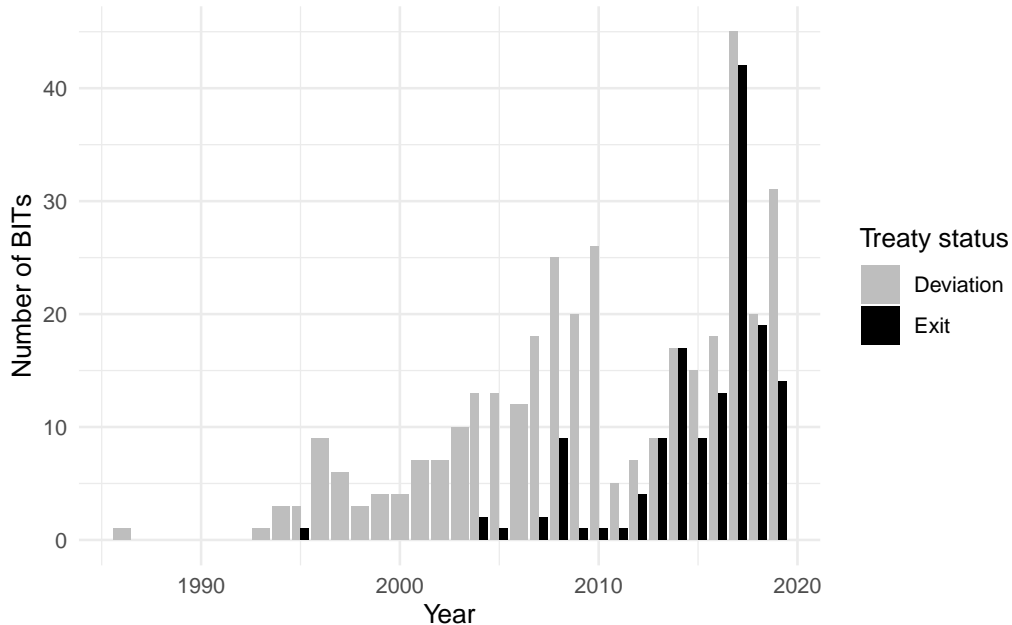


Figure 3: *The number of BIT deviations and exits over time (1980-2019)*

the treaties. As shown in Figure 3, the trend of BIT exits has been rising over the past decade, which provides sufficient data for analysis.

4.2 Explanatory Variables

There are various ways to evaluate a country’s market reputation. One way is to look at country performance indicators. Existing studies find that country performance indicators can change state behaviors by spurring and disseminating information on what it takes to garner social (dis)approval (Kelley and Simmons, 2015, 2019), incentivizing market actors to punish non-compliance (Morse, 2019, 2022), and shaming the non-compliant countries (Weisband, 2000; Rotberg, 2004)). Rating and publicizing indications of country performance is a way to impose reputational costs on those countries that do not abide by international rules (Sharman, 2009). Media coverage can amplify the effects of the indicators by broadcasting the achievements or failures of countries, which can lead to a social process in which public

knowledge about the countries is constructed and, in turn, pressures states to improve their performance (Doshi et al., 2019). Therefore, country performance indicators can change the informational environment in which countries, the general public, and relevant audiences interact, and reputation is the major product of this informational environment. Countries gain status from business climate indicators, and reputation comoves with status defined by widely observed or frequently used indicators. In line with previous research (Dafoe et al., 2014, 2021), I refer to a country’s position in the ranking as “status,” whereas the first-order beliefs about the status of a ranked country are referred to as “reputation” in this paper.¹⁷

To capture a country’s investment reputation in the capital market, I examine the World Bank’s Ease of Doing Business (EDB) Index, a particular type of country performance indicators that evaluate national business environments and are intuitively most relevant to judgments about how investor-friendly the countries’ economic environment might be. The EDB Index serves to identify regulatory obstacles and promote reforms that enhance business efficiency. It measures the ease with which businesses can start, operate, and grow within a country. Specifically, it investigates countries’ performance in a variety of areas including starting a business, dealing with construction permits, getting electricity, registering property, obtaining credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. Countries are ranked based on their performance in each of these areas, and an overall score is calculated. The index is updated annually, reflecting reforms and changes in regulations.

Admittedly, the EDB Index has its limitations. The concerns over data integrity led to

¹⁷First-order beliefs do not require agreement among a group of actors, whereas second-order beliefs do (Dafoe et al., 2014, 2021). The latter are beliefs about what others believe. A typical example of second-order belief is prestige. Second-order beliefs do not necessarily converge with first-order beliefs. For example, individual investors can think highly of a country’s business climate, but if they do not think that all investors around the globe also think highly of it, the country will have a good reputation in the business climate without having prestige. For country performance indicators that enjoy a dominant market share and high media exposure, the reputation and prestige of well or increasingly better-ranked countries are likely to converge. In this paper, I will focus on reputation solely. The threshold at which reputation upgrades to prestige needs to be identified and falls out of the scope of this paper.

the discontinuation of the project by the World Bank in 2021. Despite the transparency and ethical issues, the EDB Index received high attention and has been one of the most popular business climate indicators. According to the reported statistics drawn from the Media Cloud Database,¹⁸ the World Bank's EDB Index enjoyed the top seat in terms of both the number and percentage of hits (Doshi et al., 2019). The World Economic Forum's Global Competitiveness Index and the Heritage Foundation's Index of Economic Freedom followed, with the former receiving less than 20% of the hits and the latter accounting for around 8%. There is also evidence that the EDB ranking shaped policy decisions and outcomes. Countries such as Kazakhstan, India, Vietnam, Rwanda, and Kenya implemented multiple reforms to improve their EDB rankings. Reforms in improving performance in EDB indicators are also found to have significantly boosted economic performance in the post-reform period (Haidar, 2012; Jayasuriya, 2011).

Given the theoretical and empirical importance of the EDB Index and data availability, I use both the raw score and rank of the EDB Index to capture investment reputation in my quantitative analysis.¹⁹ The temporal range of the EDB score data is from 2010 to 2020, whereas that of BITs is from 1973 to 2019. My empirical analysis is confined to the 10 years between 2010 and 2019. As a robustness check, I use the Heritage Foundation's Index of Economic Freedom, which I call the Heritage Index in the following text, as an alternative measure of a country's investment reputation. The World Economic Forum's Global Competitiveness Index is not considered due to the frequency of its release: it was measured every three years until 2017 when evaluations began to deploy annually.

My key explanatory variable is the *change in host EDB score*, of which the data on

¹⁸Media Cloud Database: <https://www.mediacloud.org>.

¹⁹A business climate indicator reports how a country's business climate in relative terms, and thus changes in any country's rank will affect the others' rank.

