Strategized Exit: Sunset Clauses and Unilateral Terminations of BITs*

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Abstract

Since peak enthusiasm in the 1990s, governments worldwide have increasingly renegotiated or terminated bilateral investment treaties (BITs). This paper examines the politics underlying this trend, asking how choices of institutional design– specifically the length of the validation duration of sunset clauses – correlate with subsequent decisions of institutional exit. Sunset clauses were designed to lock in capital-importing countries with treaty responsibilities. A long sunset period, however, may benefit host governments in a way that contradicts the purpose of the clauses. Examining 473 BITs across 112 countries and 50 years, the paper demonstrates that a BIT party is more likely to unilaterally terminate its treaty when the invoked sunset clause can pose a longer-term threat to bilateral investment relations. States are most likely to use the strategy of BIT exit when they are experiencing a decline in GDP growth and thus a decrease in relative position on the negotiation table. The paper contributes to the emerging literature on institutional exit by indicating how particular forms of exit may be used to gain leverage in bargains.

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1 Introduction

After reaching a high point in the 1990s, international investment agreements have experienced a wave of withdrawals. Although there is a rising trend around the globe of revising international economic governance, few international economic institutions have sparked controversy as stark as investment regimes (Poulsen and Gertz, 2021). Bilateral investment treaties (BITs) are criticized for failing to block out power politics and for offering a means for private actors to impose exorbitant costs on sovereign governments. Some argue that the investor-state dispute settlement (ISDS) mechanism, which is the dispute settlement mechanism of BITs, is designed in a way that protects the interests of more powerful, capital-exporting states rather than the usually weaker, capital-importing states (Allee and Peinhardt, 2010). Others draw attention to the right that BITs endow foreign investors with to sue host governments at an international venue (e.g., (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).

In recent decades, antagonism toward BITs has been spilling from the developing world to developed societies and has taken various forms, ranging from termination of BITs to withdrawal from the ISDS mechanism often embedded in BITs. Some governments have started to re-examine their policies toward BITs and question whether investment agreements with the ISDS are necessary or in the interest of host states. For example, Indonesia and South Africa, both large capital importers but also emerging regional capital exporters, have publicly stated that their domestic institutions have evolved to the point where existing ISDS provisions are now less relevant (Lester, 2016). In addition, important middle-power countries like India, Brazil, and South Africa never joined the ISDS mechanism, while Venezuela and Bolivia have officially withdrawn. In the existing stock of 3,000 investment treaties, the trend of terminations is increasingly noticeable. 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 (UNCTAD, 2022). Overall, more and more BITs are being terminated, and many major economies are reconsidering their policies toward BITs.

When a state is dissatisfied with the politics of international investment, it has several options to change its status-quo policy on BITs. The government can sign a new agreement with its treaty partner to replace the active BIT that they ratified. Alternatively, it can terminate the active BIT either with or without the consent of its treaty partner. While some states opt for replacement, others terminate their BITs and renegotiate new investment agreements with the same treaty partners. What explains the variations in the forms of efforts that countries took to change the terms of their treaties? This is the central question I seek to explore.

There is a rich body of research addressing why states join investment regimes. However, the discussion in the literature about states' backlash against BITs remains insufficient. The emerging literature on institutional exit does not put much emphasis on investment regimes, either (e.g., (Von Borzyskowski and Vabulas, 2019; von Borzyskowski and Vabulas, 2023)). A very limited number of studies consider BIT exits as a reflection of revisionist power (Huikuri, 2023) or a reaction to exorbitant costs imposed by investment arbitrations (Haftel and Thompson, 2018; Thompson et al., 2019). Nevertheless, BITs involve bilateral investment relations between signatory governments. The decision of one party should not be isolated from the behavior of the other. I thus suggest understanding changes in one party's policy decisions on BITs as an outcome of both a decision-making process that connects with domestic policy concerns of the government and a bargaining process that is based upon interactions between treaty parties.

Rather than treating BIT terminations and renegotiations as independent, the paper theorizes that both arise from a similar causal process whereby governments struggle to implement preferred regulations in the face of rising lawsuits. I argue that the unilateral termination of BIT is not a full exit but serves as a threat of exit. States have incentives to unilaterally terminate their BITs for the sake of leverage in renegotiation. This is because the unilateral termination of BIT will trigger the treaty's sunset clause which continue to protect existing rather than future investors for an extended period after treaty termination. An invoked sunset clause thereby puts the host state in a better position to pressure its treaty partner's concessions if the partner is concerned about the lack of BIT protections for its own future outward investors. My argument is consistent with the fact that BIT exits are sometimes accompanied or followed by renegotiation.[1]

I illustrate my argument by analyzing how sunset clauses correlate with BIT termination among 473 BITs, covering 112 countries and 50 years. Using logistic regression, I show that longer validation duration of sunset clauses increases the odds of capital-importing countries' policy decision to unilaterally withdraw from BITs. The results also provide support for a conditioning effect of the host country's growth rate on the relationship between sunset clauses and the policy of unilateral withdrawal. The duration of the sunset clause has the strongest effect on BIT's unilateral termination in host countries that have been experiencing a decline in economic strength.

This paper contributes to the literature by investigating how institutional design choices correlate with subsequent policy decisions of institutional exit. While sunset clauses were designed to lock in capital-importing countries with treaty responsibilities, a long sunset period may benefit host governments in a way that contradicts the purpose of the clauses. The evolving policy stances on BITs may highlight the necessity of further exploring unintended outcomes of institutional design choices. Lock-in mechanisms can be used to increase bargaining leverage by initially weaker parties in economic exchange, especially when those

[1] For example, Indonesia unilaterally terminated its 2005 BIT with Singapore in 2016, which immediately invoked a 10-year sunset clause. Interestingly, the two parties signed a new BIT in 2018, two years after the old treaty was unilaterally terminated. This implies that the renegotiation occurred during the validity of the sunset clause.

parties experience declining growth and are short of channels that give them an upper hand in negotiations.

2 The Puzzle

Given the potential positive effects of foreign direct investment (FDI) on growth, national governments are often keen to attract investment flows. While tax incentives and regulatory policies are prevalent mechanisms under the control of sovereign states, international investment agreements are the cooperative regimes that states adopt in the international sphere. Countries concluding these agreements commit themselves to adhere to specific standards on 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 common 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.[2] The enthusiasm of states toward BITs was attributed to the belief that BITs reassure foreign investors (Büthe and Milner, 2008). BITs benefit treaty signatories in two ways. First, countries sign BITs because treaty signing can serve as a signaling device. Since capital would turn into immobile assets once invested in the host market, capital owners would worry that the host government cannot credibly promise to refrain from interfering with foreign investment (Simmons, 2000). Investors from overseas are thus often concerned about the quality of domestic institutions and the enforceability of law in the host countries (Jensen, 2008; Staats and Biglaiser, 2012; Lee et al., 2014; Xu, 2020). Binding institutions are better than "cheap talk," as the former conveys the seriousness of the host government's intentions to protect foreign investment

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

and treat equally domestic and foreign investors. In host states that ratified BITs, foreign investors are allowed to use international legal resort if they find domestic institutions incapable or biased (Ginsburg, 2005; Büthe and Milner, 2008; Malesky and Milner, 2021). Granting foreign investors access to the international judicial system signals that the signatory government consents ex-ante to yield its autonomy over the procedures and results of investment dispute settlement.