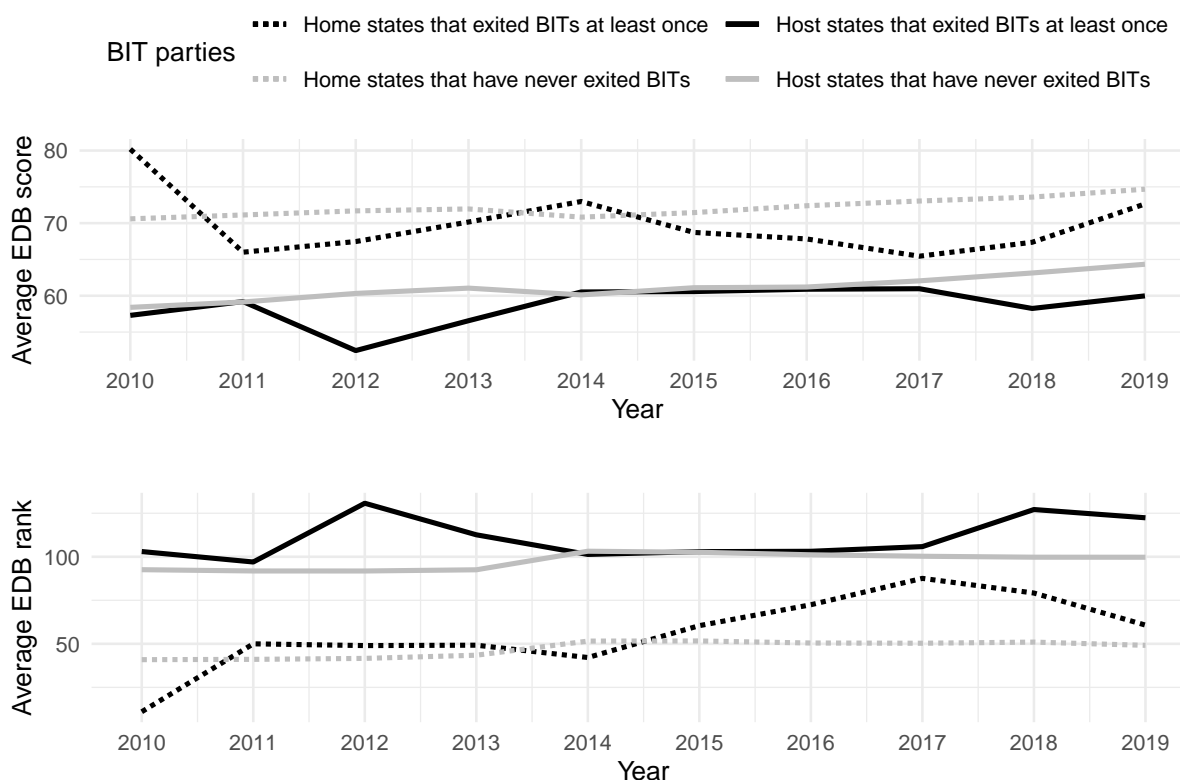


Figure 4: *Development of BIT parties' reputation over time (2010-2019)*

raw score for each country comes from the World Bank EDB database.²⁰ A positive value of the score change means that the score improved, while a negative value means a decrease in score and deterioration of reputation in the capital market. I also proxy reputation change using the *change in host EDB rank*. I rank the countries in terms of their EDB score, and the best performer gets the highest score and is ranked first. A negative value of the rank change thus reflects the case of investment reputation gains. I lag both variables by one year to avoid the issue of endogeneity. Figure 4 displays the average EDB score and rank among traditional home and host countries, both those that exited BITs at least once and those that never did. Overall, the EDB performance of host countries that ever terminated BITs fluctuated over time, while that of status-quo-keeping countries remains stable.

²⁰The World Bank EDB project: [https://archive.doingbusiness.org/en/data/doing-business-score?topic=.](https://archive.doingbusiness.org/en/data/doing-business-score?topic=)

The moderating variable of interest is *sunset length*. The length of the sunset period determines how long the continuing protection for existing investors will last beyond the date of treaty termination and thus can also impact treaty challengers' policy decision of choosing a particular method to exit BITs. The shorter the sunset period, the stronger the exit threat, and the more likely a country would seek treaty revision when its investment reputation improves. I interact the sunset period length with the change in the EDB score of each treaty party respectively to examine whether a longer sunset period attenuates the effect of investment reputation on countries' renegotiation attempts.

4.3 Confounders

Following previous studies (e.g., Haftel and Thompson, 2018; Thompson et al., 2019; Huikuri, 2023), my controls include several variables that are likely to impact states' economic prospects and thereby confound the relationship between reputation change and states' propensity to exit BITs. I include *GDP growth* of both treaty parties of BITs which captures the economic development pace of both treaty parties. It is lagged by one year, as a policy decision to exit BITs would have a medium or even long effect on investment flows and should not be highly responsive to temporary shifts in economic performance. I also control for *FDI outflows* of both treaty parties, measured as the percentage of the FDI outflows of a country's GDP to capture the effect of investment activities of treaty parties.

I also control for three variables representing the domestic political circumstances of both treaty parties that can potentially affect leaders' propensity to BIT reforms. The variable *government stability* captures the time horizons of political leaders. Policymakers in less uncertain times or in governments with longer time horizons are believed to prioritize policy decisions that yield short-term gains to those that yield longer-term benefits (Pierson, 2000; Rosendorff and Milner, 2001; Blake, 2013). I code *leftist leader* as 1 if the executive leader

is labeled as a left-wing, communist, socialist, or social democratic and as 0 if otherwise. As existing studies identify a significant relationship between political ideology and governments' policy stances toward FDI (Pinto, 2013), a leader with a leftist ideological orientation may be particularly proactive in the efforts to reform BITs. The World Bank's Database of Political Institutions (Cruz et al., 2021) will be the source of data for the ideological orientation of the executive leader for each country. Shifts in the leadership of the ruling government are found to have an impact on economic and foreign policies (Mattes et al., 2016), so I control *leader transition* and code it as 1 if there is at least one leadership change in a given year and 0 otherwise. All political-condition variables are lagged by one year to account for the time it takes for policy decisions to have an impact.

In addition, I incorporate the variables that are found explanatory to BIT reforms in the existing literature. I control for a country's record of participation in investment disputes as a respondent, as Thompson et al. (2019) suggest that states learn from their experience of being involved in investment arbitrations. Their studies find an association between the efforts of a state to reform BITs and the number and outcomes of legal disputes that the state experienced. I measure this identified relationship as *ISDS respondent cumulative* which captures the cumulative number of investment disputes that the host government was involved in as a respondent. A home government would favor BITs given that investors at home frequently use the ISDS and benefit from its protection. I thus control *ISDS home cumulative* which refers to the number of disputes at the ISDS where a country is involved as the home country of the complaining investor. I log the data because it was highly skewed originally, and I lag it by one year because the effect of the legal challenges posed by foreign investors takes time to manifest.

The most plausible alternative explanation is that host countries may benefit not from investment reputation but from power balance. Aligned with the rationalist account, Huikuri (2023) finds that states initially in a weaker position in bargaining have stronger incentives

to change the BITs that they previously signed. The revisionist logic emphasizes that a rise in relative power can increase a country’s capacity to seek BIT reform. Urpelainen (2011) identifies economic development as the source of bargaining power for countries that seek to attract FDI. I thus control for the potential of this power-based explanation where I use Huikuri (2023)’s data that operationalizes power balance as the difference within the treaty dyad in GDP. A positive value of *GDP gap* signifies that the home countries’ GDP is higher than the host countries’, whereas a negative value means the opposite. A one-year lag is applied to avoid endogeneity. In all models, I cluster standard errors by country dyad.

5 Findings: Improved Market Reputation Increases BIT Renegotiation

The empirical results strongly support Hypothesis 1, indicating a positive relationship between a country’s investment reputation improvement and its demand for revising its BIT. Table 1 shows the effect of a country’s EDB score change on the likelihood that it withdraws from its BIT and the moderating role of political regimes, lending quantitative evidence to endorse Hypotheses 1 and 2. Model 1 serves as a baseline for the effect of EDB score change with only basic features of economic growth, investment flows, treaty features, and domestic politics being controlled for. Model 2 examines the effect of the change in the EDB rank. Model 3 and 4 add controls for both governments’ experience of being complained at the ISDS as well as the intra-dyadic power balance. Model 5 and 6 focus on BIT exit rather than BIT deviation as the dependent variable.