The second type of benefit countries can gain from signing BITs is realized through the ISDS mechanism that BITs grant access to. The ISDS mechanism is a dispute resolution system where two parties to a dispute agree to arbitrate or operate under the BIT that specifies that arbitration is the remedy. The ISDS mechanism, unlike state-to-state arbitration, allows private actors to formally sue sovereign states in the international jurisdictional system.[3] The International Centre for Settlement of Investment Disputes (ICSID) is the ISDS mechanism to which BITs provide treaty parties with access. BITs and the ICSID are legally tied to each other. The ratification of BITs is a prerequisite for the application of the ICSID Convention. More specifically, if a state wants to forbid the use of the ISDS mechanism, simply denouncing the ICSID Convention is not enough. It will also need to break the BITs it signed. Otherwise, the parties of its treaties that are not terminated can still file cases at the ICSID against its government even if it is no longer an ICSID member.

Failure to comply with treaty terms should be costly enough to make host states' commitments credible to investors. A BIT constrains a state's behavior by imposing penalties in the case of non-compliance (Büthe and Milner, 2008). The ex-post costs, including financial and reputational loss, are triggered only when disputes are filed and/or awarded at international courts (Haftel, 2010; Allee and Peinhardt, 2010). The mechanism to achieve this is thus the ISDS system, which enables investors to seek compensation from host countries

[3]The 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).

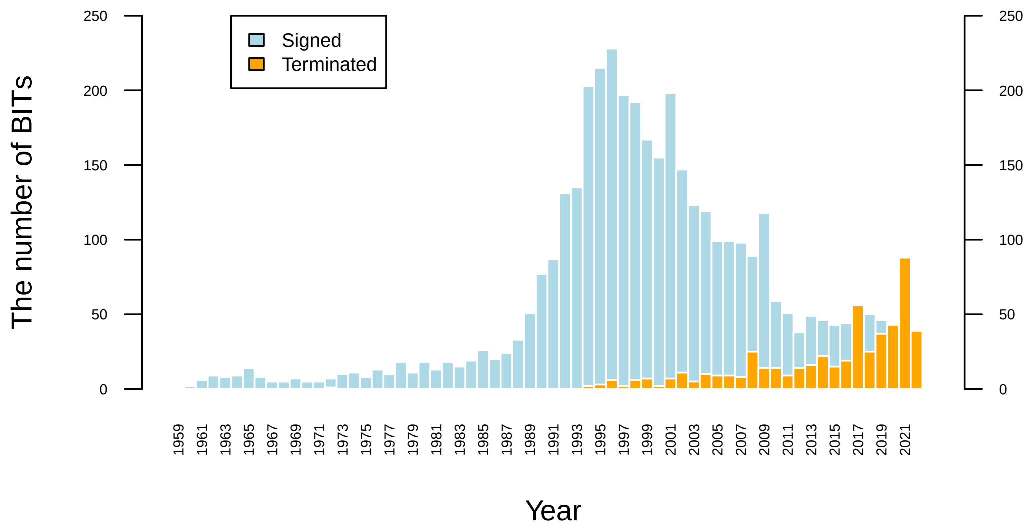


Figure 1: *Signed and terminated BITs, 1959-2022*
Data collected from UNCTAD Investment Policy Hub. Last updated in December 2022. Source: `https://investmentpolicy.unctad.org/international-investment-agreements`.

for failing to fulfill the committed protection. This is called "hands-tying" (Fearon, 1997) which imposes ex-post costs on an actor who does not follow through on a commitment. By tying the hands of signatory governments, a BIT provides informational value through its arbitration system. Correspondingly, the benefits that a state gains from signing or ratifying BITs are enhanced credibility which makes it more attractive as a host destination for FDI.

Given the benefits of BITs, states should be expected to preserve their BITs once they sign the treaties. However, what the standard narratives predict is inconsistent with the reality. In the existing stock of 3,000 investment treaties, the trend of terminations is increasingly noticeable, as shown in Figure 1. 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 (UNCTAD, 2022). If BITs provide informational value and benefit signatory states by being costly, why do states exit BITs after paying the costs of joining these agreements? Do terminations of BIT reflect states' antagonism against investment regimes? Existing studies show that the shrinking gap of economic strength between BIT parties can encourage host governments to adopt revisionist policy by terminating the treaties that no longer serve their development goals (e.g., (Huikuri, 2023)). However, the variations in the forms of efforts that countries took to change the status of their treaties have not been sufficiently explored so far.

Particularly, many BITs allow signatory states to replace old investment treaties with new ones. While some states opt for replacement or mutual termination, many states opt for unilateral termination. In theory, this is puzzling. Compared to replacement or mutual termination, unilateral termination is costly – most BITs have "sunset clauses" (sometimes also referred to as survival clauses) that go into effect and bind countries together under the treaty's conditions for a certain number of years. Sunset clauses guarantee that all investments made prior to the termination of a BIT continue to be protected during a period that ranges from 5 to 20 years.

Only unilateral withdrawal from in-force BITs automatically triggers sunset clauses. This policy choice thus locks in states with their treaty responsibilities to existing investors for an extended period beyond treaty termination (Lavopa et al., 2013). Although the invocation of sunset clauses prevents states from immediately freeing themselves from the treaty obligations in at least the medium term, unilateral termination has increasingly become a popular way for states to change the BIT status quo Figure 2.[4] Why would states opt for unilateral termination when other options – i.e., treaty replacement and termination by consent – are available? As either of the alternatives should theoretically be a better choice, it is puzzling why there has been a rising number of unilateral withdrawals in recent years.

[4] A more specific breakdown of the countries that terminated BITs is shown in Appendix A Appendix B Appendix C.

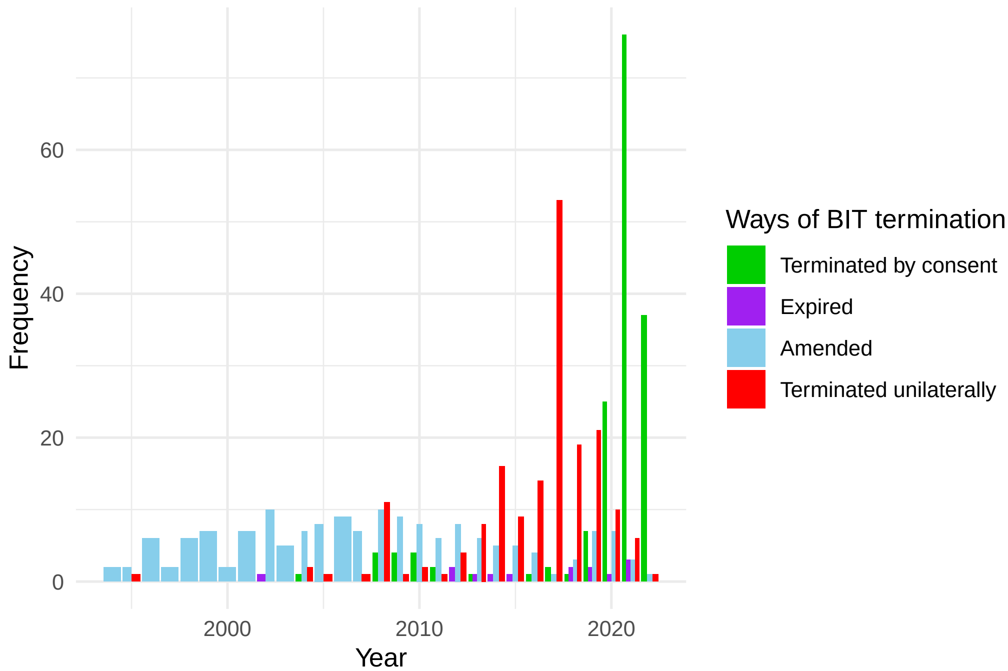


Figure 2: *Alternative ways of terminating BITs, 1990-2022*
Data collected from UNCTAD Investment Policy Hub. Last updated in December 2022. Source: `https://investmentpolicy.unctad.org/international-investment-agreements`.