An increase in the EDB score of the host country has a positive and statistically significant impact on the likelihood of BIT deviation across all models (see Figure 5), lending support to Hypothesis 1. In Model 1, a one-point increase in the host country’s EDB score leads to

Table 1: *BIT deviation/exit, and EDB score/rank change: rare-event logit models*

	<i>Dependent variable</i>					
	BIT deviation (=1)			BIT exit (=1)		
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Host EDB score change _{t-1}	0.070*** (0.008)		0.050*** (0.008)		0.077*** (0.009)	
Home EDB score change _{t-1}	0.031*** (0.008)		0.005 (0.009)		0.039*** (0.008)	
Host EDB rank change _{t-1}		-0.017*** (0.002)		-0.014*** (0.002)		-0.019*** (0.002)
Home EDB rank change _{t-1}		-0.012*** (0.002)		-0.012*** (0.002)		-0.017*** (0.002)
Sunset length	0.015*** (0.003)	0.015*** (0.003)	0.014*** (0.003)	0.015*** (0.003)	0.009*** (0.002)	0.010*** (0.002)
Host FDI outflows _{t-1}	-0.003*** (0.001)	-0.003** (0.001)	-0.002* (0.001)	-0.002 (0.001)	-0.002** (0.001)	-0.001 (0.001)
Home FDI outflows _{t-1}	0.001** (0.0003)	0.001** (0.0004)	-0.0002 (0.0004)	-0.0002 (0.0004)	-0.001*** (0.0004)	-0.001** (0.0004)
Host GDP growth _{t-1}	-0.013** (0.006)	-0.007 (0.005)	-0.017** (0.009)	-0.011 (0.007)	-0.011 (0.008)	-0.0001 (0.006)
Home GDP growth _{t-1}	0.011*** (0.004)	0.011*** (0.004)	0.008*** (0.004)	0.008** (0.004)	0.019*** (0.004)	0.017*** (0.003)
Host left executive _{t-1}	-0.242*** (0.050)	-0.229*** (0.051)	-0.257*** (0.058)	-0.238*** (0.057)	-0.311*** (0.063)	-0.278*** (0.063)
Home left executive _{t-1}	-0.058*** (0.020)	-0.053*** (0.020)	-0.049** (0.022)	-0.042* (0.022)	0.033* (0.020)	0.046** (0.019)
Host leader transition _{t-1}	0.091*** (0.033)	0.135*** (0.035)	0.081** (0.035)	0.132*** (0.035)	0.067** (0.032)	0.116*** (0.033)
Home leader transition _{t-1}	-0.225*** (0.030)	-0.231*** (0.029)	-0.202*** (0.029)	-0.210*** (0.029)	-0.192*** (0.023)	-0.195*** (0.022)
Host gov stability _{t-1}	0.005 (0.017)	0.011 (0.017)	0.018 (0.019)	0.021 (0.018)	0.064*** (0.018)	0.056*** (0.018)
Home gov stability _{t-1}	-0.054*** (0.011)	-0.063*** (0.011)	-0.043*** (0.012)	-0.052*** (0.013)	-0.019* (0.011)	-0.027** (0.011)
Host ISDS resp cum (logged) _{t-1}			0.557*** (0.086)	0.413*** (0.079)	0.339*** (0.069)	0.177*** (0.061)
Home ISDS resp cum (logged) _{t-1}			0.055*** (0.009)	0.054*** (0.008)	0.077*** (0.008)	0.080*** (0.007)
Host ISDS home cum (logged) _{t-1}			-0.216*** (0.039)	-0.128*** (0.039)	-0.140*** (0.036)	-0.053 (0.038)
Home ISDS home cum (logged) _{t-1}			0.098*** (0.013)	0.104*** (0.013)	0.160*** (0.012)	0.167*** (0.012)
GDP gap _{t-1}			-0.107*** (0.029)	-0.137*** (0.031)	-0.261*** (0.026)	-0.298*** (0.027)
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Number of BITs	270	270	254	254	254	254
Number of Countries	66	66	66	66	66	66
Number of Years	7	7	7	7	7	7
Observations	1,067	1,067	992	992	992	992

Note: * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

All models are logistic regression with country and year fixed effects. Standard errors are clustered by country dyad and shown in parentheses.

a nearly 7.2 percent increase in the probability of BIT deviation, while the same increase in the home country's EDB score results in a 3.1 percent increase. When controlling for alternative explanations, the effect of the host country's EDB score decreases slightly to 5.1 percent but remains positive and statistically significant. Regarding the likelihood of BIT exit, Model 5 demonstrates that for every one-point increase in the host country's EDB score, the probability of BIT deviation increases by approximately 8 percent, holding all other variables constant, whereas the corresponding increase in the home country's EDB

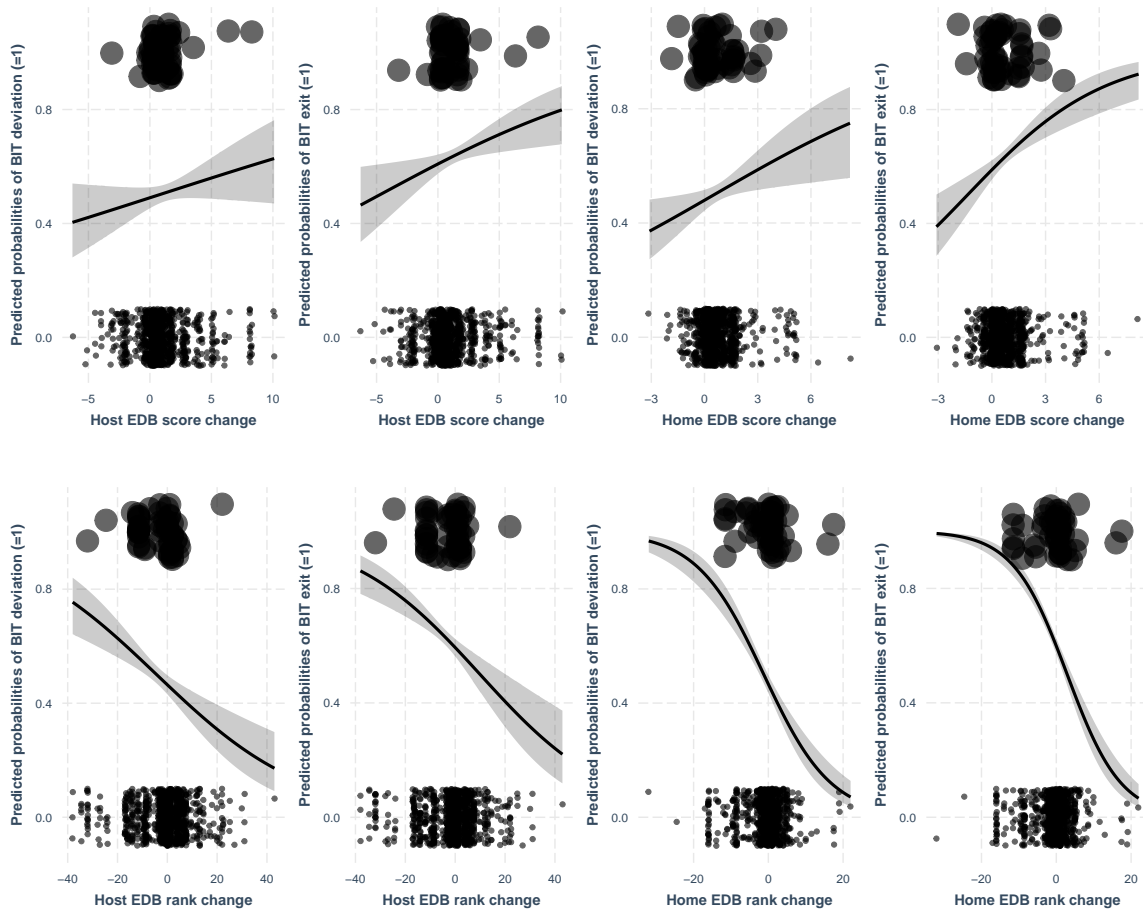


Figure 5: *Marginal effects of change in EDB score and rank*

score leads to an increase in BIT deviation by around 4 percent.

Across all models, the change in the EDB score of the host country has a greater impact on BIT deviations than that of the home country. Specifically, in Model 1 and Model 5, the effect of the former is roughly twice that of the latter. Model 2, Model 4, and Model 6 investigate the effect of treaty parties' EDB rank. A one-position status improvement in either party's EDB rank corresponds to around a two-percent increase in the likelihood of BIT deviation, all else being equal. A country's investment reputation gains have a slightly stronger impact on the occurrence of a terminated BIT than that of a renegotiated treaty.

The Heritage Index is another global performance indicator that evaluates countries' business climates. For robustness checks, I replicate Models 3 and 4 using the Heritage Index,

with the results presented in Appendix C. The likelihood of BIT deviation shows a positive correlation with changes in treaty parties' EDB scores and a negative correlation with changes in EDB ranks. These relationships are statistically significant, providing strong support for Hypothesis 1. However, the effect of investment reputation, as measured by the Heritage Index, is considerably smaller compared to when the EDB Index is used. This difference likely stems from the EDB Index's specific focus on the regulatory environment affecting businesses, whereas the Heritage Index has a broader emphasis on economic freedom. The Heritage Index includes indicators such as government spending, fiscal health, trade freedom, and monetary freedom, which are crucial for overall economic stability but do not directly impact the administrative and regulatory processes businesses face. Conversely, the EDB Index evaluates factors such as the ease of starting a business, dealing with construction permits, getting electricity, registering property, and obtaining credit, providing a detailed assessment of the operational environment for businesses. Due to its higher relevance, the EDB Index may serve as a better proxy for countries' investment reputations and thus exhibits a larger, statistically significant effect on governments' demand for BIT revisions.

A second empirical test examines Hypothesis 2 which argues that a country with an improved investment reputation is more likely to request treaty revision when the BIT has a shorter sunset period. The results of this analysis, displayed in Table 2, provide mixed support. Across all models capturing the EDB score, the impact of the host party's score improvement on the practice of treaty deviation is stronger when the BIT's sunset period is shorter (see Figure 6), which is in line with the hypothesis. Model 7 indicates that a five-year increase in the sunset period is linked to a two-percent rise in the effect of the change in the EDB score of the traditional host party on the likelihood of BIT deviation, all else being equal. This effect is also statistically significant in Model 9, with a similar magnitude.

In contrast, Model 8, Model 10, and Model 12 suggest that the home party's EDB score has the greatest effect on BIT deviation or BIT exit when the BIT's sunset period is longer

Table 2: *BIT deviation/exit, EDB score change, and sunset period: rare-event logit models*

	<i>Dependent variable</i>					
	BIT deviation (=1)			BIT exit (=1)		
	Model 7	Model 8	Model 9	Model 10	Model 11	Model 12
Host EDB score change _{t-1}	0.125*** (0.022)	0.070*** (0.008)	0.132*** (0.023)	0.051*** (0.008)	0.125*** (0.024)	0.078*** (0.009)
Host EDB score change _{t-1} * Sunset length	-0.004*** (0.002)		-0.007*** (0.001)		-0.004*** (0.002)	
Home EDB score change _{t-1}	0.031*** (0.008)	-0.079** (0.033)	0.005 (0.009)	-0.065* (0.037)	0.038*** (0.008)	-0.137*** (0.037)
Home EDB score change _{t-1} * Sunset length		0.009*** (0.003)		0.005* (0.003)		0.014*** (0.003)
Sunset length	0.019*** (0.003)	0.011*** (0.003)	0.020*** (0.003)	0.012*** (0.003)	0.012*** (0.003)	0.002 (0.002)
Host FDI outflows _{t-1}	-0.003** (0.001)	-0.003*** (0.001)	-0.002* (0.001)	-0.002** (0.001)	-0.002* (0.001)	-0.002** (0.001)
Home FDI outflows _{t-1}	0.001** (0.0003)	0.001* (0.0003)	-0.0001 (0.0004)	-0.0002 (0.0004)	-0.001*** (0.0004)	-0.001*** (0.0004)
Host GDP growth _{t-1}	-0.013** (0.006)	-0.012** (0.006)	-0.018** (0.009)	-0.017** (0.008)	-0.012 (0.008)	-0.010 (0.007)
Home GDP growth _{t-1}	0.010*** (0.004)	0.013*** (0.004)	0.007* (0.004)	0.009** (0.004)	0.018*** (0.004)	0.023*** (0.004)
Host left executive _{t-1}	-0.240*** (0.049)	-0.237*** (0.049)	-0.257*** (0.057)	-0.253*** (0.057)	-0.310*** (0.062)	-0.298*** (0.062)
Home left executive _{t-1}	-0.054*** (0.020)	-0.058*** (0.020)	-0.042* (0.022)	-0.049** (0.022)	0.037* (0.020)	0.035* (0.020)
Host leader transition _{t-1}	0.090*** (0.033)	0.085** (0.033)	0.077** (0.034)	0.078** (0.035)	0.068** (0.032)	0.068** (0.032)
Home leader transition _{t-1}	-0.224*** (0.030)	-0.232*** (0.030)	-0.199*** (0.029)	-0.207*** (0.030)	-0.191*** (0.023)	-0.208*** (0.024)
Host gov stability _{t-1}	0.007 (0.017)	0.004 (0.018)	0.020 (0.019)	0.018 (0.019)	0.065*** (0.018)	0.071*** (0.018)
Home gov stability _{t-1}	-0.055*** (0.011)	-0.053*** (0.011)	-0.044*** (0.013)	-0.043*** (0.012)	-0.019* (0.011)	-0.019* (0.010)
Host ISDS resp cum (logged) _{t-1}			0.586*** (0.087)	0.553*** (0.086)	0.363*** (0.069)	0.314*** (0.067)
Home ISDS resp cum (logged) _{t-1}			0.051*** (0.008)	0.055*** (0.008)	0.075*** (0.007)	0.078*** (0.007)
Host ISDS home cum (logged) _{t-1}			-0.247*** (0.039)	-0.215*** (0.039)	-0.162*** (0.035)	-0.132*** (0.036)
Home ISDS home cum (logged) _{t-1}			0.100*** (0.013)	0.097*** (0.013)	0.162*** (0.012)	0.162*** (0.011)
GDP gap _{t-1}			-0.107*** (0.029)	-0.103*** (0.029)	-0.262*** (0.026)	-0.255*** (0.026)
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Number of BITs	270	270	254	254	254	254
Number of Countries	66	66	66	66	66	66
Number of Years	7	7	7	7	7	7
Observations	1,067	1,067	992	992	992	992

Note: * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

All models are logistic regression with country and year fixed effects. Standard errors are clustered by country dyad and shown in parentheses.