3 Understanding BIT Terminations

Investment treaties are expected to be not only beneficial but also resilient. Institutions are considered "sticky" by scholars who share the premise that "international organizations are notoriously resistant to reform and redirection" (Barnett and Finnemore, 2004). Historical institutionalists argue that institutions tend to become self-reinforcing and lock in the status quo by structuring expectations, providing focal points for investment, and generating consecutive feedback (Pierson, 2004). Rational-choice institutionalists maintain that institutional reform should be difficult especially when member states complete domestic ratification and corresponding adjustments (Jupille et al., 2013). Another barrier to reform is the proliferation of institutions with overlapping jurisdictions and ambiguous boundaries (Benvenisti and Downs, 2007). Given the "stickiness" of international institutions, institutional reforms would be expected to occur only under particular circumstances such as in times of political shock (Bennett and Elman, 2006). In addition to structural factors, domestic political institutions including political regime types, and the ideology of the incumbent political party are found to be relevant (Von Borzyskowski and Vabulas, 2019). Member states of an international organization could also threaten to withdraw in order to achieve reforms of the organization (von Borzyskowski and Vabulas, 2023). There are only a few studies on the backlash against BITs, and they are mostly recent.

Poulsen (2015) draws upon bounded rationality theory to suggest that governments, especially those in the developing world, may suffer from cognitive biases in the ratification of their investment agreements. Being not fully aware of the risks of ISDS, they signed up to BITs. As arbitration cases accumulated, they began to gain new information about the investment regime from their own or others' unpleasant experiences of being sued and paying awards (Haftel and Thompson, 2018). In other words, it is the effects of learning that offset the effects of bounded rationality for BIT signatories and, in turn, lead to an increase in the instances of policy revision. The post-ratification experience altered the informational environment in which states practiced, learned, and adjusted. This bounded-rationality account, however, does not explain why states differ in terms of how they adjusted their BIT policies or why some states renegotiate while others terminate the BITs that they previously ratified. Notably, this explanation is in contradiction with two facts. First, a majority of states that were exposed to ISDS arbitration at varying degrees have not terminated any BITs. Second, some BITs were terminated by states that face none, or relatively few arbitration cases.

Changes in intra-dyadic power balance can also determine whether the dissatisfied state can *act upon* the newly learned information that the bounded rationality account emphasizes. Huikuri (2023) centers on geopolitics and power asymmetry and argues that the source of a government's bargaining leverage is its increased power in a relative sense. Only when an initially weak party succeeds in improving its position in terms of both economic development level and bureaucratic expertise would the party agree to renegotiate the BIT without risking the collapse of the regime. This model contributes to our understanding of the variations in states' reform efforts. The possession of more economic capacity increases the scope of choices that are available to states, and bureaucratic expertise represents the upper limit of a party's capability to achieve its aims. Nevertheless, both explanatory variables signify what states *can* do but neither addresses what states *want to* do. I suggest taking into consideration possible determinants of states' incentives, not to build a deterministic analysis but to get closer to the full picture of what states are both able and willing to do.

A third explanation comes from functionalists who believe that states cooperate for the sake of the benefits that such institutions can bring and quit when the presumed benefits did not come into reality. They stress the loss of money and reputation that follows ISDS filings or arbitrations. Thompson et al. (2019), for example, identify the association between the number of investment disputes filed against a government and the reform efforts the government will make to change the BIT status quo. Pelc (2017) finds empirical evidence of the low success rate of ISDS litigations, which supports Thompson et al.'s argument about governments' reaction to what international investment regimes have brought to them. Although this literature ties the bounded rationality assumption with the costs resulting from dispute settlement, it does not sufficiently investigate the nature of the costs or fully explore the causal mechanism through which arbitrations lead to changes in state behaviors.

4 A Theory of Strategized Exit

Conventional studies often consider states' withdrawal from cooperative mechanisms as a backlash against international institutions.[5] In contrast, I argue that unilateral termination of BIT is not necessarily a form of institutional exit. With sunset clause being included

[5] An exception is von Borzyskowski and Vabulas (2023)'s argument that states can seek to reform the international organizations that they joined by threatening to withdraw.

in BIT, policymakers face a tradeoff between waiting for the partner country to agree to terminate the treaty and being constrained by treaty obligations for an extended period defined by the sunset clause. My explanation for the policy of unilateral withdrawal from BIT is deployed below in two parts. I first explain why unilateral termination should not be straightforwardly considered as institutional exit resulting from states' backlash against BITs. I then analyze how and when sunset clauses can be used strategically by governments as a coercive means.

4.1 Unilateral Termination More as a Means Than an End

Although states seek to change their policies toward BITs, the change does not have to be thorough. As decision-makers "accept solutions that are good enough rather than optimal" (Jupille et al., 2013), being a "good enough" policy option will enable BITs to survive. On one hand, the benefits that BITs provide still exist. States in need of FDI would still find BITs attractive since the benefit remains in place. Granting access to such investor-state litigation imposes costs on non-compliance and thus enhances the credibility of the host government's commitment (Haftel, 2010; Allee and Peinhardt, 2010) which makes the host state more attractive as a host destination for foreign investments (Büthe and Milner, 2008). BITs would continue functioning as a credibility device for capital recipients despite being (increasingly) costly.

On the other hand, BITs represent a major advance in the treatment of foreign investors in the contemporary age. While today's system of investment regime is easy to take for granted, the current levels of legal protection provided by BITs and the ISDS mechanism are a "focal point" where the interests of governments and those of market actors converge (Skovgaard Poulsen, 2020). The necessary condition for a "focal point" to be relevant is the expressive function of law that provides a feasible option for investors, home governments, and host states (McAdams, 2015). As states may have the demand to depoliticize economic disputes (Bonnitcha et al., 2017; John, 2018) or isolate economic relations from power politics (Davis and Morse, 2018), the ISDS mechanism serves as a suboptimal equilibrium that states opt for to protect the prospect of investment inflows in uncertain times. In the post-colonial era, the customary international law standard for expropriation was pushed back by developing countries, and the domestic laws of host states were clearly unacceptable to foreign investors. Great powers like the US have practiced military interventions to protect Americans' private commercial interests, which was later labeled as "gunboat diplomacy." The political dimension of state-to-state disputes has been a fact of life until the introduction of the ISDS mechanism. BITs were thus what states ended up with after opting out of existing alternatives including domestic laws and state-state investment arbitrations that are easily subject to geopolitics.