(see Figure 6). The discrepancy between my expectations and the statistical results may be attributed to the lack of a direct measure of the party that initiated the treaty reform. In theory, traditional host parties may experience more – and likely positive – change in their investment reputation. Consequently, traditional home parties may more likely be the countries requesting to make concessions. When renegotiation attempts are initiated more frequently by the traditional host parties, a longer sunset period favors the traditional home parties as it binds the revision-seeking host parties for a longer duration. Another possible explanation for the mixed evidence is that, when a BIT has a longer sunset period, the party

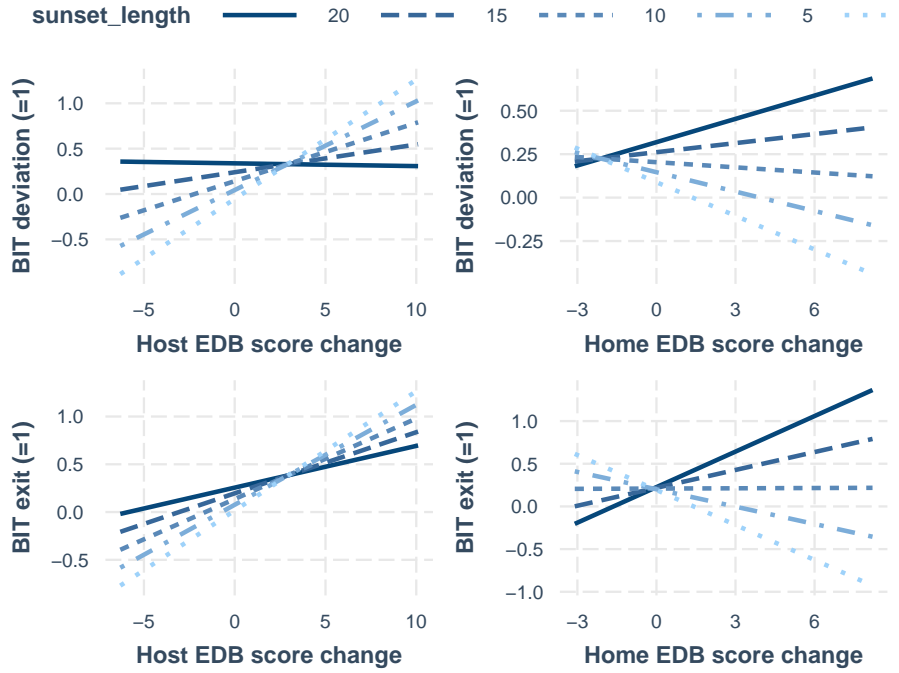


Figure 6: *Marginal effects of EDB score change on BIT deviation/exit, conditioned upon the duration of the sunset period*

that threatens exit will be locked in for longer once terminating the treaty without consent. That the threatening party does not back down when facing the absence of the other party's consent can, in turn, unveil its unwavering determination to challenge the status quo. The models investigating BIT exit as the dependent variable also receive mixed support.²¹ I use the Heritage Index to replicate Models 9 and 10 for a robustness check, with the results provided in Appendix C. All statistically significant coefficients maintain consistent signs but, likely due to different assessment foci, exhibit a smaller magnitude than in the findings from the EDB Index-based models.

I investigate the effects of EDB score and rank changes across quartile groups. Figure 7 demonstrates that for countries in the highest quartile of EDB score changes, a one-unit

²¹ Appendix B shows the empirical results for models that investigate Hypothesis 2 and focus on BIT exit as the dependent variable.

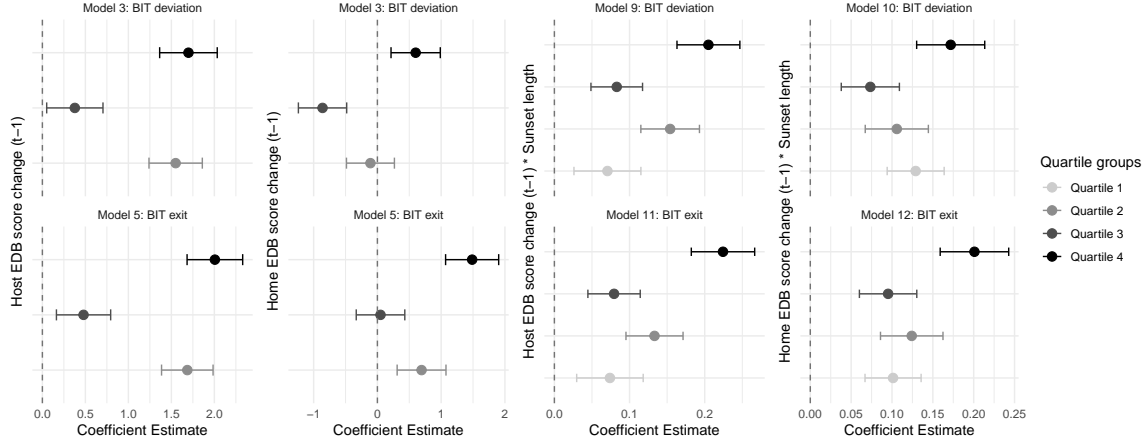


Figure 7: Marginal effects of EDB score change, by quartile groups, on BIT deviation/exit

increase in the EDB score is associated with a significantly larger increase in the probability of BIT deviation compared to countries in the lower quartiles. This heightened sensitivity to BIT deviation in the highest quartile persists even when accounting for the intervention of the sunset period. Similar patterns are observed in models assessing BIT exits. These findings suggest that substantial impacts on the investment reputation of treaty parties can lead to more pronounced changes in their behavior regarding BIT renegotiation.

6 The Case of India

India is among the few countries that have terminated BITs with multiple treaty partners in a short timeframe. In 2016, the Modi government released a new model of BITs in the same period and re-opened negotiations with those partner states over the new model (Ranjan et al., 2018). India's case provides evidence in line with my theoretical proposition that investment reputation empowers states to threaten exits in renegotiation efforts.

As part of its market liberalization measures in the 1990s, India signed its first BIT with the United Kingdom in 1995, followed by more than 80 others (see Figure 8.) Less than

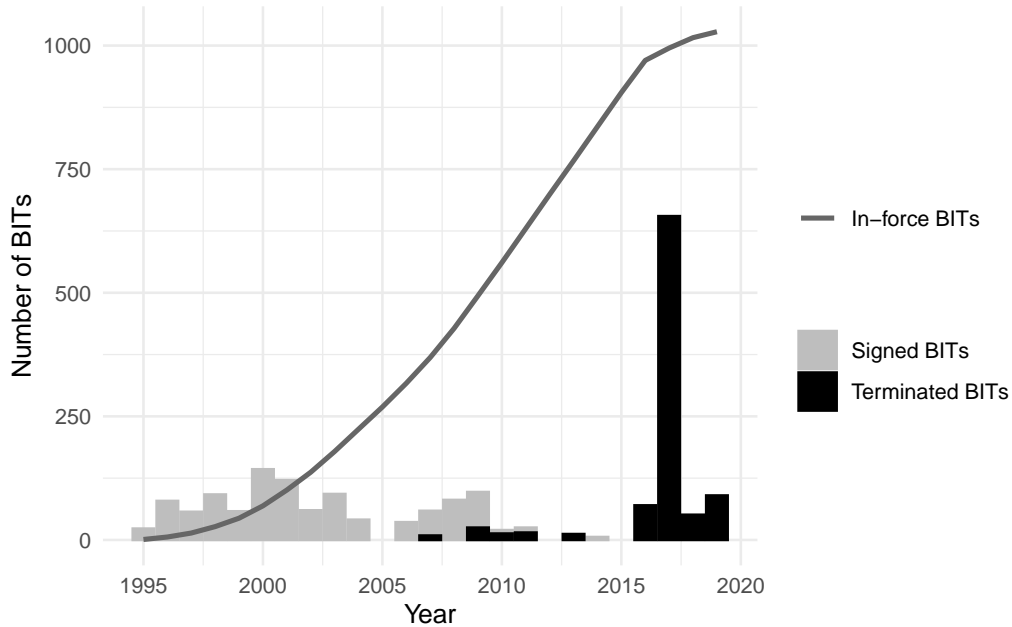


Figure 8: *Signed, terminated, and in-force BITs of India*

two decades later, India lost an investment arbitration for the first time. White Industries, an Australian foundry business, filed a dispute against India under the Australia-India BIT ratified in 1999.²² The tribunal found India responsible and, in 2011, awarded compensation of 4.08 million Australian dollars to White Industries, who had claimed over 10 million Australian dollars for loss and damages. The White Industries dispute led to numerous arbitration cases being brought against India, which in turn sparked a domestic backlash against the ISDS mechanism. Since then, more than fifteen cases have been filed against India. As of May 2024, seven cases have been resolved, with four ruling in favor of the investor claimants. As shown in Table 3, India unilaterally terminated all of the BITs invoked by the four unsuccessful disputes, but none of these terminations occurred immediately after the rulings.