As a result, states challenge the BIT status quo by pushing for reforms that help them preserve policy autonomy (Thompson et al., 2019) without breaking away from the BIT system. Lacking better options, states may not have incentives to quit the network of BITs for good. Even the most skeptical countries including India and Indonesia have been releasing new models of BITs serving as templates for future BITs and renegotiating for new BITs that align better with their interests of regaining autonomy.[6]

4.2 The Use of Sunset-Clause Invocation as a Coercive Strategy

The purpose of sunset clauses is to render the BITs resilient to change or termination; they serve as an "immune system" of investment agreements. Over the past decades, sunset clauses of longer duration have become prevalent. As shown in Figure 3 the number of BITs signed with a 10-year sunset clause increased sharply in the 1990s. BITs without sunset periods have been infrequent. As capital-importing states often have less influence over the

[6]Both 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 C.

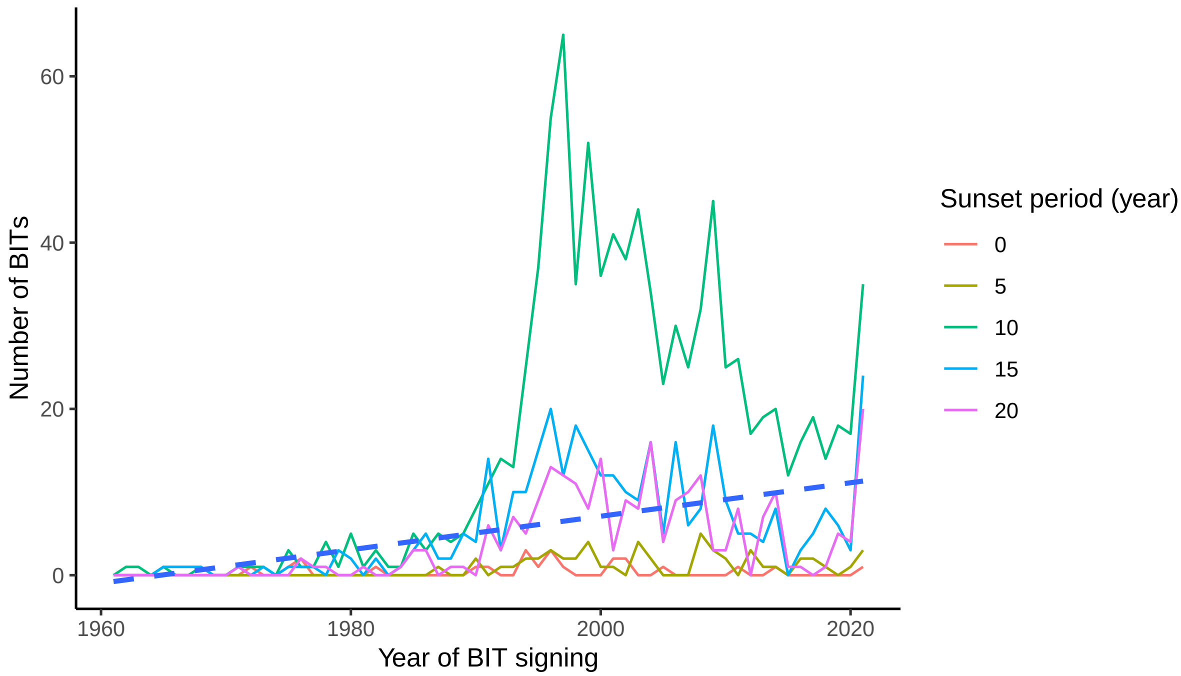


Figure 3: *BITs signed with sunset clauses of varying lengths (1962-2021)*

design of BITs than capital-exporting governments (Alschner and Skougarevskiy, 2016), this trend would reflect home countries' intentions to make the treaties resilient to policy changes of their treaty partners. It is in the interest of the home country to extend the validity of treaty obligations of the host state beyond the time when the host government unilaterally decides to withdraw from BIT.

Once triggered, sunset clauses will extend the rights of investors and the obligations of states into the designated period. This signifies that, after BITs are unilaterally terminated, only the investors who entered the host market from the partner country before the time of unilateral termination can continue to file legal claims or make threats of claims until the conclusion of sunset clauses. This has two important implications. First, a host state can inflict the costs of interruption on its treaty partner by invoking the sunset clause that allows it to discriminate against future investors from its treaty partner. Second, unilateral termination does not mean a full exit, as existing investors will remain protected by BIT provisions.

I argue that unilateral termination is a coercive strategy implemented by states that seek to reform their BITs. My argument is consistent with the empirical clues that states' activities of replacing, unilaterally or mutually terminating treaties are often intertwined. Terminations rarely happen between treaty partners without initial rounds of renegotiation, and terminations sometimes follow treaty expiration or failures in renegotiations. For example, some states such as Indonesia would allow their existing BITs to expire so that they can renegotiate them (Trakman and Sharma, 2015), whereas others would find it unnecessary to renew the commitment after treaty expiration. In the case of Indonesia, discontinuing BITs is the first step that the state takes in a bargaining process to increase leverage against its potential future treaty partners. Another example is India, which is among the few countries that have unilaterally terminated BITs with multiple treaty partners in a short timeframe. The Modi government released in 2016 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). Both cases of India and Indonesia are typical in demonstrating unilateral termination as one step taken by BIT signatories in a long process of attempting reform.

In the scant literature on states' withdrawals from BITs, Thompson et al. (2019) operationalize BIT termination as a more drastic form of renegotiation than BIT replacement. However, their empirical investigation is based on an unproved assertion that BIT termination is part of treaty renegotiation. No efforts have been made so far in the literature to proceed with theorization or empirical testing. This paper would thus be the first attempt to address this theoretical void and provide empirical proof for the causal mechanism that underlies Thompson et al. (2019)'s claims about the effects of arbitration costs on states' renegotiation of BITs.

Existing literature on bargaining and sanctions sheds light on how unilateral treaty termination may operate as a coercive threat. Sanctions are most efficient not when they are practiced but when they are threatened (Fearon, 1994; Drezner, 1999; Powell, 2006). Economic sanctions inflict costs indirectly through private actors and their economic activities, which contrast with a military force that imposes costs directly on the target government (Morgan and Bapat, 2003; Early, 2009). To impose costs on the target, the sender of the threat needs to create market imperfections that deter economic exchanges between market actors from the two parties (Stiglitz, 1989; Brewer, 1993). As more recent studies on sanctions (e.g., (Bapat and Kwon, 2015)) begin to focus on how host states raise the costs of their firms to engage in economic activities with the target country, this paper can highlight how host states may disincentivize future investors originated from the target country from entering the host market.

Because transnational economic exchanges are, unlike military forces, not under the full control of state authorities, states would need to alter the motivations of market actors to continue the relationship by inflicting costs on those actors via international regimes. Threatening to exit an international institution can be useful to pressure the members to agree to reform the institution, especially when the threat is posed by a key player with either significant political influence or economic status (von Borzyskowski and Vabulas, 2023). A unilateral termination with the sunset clause being activated can serve as a threat of institutional exit. Since existing investors will remain protected by BIT provisions once the sunset clause is triggered, unilateral termination should be understood as at most a threat of exit rather than an actual exit.

Exit and renegotiation would thus arise from a similar causal process whereby host governments struggle to neutralize the financial loss resulting from arbitrations and implement preferred regulation in the face of rising lawsuits. With the presence of sunset clauses, unilateral termination would not signify a full exit but stand for part of host states' efforts to reform BITs. Knowing that unilateral termination will automatically trigger sunset clauses, the state could use unilateral termination, not as a resort to exit a BIT for good, but as a threat of long-term exit. The host government would have incentives to trigger sunset clauses for the sake of its leverage in renegotiation. Not all BITs contain sunset clauses, and the unilateral termination of only the BITs that contain them would be useful for host states to increase leverage in future renegotiations between the BIT partners.

For economic sanctions to work, there must be a relationship to be interrupted (Hirschman, 1980; Keohane, 1977; Wagner, 1988). The effectiveness of sanction threats in extracting policy concessions from a target state depends on how costly the sanction can be to the target (Schultz, 1999). The higher the potential cost the interruption of the relationship can impose on the target, the more likely it is that the target will surrender (Keohane, 1977). The interdependent investment relationship between the treaty partners is thus the key. As long as the target government has an interest in preserving or developing the bilateral investment relations, suspending the protection of future investors would enable the host state to increase the expected economic cost facing the target government. Once a sunset clause is triggered, it would be the duration of the clause that determines how long the absence of treaty protection will persist, and it will be the host state that decides whether the absence of protection will extend to affect existing investors from the target country when the sunset clause ends.

A host country would thus be more prone to coerce mutual concession or agreement by unilaterally terminating the treaty when the invoked sunset clause can, to a larger extent, undermine the investment relations between the treaty partners. How much costs a sunset clause can inflict would depend on the duration of the clause, which I refer to in the following text as "sunset period". When a sunset clause can remain active for a longer period, the costs that both treaty parties expect to result from clause invocation would be higher. The potential loss resulting from a longer-term interruption of bilateral investment relationships would provide both treaty parties incentives to return to the negotiation table. The hypothesis is as follows:

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

Invoking sunset clauses, however, may not be the only way of coercing future cooperation with treaty partners. When a host state's economic strength increases, clause invocation may become increasingly feasible whereas decreasingly desired choice. Since the risen power of the host state itself can serve as an alternative and more straightforward source of coercive power in host-home bargains over treaty obligations, I expect that an increase in the economic power of the host state would neutralize the association between the length of a BIT's sunset period and the unilateral termination of BIT. The hypothesis is as follows:

H2: The relationship between sunset period and unilateral termination of BIT should be 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.

In brief, I argue that unilateral termination is one step in a long process of renegotiation. The costs of interrupted investment relationships are essential to the viability and effectiveness of the coercive strategy of unilateral exit. How coercive the strategized exit can become should primarily depend on how long a BIT's sunset clause lasts. A host government may seek to coerce the cooperation of a treaty partner by means of unilaterally terminating their BIT with a long sunset period, and this coercive strategy should be used more likely by the host states experiencing declining economic growth than by the host economies that thrive.

5 Empirical Approach

I examine 473 BITs across 112 countries and 50 years for the purpose of empirical testing. All these BITs fit two criteria. First, each of them includes a provision for unilateral termination, meaning that the treaty parties are allowed to unilaterally terminate the old treaty. A BIT

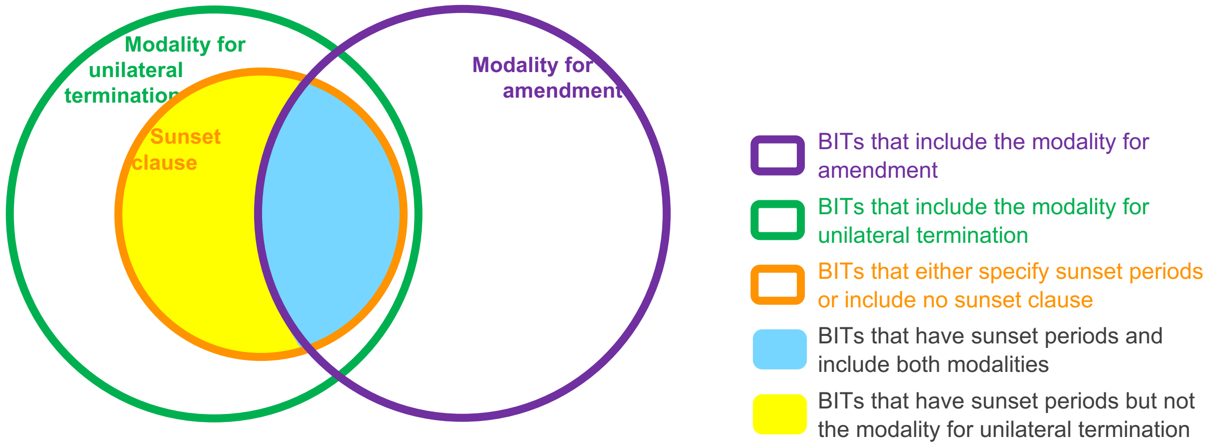


Figure 4: *The scope of the sample*

that does not include this provision for unilateral termination prohibits treaty parties from unilaterally terminating the treaty. Second, the BITs that are examined either specify the length of the sunset period or do not include a sunset clause at all. The sunset clauses that last until the conclusion of prior investments are considered indeterminate and excluded from my sample. I visualize the selection criteria in Figure 4, and the circle in green represents the scope of my sample. Among these 473 BITs, 160 were unliterally terminated, accounting for 33.8 percent of the dataset.[7]

There are two analytically distinguishable groups of BITs in my sample. One group includes sunset clauses and the provisions for both unilateral termination and replacement, as marked in blue in the diagram. Another group includes sunset clauses and the provision of unilateral termination only, as marked in yellow in the diagram. As indicated previously, the former allows the signatory states to change their BIT status by either one of the three means: unilateral termination (with the sunset clause invoked), mutual termination, and amendment (i.e., direct replacement). The latter, in contrast, allows two alternative means: unilateral termination (with the sunset clause invoked) and mutual termination. The difference in the range of choices provided to treaty partners is not theoretically important for hypothesis

[7]Given the rarity of unilateral terminations in the whole population of BITs, I am also considering using the Cox proportional hazard model as a robustness check.

H1, since all policy decisions to change BIT status other than unilateral termination are the counterfactuals that my theory considers. As long as the treaty is not unilaterally terminated, its sunset clause will not be invoked and thereby cannot contribute to the bargaining leverage of the host government.[8]

The dataset is built upon the UNCTAD IIA database,[9] which provides information on the attributes of BITs and sunset clauses. The unit of analysis is treaty-year. Each country dyad in the dataset can have more than one treaty due to BIT replacements or re-entries.[10] For example, Finland-Bulgaria BIT (1997) and Finland-Bulgaria BIT (2022) are included as separate treaties which belong in the same dyad of Finland-Bulgaria. 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). I thus code the party whose gross domestic product (GDP) was higher in the year of BIT signature as the home country and the weaker party as the host country. I use logistic regression model and cluster standard errors by country dyad.[11]

[8]The frequency of sunset periods for all sunset clauses included in my sample is shown in Appendix D.