India's reluctance to initiate renegotiations was attributed to the severe limit in its repu-

²²The information on the allegations and decisions in the White Industries v India case is acquired from the UNCTAD Investment Policy Hub.

YEAR OF INITIATION	CASE NAME	APPLIED BIT	HOME STATE OF INVESTOR	AMOUNT AWARDED	BIT STATUS
2010	White Industries v. India	Australia - India BIT (1999)	Australia	4.10 mln AUD (4.10 mln USD)	Unilaterally denounced by India in 2017
2012	Devas v. India (I)	India - Mauritius BIT (1998)	Mauritius	111.30 mln USD	Unilaterally denounced by India in 2017
2013	Deutsche Telekom v. India	Germany - India BIT (1995)	Germany	93.30 mln USD	Unilaterally denounced by India in 2017
2014	Vodafone v. India (I)	India - Netherlands BIT (1995)	Netherlands	Data not available	Unilaterally denounced by India in 2016
2015	Cairn v. India	India - United Kingdom BIT (1994)	United Kingdom	1232.82 mln USD	Unilaterally denounced by India in 2017

Table 3: *The investment disputes that India lost and the BITs applied*

tational leverage. According to an official from the Modi government, the idea of pushing for renegotiation took hold around five years before the actual enactment of BIT terminations, as India was hit by a series of lawsuits starting from the White Industries case.²³ Investment arbitrations and failures in defending are thus unlikely the sole reason incentivizing countries to exit BITs and invoke sunset clauses. A few years before the Modi government started its massive actions of BIT withdrawals, India did not enjoy a good image as a destination for capital owners. In 2013, the World Bank released its EDB annual report assessing countries' performance in building an investor-friendly business climate, and India ranked 131st among 189 countries. It fell further by three places to 134th in 2014. A breakdown of the various aspects of EDB shows that India ranks near the bottom in four categories: starting a business, obtaining permits, enforcing contracts, and paying taxes. The media criticized the improvements in India's market status for being "marginal" due to "policy paralysis."²⁴

India sought to improve its EDB rating. Led by the Department of Industrial Policy and Promotion, government bodies and agencies in Mumbai and New Delhi launched a series of major initiatives in 2015 and 2016 relating to policy simplification, reducing the cost of capital entry through interest relief, document reduction, and information-technology-centered measures including moving application filing to online, creating trade portal, and deploying training and outreach activities.²⁵ At an unprecedented speed, India improved its rating in the World Bank report (see Figure 9). The country placed 100th in 2017 and moved up further by 23 places in 2018 when it ranked 77th. The government quickly

²³ "India looks to revisit foreign investment pacts." India TV. July 11, 2016.

²⁴ "Ease Of Doing Business: India Ranks 134th Among 189 Countries." Trak.in. May 9, 2014.

²⁵ "India: Ease of Doing Business initiatives implemented by DGFT." TendersInfo. July 13, 2016.

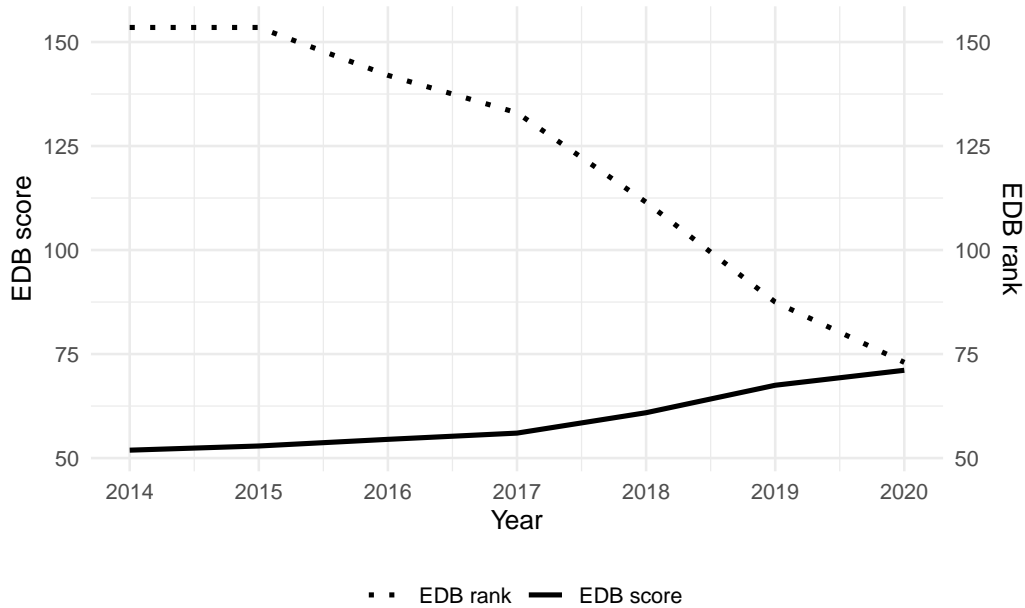


Figure 9: *India's EDB rating over time*

spread the news. The president tweeted: “Delighted at yet another rise in India’s ‘Ease of Doing Business’ rank. We are unwavering in our commitment towards economic reforms, which will ensure an environment that fosters industry, investment, and opportunities.”²⁶ Industrial associations, bankers and businesses, and non-governmental agencies hailed the Modi government for bringing up the country’s status in this high-profile global indicator.²⁷ The notable improvements in India’s EDB rating attracted foreign investors. European companies announced plans to invest multi-billion US dollars in India between 2017 and 2019. French companies alone intended an annual investment of 4 billion euros, as stated by France’s ambassador Alexandre Ziegler.²⁸

It was only after the country’s EDB ranking largely improved that India began to with-

²⁶“Ease Of Doing Business: India’s Rank Jumps By 23 Places.” Trak.in. November 1, 2018.

²⁷“Assocham applauds India position at Ease of Doing Business.” United News of India. November 1, 2018.

²⁸“India refuses to accede to European Union requests; post-March, investors to have no legal cover.” The Financial Times. March 1, 2017.

draw from BITs (see Figure 8). In March 2017, the Modi government informed the EU of its decision not to renew the expiring BITs pacts. The Modi government meanwhile stressed the need for renegotiating the investment agreements based on the new model of BIT it released a year ago. European countries soon expressed concerns over India’s decision to exit. Geoffrey Van Orden, the chair of the European Parliament delegation for relations with India, said that the European Union would want India to extend the validity of the BIT beyond the termination date so that fresh investors would enjoy the same protection as existing investors in India.²⁹ Despite publicly announced dissatisfaction of treaty partners, India unilaterally terminated more than twenty BITs in the following years between 2018 and 2021.