[9]These 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/iia-mapping`.

[10]A 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.

[11]The indicator of GDP is not a perfect proxy for economic strength, but the availability of its data for all countries in all times provides the best coverage for coding the treaty dyads.

5.1 The Main Dependent and Independent Variables

The main dependent variable, *unilateral termination*, is binary. I score 1 for the onset of clause invocation (i.e., unilateral termination of the BIT) and 0 for other ways of changing treaty status that do not trigger the sunset clause. I have two independent variables of interest. The key independent for Hypothesis 1 is the length of sunset period. The value of *sunset length* variable ranges from 0 to 20 years,[12] with 0 signifying either the absence of a specified sunset period or an indication of zero sunset period in the BIT. For Hypothesis 2, the key independent variable is an interaction term between the length of sunset period and the growth of the host country's economic strength. *Host GDP growth* is captured by the annual GDP percent growth rate measure from World Development Indicators. I lag this variable by two years for the following reason. Exiting an in-force BIT should be a policy decision that governments undertake only after a thorough evaluation of potential advantages and disadvantages given the potential economic ramifications and partner country's reaction. It should not be a hastily executed contingency plan but a considered choice. Therefore, the effects of economic growth on policy decisions to change the status of an inter-governmental agreement should take time to fully manifest.

Figure 5 shows the average annual GDP growth rate among host states in the year of BIT ratification. Overall, the growth rate of host economies peaked at above 7 percent during 2003-2007 and declined sharply in 2008 when the Asian Financial Crisis broke out. The rate of economic growth quickly returned to around 4 percent during the time when the crisis spread to the Russian and Brazilian economies. Figure 6 demonstrates the distribution of the length of sunset period across the varying host economies' annual growth rates of GDP.

I also measure a country's record of participation in investment disputes as a respondent.

[12]Sunset clauses are either 5-year, 10-year, 15-year, or 20-year, except for three BITs: Azerbaijan-Syria BIT (2009) has a 7-year sunset clause; Azerbaijan-Croatia BIT (2007) has an 8-year; and Belarus-Mongolia BIT (2001) has a 12-year.

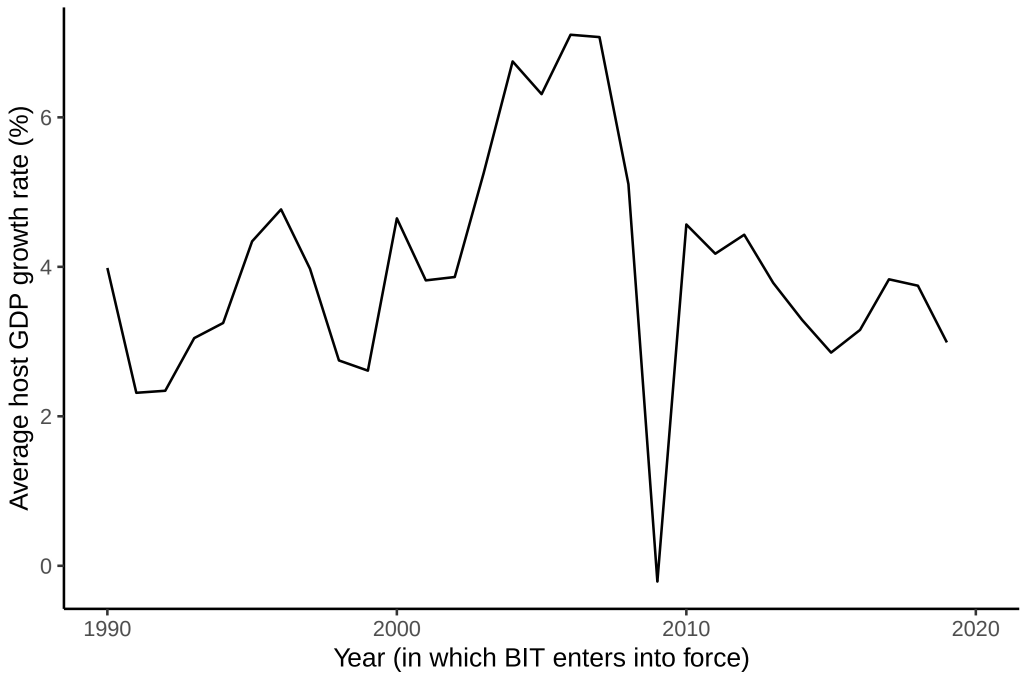


Figure 5: *The average GDP growth rate of host countries (1990-2020)*

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 will control for this identified relationship with *host ISDS respondent cumulative* which captures the cumulative number of investment disputes that the host government was involved in as a respondent. The data for this variable comes from Huikuri (2023)'s database. I transform the variable by logging it because the data are highly skewed.

The other two variables I control for are *home growth* which captures the economic development pace of the home state and *GDP gap* which measures the gap of economic strength between two signatory parties of a BIT. Both variables are lagged by two years, 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. 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

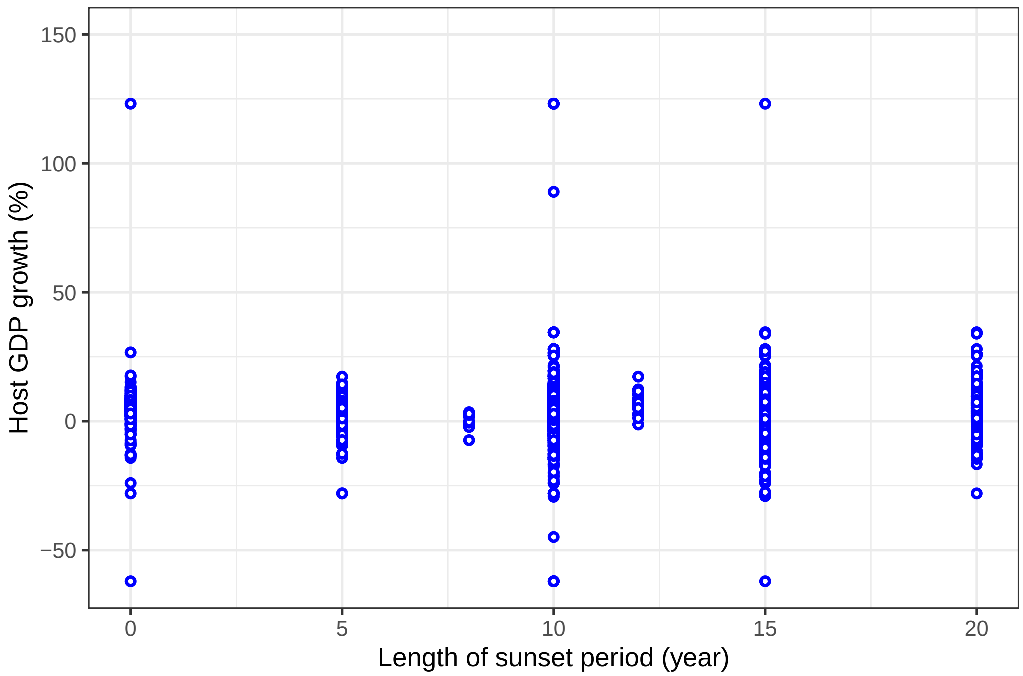


Figure 6: *The sunset period of BITs and the annual GDP growth rate of host countries*

rise in relative power can increase a country's demand for BIT reform. Urpelainen (2011) identifies economic development as the source of bargaining power for countries that seek to attract FDI. The control variable is thus operationalized as the difference within the treaty dyad in GDP.

5.2 Confounders

To capture the domestic political circumstances of signatory states of BITs, I control for democratization and political stability of host countries. Moves toward democracy require a strengthening of rules and regulations and thus can reduce the need to attract foreign investors with restrictive international regimes (Stasavage, 2002). I employ the Polity IV dataset Marshall et al. (2019) for the dichotomous variable of *democratization*. I lag it by two years because it should take time for countries under democratization to improve their domestic institutions. I follow (Haftel and Thompson, 2018) to score 1 if at least one of the treaty parties increases its Polity score by at least three points over a period of no more than three years. *Government stability* captures the time horizons of political leaders, as policymakers in less uncertain times or in governments with longer time horizons are proved to prioritize policy decisions that yield short-term gains to those that yield longer-term benefits (Pierson, 2000; Rosendorff and Milner, 2001; Blake, 2013).

Another control variable will be *Intra-EU* BIT which is dichotomous and scores 1 if both treaty parties are member states of the European Union (EU). In March 2018, the European Court of Justice found an arbitration clause in a BIT between two EU members incompatible with EU law in Case C-284/16 Achmea. In the two years following the Achmea judgment, over twenty EU member states signed an agreement for the termination of intra-EU BITs.[13] Observably, many of the mutually terminated BITs were signed between EU members. I thus find it necessary to account for this important legal change among European countries.

6 Findings

The results provide support for both hypotheses 1 and 2. BITs with longer sunset periods are more likely to be unilaterally terminated than those with shorter sunset periods. Table 7 reports the results from the main logistic regression models on the host government's policy decision to unilaterally withdraw from its BIT. Models 1 and 2 serve as a baseline for the effects of the sunset period and economic growth without controlling for any political factors for either or both of the treaty parties. Model 1 tests the effects of the length of the sunset period on the unilateral termination of BIT (Hypothesis 1), whereas Model 2 tests the interaction effects of the sunset period with the host economy's growth rate (Hypothesis 2). Model 3 tests the interaction effects and adds a control for the host country's democratization, and Model 4 adds a control for the stability of the host government. Model

[13] "EU Member States sign an agreement for the termination of intra-EU bilateral investment treaties". European Commission. Source: `https://finance.ec.europa.eu/publications/eu-member-states-sign-agreement-termination-intra-eu-bilateral-investment-treaties_en`.

	Dependent variable: Unilateral termination of BIT (=1)				
	(1)	(2)	(3)	(4)	(5)
Sunset length	0.087^{**}	0.185^{**}	0.192^{**}	0.175^{**}	0.188^{*}
	(0.044)	(0.078)	(0.080)	(0.079)	(0.103)
Sunset Length * Host GDP growth$_{t-2}$		-0.021	-0.020	-0.016	-0.022
		(0.013)	(0.013)	(0.013)	(0.018)
Host GDP growth$_{t-2}$	0.025	0.282^{*}	0.278^{*}	0.240	0.330
	(0.038)	(0.166)	(0.167)	(0.169)	(0.238)
Host ISDS resp cum (logged)	0.146	0.207	0.139	-0.001	0.156
	(0.191)	(0.195)	(0.204)	(0.223)	(0.264)
GDP gap$_{t-2}$	0.328^{*}	0.352^{*}	0.345^{*}	0.311	0.373
	(0.186)	(0.187)	(0.190)	(0.216)	(0.264)
Home GDP growth$_{t-2}$	-0.101^{*}	-0.112^{*}	-0.117^{**}	-0.135^{**}	-0.235^{***}
	(0.055)	(0.057)	(0.059)	(0.064)	(0.080)
Host democratization$_{t-2}$			-0.631	-0.910	-1.000
			(1.687)	(1.652)	(1.716)
Host gov stabilty				-0.316^{*}	-0.376^{**}
				(0.165)	(0.180)
Intra EU					-3.925^{***}
					(0.755)
Year	0.191^{***}	0.188^{***}	0.203^{***}	0.187^{***}	0.220^{***}
	(0.040)	(0.040)	(0.042)	(0.045)	(0.050)
Constant	-384.930^{***}	-379.714^{***}	-410.183^{***}	-374.935^{***}	-441.516^{***}
	(80.544)	(80.512)	(84.906)	(89.650)	(100.039)
Observations	212	212	207	189	189
Log Likelihood	-109.927	-108.558	-104.337	-93.231	-73.283
Akaike Inf. Crit.	233.853	233.116	226.673	206.462	168.567

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

Figure 7: *Sunset period, economic growth, and BIT termination: Logistic regression models for the full sample*

5 controls for intra-EU dyad.

There are two key findings of this analysis. First, the sunset period has a positive and statistically significant effect on the likelihood of unilateral termination of BIT across all five models. According to the statistical results of Model 2, a one-year increase in the length of the sunset period will result in a 2.25 percent increase on average in the odds of unilateral termination of the BIT, all else being equal.[14] The effect of the sunset period is stronger when the economic and political factors are considered. In Model 4, the increase in the odds of the BIT's unilateral termination resulting from the one-year increase in the sunset

[14] The marginal effects of the sunset period on BIT's unilateral termination are shown in Appendix E, based on the statistical results of Model 2.

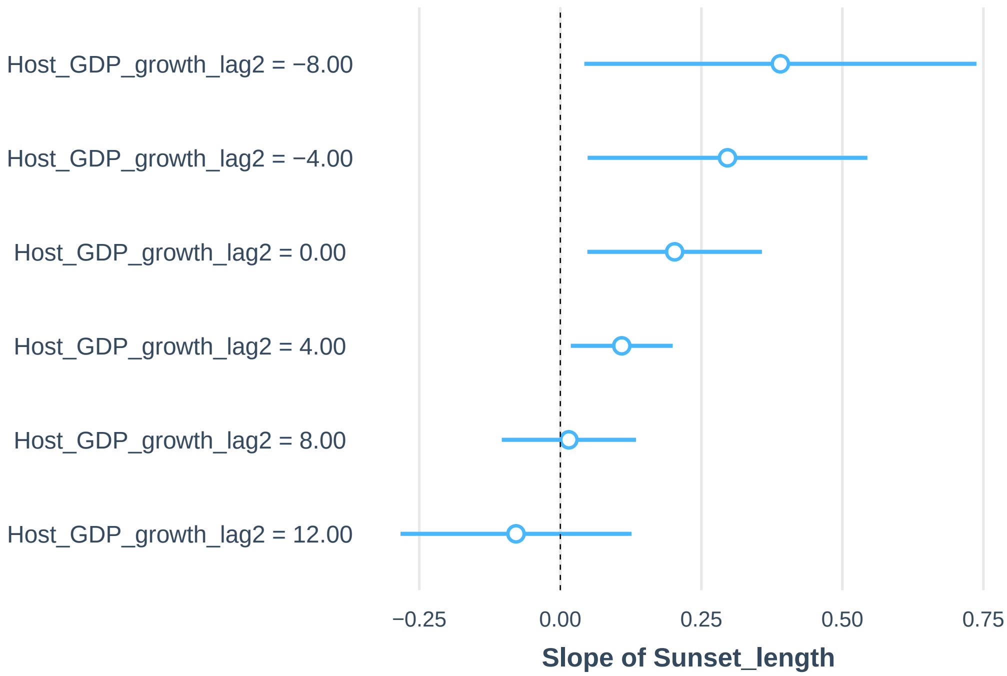


Figure 8: *Economic growth diminishes the effect of the sunset period on the unilateral termination of BIT*

period rises to 2.5 percent, ceteris paribus. The host country's economic growth has also a positive effect on BIT's unilateral termination, which is consistent with my proposition that the coercive strategy of sunset-clause invocation can be made more feasible to host governments by the rise of economic strength.