7 Conclusion

This paper addresses the conditions under which a state would threaten exit to coerce cooperation. Examining 2620 BITs across 178 countries and 47 years, the paper demonstrates that a treaty party seeking BIT reforms is more likely to use exit threats when it gains reputational leverage, in this case, an improved investment reputation. The underlying logic for this finding is straightforward: a better market reputation makes exit threats more credible and thus provides bargaining leverage to terminating parties. The paper also identifies the conditioning effect of the sunset period of BITs. An increase in a traditional host country’s investment reputation is most associated with the likelihood of BIT renegotiations when the treaty has a shorter sunset period, whereas a treaty with a longer sunset period is more likely to be renegotiated by a traditional home party whose investment reputation improves. The empirical results also suggest a high sensitivity of BIT renegotiation to the largest changes in the EDB score or rank.

²⁹“India refuses to accede to European Union requests; post-March, investors to have no legal cover.” The Financial Times. March 1, 2017.

The paper contributes to our understanding of international relations in three ways. First, in today’s world, where we have access to a variety of information channels, reputation stands as a cornerstone of trust and cooperation among states. A state’s reputation not only influences its power projection and diplomatic standing but also shapes its strategic decision-making. Such decisions can lead to a change in its status quo policies, especially when it comes to institutional engagement. In this process, global performance indicators play an important role in channeling the effect of reputation on a state’s bargaining leverage through transnational market actors.

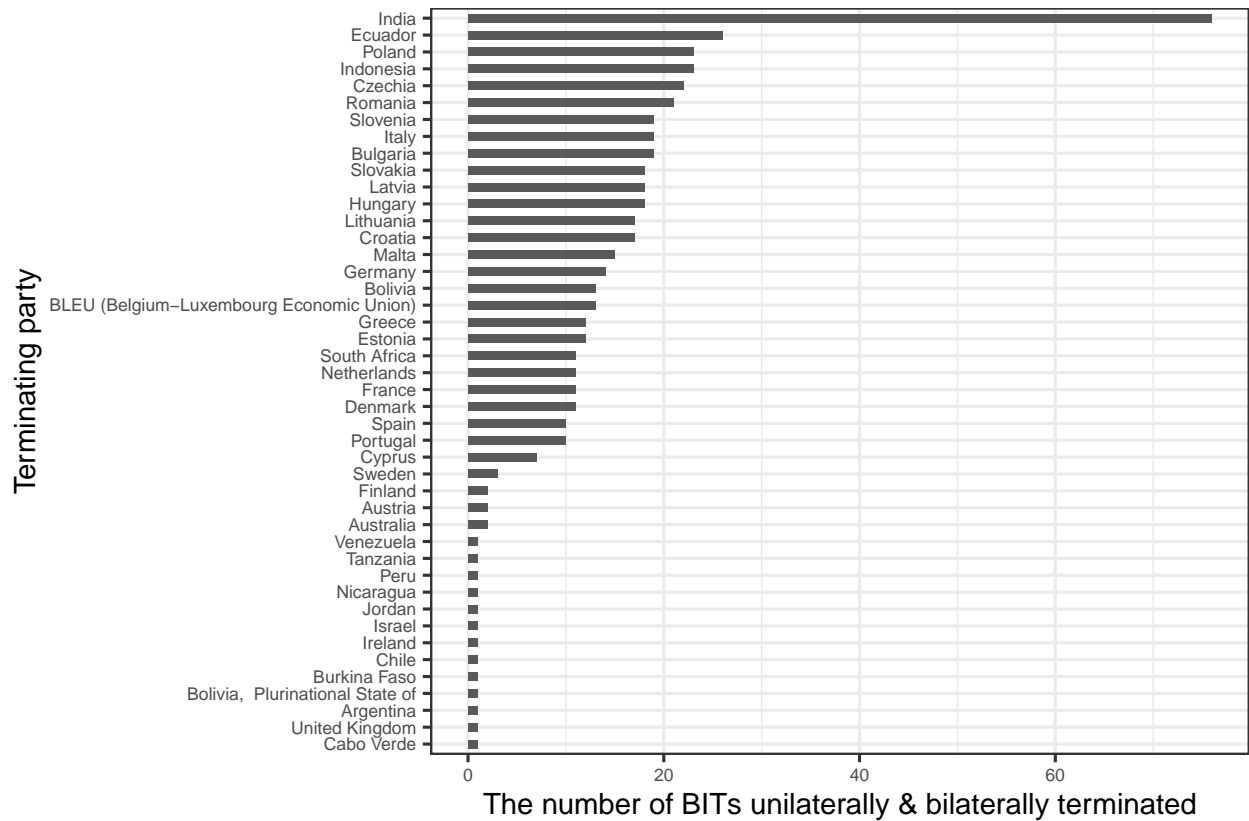
Second, the paper fills in a void in the emerging literature on institutional exit (e.g., Von Borzyskowski and Vabulas, 2019; Huikuri, 2023) by indicating not only why but also how states exit international institutions. Treaty terminations and renegotiations may arise from a similar causal process whereby emerging economies struggle to protect themselves from regulatory challenges and rising lawsuits. In this scenario, particular mechanisms designed to favor stronger treaty parties, such as sunset clauses, can be used by emerging economies to their advantage. As state exits may have triggered institutional reforms in recent decades and are likely also in the foreseeable future, it is important to consider how and when states use the ultimate bargaining chip of exit threat to push for institutional reforms.

Third, the coercive use of exit would likely parallel the trend of “informal governance” (Stone, 2008) where opportunities for derogating formal rules are intentionally embedded to safeguard the interests of powerful states. More importantly, the “powerfulness” can be interpreted in divergent ways. At least in the world of investment regimes, coercion is no longer the privilege of the club of the traditional big powers. Both reputational status and the economic connections developed over time can empower countries of which the economic might was once limited. This process of empowerment has been facilitated by the development of communication techniques and transnational activities of private actors. Ultimately, in a globalized world characterized by a proliferation of informational devices

and channels, exerting power in one direction has become more challenging.

There are a few implications for future research. First, international agreements are optimal equilibriums in that any change to the status quo arrangements will make at least one party worse off (Rosendorff and Milner, 2001). It is unclear what causes the failures in achieving a Pareto improvement, specifically regarding the instances where exit threats led to successful renegotiations versus those that failed. The limitations of existing data make it difficult to answer such questions. However, this creates an opportunity to explore empirical evidence through qualitative clues such as leaders' speeches, media reports, and survey experiments. Second, there is room for discussion on the generalizability of the findings of this paper, as the influence of market reputation on exit threats may vary across different international agreements and across economic sectors. Third, future research could delve deeper into the specific metrics and components of market reputation that most significantly influence a country's decision to pose an exit threat. Understanding the nuances within these indicators can provide more detailed insights into the mechanisms at play.

Appendix A



Terminations of BITs by terminating party

Data collected from UNCTAD Investment Policy Hub. Last updated in December 2022. Source: <https://investmentpolicy.unctad.org/international-investment-agreements>.

Appendix B

Table 4: *BIT deviation/exit, EDB rank change, and sunset period of BIT: rare-event logit models*

	Dependent variable					
	BIT deviation (=1)			BIT exit (=1)		
	Model 13	Model 14	Model 15	Model 16	Model 17	Model 18
Host EDB rank change _{t-1}	-0.010* (0.005)	-0.017*** (0.002)	-0.009 (0.005)	-0.015*** (0.002)	-0.010* (0.005)	-0.015*** (0.002)
Host EDB rank change _{t-1} * Sunset length	-0.001 (0.0004)		-0.0004 (0.0004)		-0.001* (0.0004)	
Home EDB rank change _{t-1}	-0.013*** (0.003)	0.031*** (0.010)	-0.012*** (0.003)	0.019* (0.011)	-0.018*** (0.003)	0.010 (0.009)
Home EDB rank change _{t-1} * Sunset length		-0.004*** (0.001)		-0.002*** (0.001)		-0.002*** (0.001)
Sunset length	0.014*** (0.004)	0.015*** (0.004)	0.015*** (0.004)	0.015*** (0.004)	0.009** (0.004)	0.008** (0.003)
Host FDI outflows _{t-1}	-0.003*** (0.001)	-0.003*** (0.001)	-0.002* (0.001)	-0.002* (0.001)	-0.001 (0.001)	-0.002*** (0.001)
Home FDI outflows _{t-1}	0.001 (0.001)	0.001 (0.001)	-0.0003 (0.001)	-0.0001 (0.001)	-0.001 (0.001)	-0.001 (0.001)
Host GDP growth _{t-1}	-0.007 (0.010)	-0.009 (0.010)	-0.010 (0.010)	-0.012 (0.010)	0.002 (0.010)	-0.008 (0.009)
Home GDP growth _{t-1}	0.012** (0.006)	0.012** (0.006)	0.009 (0.006)	0.010* (0.006)	0.018*** (0.005)	0.016*** (0.005)
Host left executive _{t-1}	-0.229*** (0.087)	-0.208** (0.086)	-0.236*** (0.087)	-0.224** (0.087)	-0.276*** (0.086)	-0.219*** (0.076)
Home left executive _{t-1}	-0.054* (0.029)	-0.040 (0.029)	-0.043 (0.030)	-0.033 (0.030)	0.043 (0.028)	0.035 (0.026)
Host leader transition _{t-1}	0.136** (0.054)	0.132** (0.054)	0.135** (0.055)	0.132** (0.054)	0.115** (0.055)	0.060 (0.047)
Home leader transition _{t-1}	-0.232*** (0.038)	-0.243*** (0.038)	-0.211*** (0.038)	-0.220*** (0.038)	-0.196*** (0.035)	-0.208*** (0.033)
Host gov stability _{t-1}	0.010 (0.027)	0.017 (0.027)	0.021 (0.028)	0.027 (0.028)	0.052* (0.028)	0.056** (0.024)
Home gov stability _{t-1}	-0.064*** (0.016)	-0.066*** (0.016)	-0.053*** (0.017)	-0.055*** (0.017)	-0.028* (0.016)	-0.033** (0.015)
Host ISDS resp cum (logged) _{t-1}			0.396*** (0.089)	0.403*** (0.087)	0.145 (0.089)	0.191** (0.076)
Home ISDS resp cum (logged) _{t-1}			0.055*** (0.011)	0.052*** (0.011)	0.083*** (0.010)	0.067*** (0.010)
Host ISDS home cum (logged) _{t-1}			-0.114* (0.069)	-0.129* (0.068)	-0.027 (0.069)	-0.110* (0.059)
Home ISDS home cum (logged) _{t-1}			0.104*** (0.014)	0.102*** (0.014)	0.166*** (0.013)	0.133*** (0.012)
GDP gap _{t-1}			-0.138*** (0.034)	-0.118*** (0.034)	-0.298*** (0.030)	-0.200*** (0.030)
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Number of BITs	270	270	254	254	254	254
Number of Countries	66	66	66	66	66	66
Number of Years	7	7	7	7	7	7
Observations	1,067	1,067	992	992	992	992

Note: * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

All models are logistic regression with country and year fixed effects. Standard errors are clustered by country dyad and shown in parentheses.

Appendix C

Table 5: *BIT deviation/exit, Heritage score/rank change, and sunset period of BIT: rare-event logit models*

	<i>Dependent variable</i>					
			BIT deviation (=1)			
	Model 3	Model 4	Model 9	Model 10	Model 15	Model 16
Host Heritage score change _{t-1}	0.008*		-0.010		0.008*	
	(0.005)		(0.014)		(0.005)	
Host Heritage score change _{t-1} *			0.001			
Sunset length			(0.001)			
Host Heritage rank change _{t-1}		0.001		-0.003		0.001
		(0.001)		(0.003)		(0.001)
Host Heritage rank change _{t-1} *				0.0003		
Sunset length				(0.0002)		
Home Heritage score change _{t-1}	0.011**		0.011**		-0.052***	
	(0.005)		(0.005)		(0.017)	
Home Heritage score change _{t-1} *					0.005***	
Sunset length					(0.001)	
Home Heritage rank change _{t-1}		-0.002**		-0.002**		0.008**
		(0.001)		(0.001)		(0.003)
Home Heritage rank change _{t-1} *						-0.001***
Sunset length						(0.0003)
Sunset length	0.011***	0.011***	0.010***	0.010***	0.009***	0.011***
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Host FDI outflows _{t-1}	0.0004	0.0004	0.0004	0.0004	0.0005	0.0004
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Home FDI outflows _{t-1}	-0.002***	-0.002***	-0.002***	-0.002***	-0.002***	-0.002***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Host GDP growth _{t-1}	0.004	0.004	0.004	0.004	0.004	0.004
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)
Home GDP growth _{t-1}	-0.004	-0.004	-0.003	-0.004	-0.003	-0.004
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)
Host left executive _{t-1}	-0.251***	-0.244***	-0.250***	-0.244***	-0.253***	-0.245***
	(0.028)	(0.028)	(0.028)	(0.028)	(0.028)	(0.028)
Home left executive _{t-1}	0.009	0.009	0.009	0.008	0.009	0.010
	(0.016)	(0.016)	(0.016)	(0.016)	(0.016)	(0.016)
Host leader transition _{t-1}	-0.071***	-0.071***	-0.071***	-0.071***	-0.067***	-0.067***
	(0.023)	(0.023)	(0.023)	(0.023)	(0.023)	(0.023)
Home leader transition _{t-1}	-0.117***	-0.117***	-0.117***	-0.117***	-0.117***	-0.119***
	(0.021)	(0.021)	(0.021)	(0.021)	(0.021)	(0.021)
Host gov stability _{t-1}	0.017*	0.021**	0.017*	0.021**	0.019**	0.022**
	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)
Home gov stability _{t-1}	0.005	0.005	0.005	0.005	0.005	0.005
	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)
Host ISDS resp cum (logged) _{t-1}	0.313***	0.308***	0.313***	0.309***	0.313***	0.307***
	(0.023)	(0.023)	(0.023)	(0.023)	(0.023)	(0.023)
Home ISDS resp cum (logged) _{t-1}	0.059***	0.059***	0.059***	0.058***	0.057***	0.059***
	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)
Host ISDS home cum (logged) _{t-1}	-0.045*	-0.052**	-0.045*	-0.052**	-0.047*	-0.053**
	(0.025)	(0.025)	(0.025)	(0.025)	(0.025)	(0.025)
Home ISDS home cum (logged) _{t-1}	0.122***	0.122***	0.123***	0.121***	0.121***	0.121***
	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)
GDP gap _{t-1}	-0.234***	-0.235***	-0.234***	-0.235***	-0.231***	-0.235***
	(0.017)	(0.017)	(0.017)	(0.017)	(0.017)	(0.017)
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Number of BITs	405	405	405	405	405	405
Number of Countries	75	75	75	75	75	75
Number of Years	22	22	22	22	22	22
Observations	3,785	3,785	3,785	3,785	3,785	3,785

Note: * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

All models are logistic regression with country and year fixed effects. Standard errors are clustered by country dyad and shown in parentheses.

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