Second, the decreasing economic strength of host states consistently amplifies the effect of the length of the sunset period on the unilateral termination of BIT. In other words, the host country's economic growth is found to condition the impact of the length of sunset period on its government's behavior of clause invocation. The sunset period has the largest effect on a host government's decision to unilaterally withdraw from BIT when the annual GDP growth rate of the host economy is negative, as is shown in Figure 8. For host countries whose annual GDP growth rate exceeds 9 percent, a longer sunset period will decrease the odds of BIT's unilateral withdrawal to a minor extent. This is because high economic growth *per se* provides host states with bargaining leverage facing their treaty parties, which signifies a substitutive relationship between sunset-clause invocation and other channels of economic coercion. Their substitution should not be perfect, however. Only when the economic growth rate of host states rises to a certain level will their governments become capable of turning from the use of sunset clauses toward other means of exploiting the interdependent investment relations with treaty partners.

The results of this analysis have shown that states' policy of unilateral withdrawal from BITs is associated with other economic and political factors.[15] A higher annual GDP growth rate of the home country is found to decrease the likelihood of BIT's unilateral termination, signifying that the promising prospect of the home economy would discourage the host government from making unilateral decisions and triggering sunset clauses. Host government stability also has a statistically significant negative impact on unilateral withdrawal from BIT, which suggests that political uncertainty and a shorter horizon would motivate policymakers to take the initiative to strategically exit BIT. The results do not provide support for any significant relationship between democratization and the host state's inclination toward unilaterally terminating BITs. Lastly, there is a temporal effect across all five models: on average, unilateral termination is 2.0 to 2.5 percent more likely to occur each year than in the year before, holding all other variables constant.

To assess the robustness of the results, a number of alternative models are employed. These include a country fixed effects model, a linear regression model, and a multinomial logistic regression model. As India is the country that most often unilaterally terminated BITs and its cases of unilateral termination are considerably numerous compared to other countries, I also run a robustness check by excluding the observations where India is the host party. The results remain significant. The effects of the key independent variables remain robust across all these alternative models.

[15] The coefficients of the variables included in all four models are shown in Appendix F.

7 Conclusion

This paper addresses the conditions under which a state would withdraw from a BIT by triggering costly sunset clauses. Rather than treating treaty terminations and renegotiations as independent, it theorizes that both arise from a similar causal process whereby governments struggle to implement preferred regulation in the face of rising lawsuits. Examining 473 BITs across 112 countries and 50 years, the paper demonstrates that a BIT party is more likely to use unilateral termination when an agreement has a longer sunset clause. The underlying logic for this finding is straightforward: longer sunset clauses provide additional negotiating leverage to host countries. I show that states are most likely to use this approach when they have been experiencing a decline in GDP growth, suggesting their relative bargaining leverage may be decreasing.

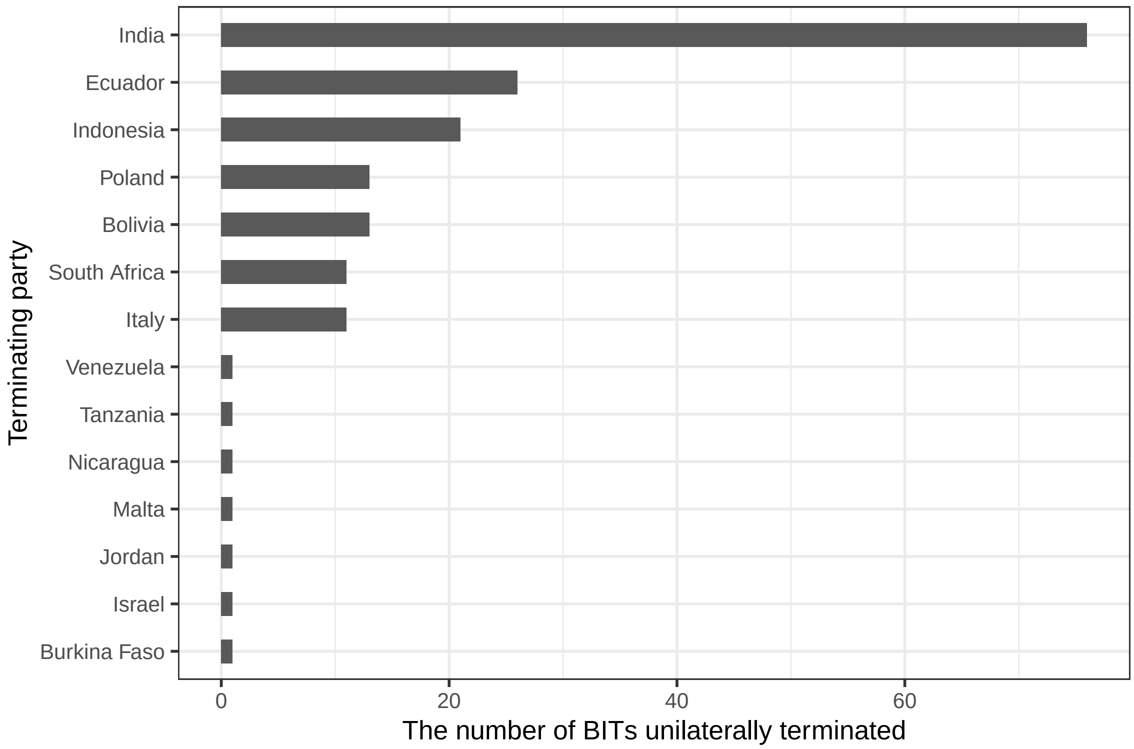
The paper contributes to our understanding of international institutions in four ways. First, it fills in a void in the emerging literature on institutional exit (e.g., (Von Borzyskowski and Vabulas, 2019; Huikuri, 2023)) by indicating not only why but also how states exit international institutions. It signifies that institutional exit in the investment sphere does not reflect a thorough break-away from international investment regimes. Exit may represent states' efforts to change the regime status quo, and it may be part of a long-term, gradual renegotiation process. State exits may have triggered institutional reforms in recent decades and are likely also in the foreseeable future.

Second, the connections between institutional exit and institutional reform provide us with a path to rethink multilateralism in a globalized context. It is important to consider the conditions under which states use the ultimate bargaining chip of exit threat to push for institutional reforms. The coercive use of exit would likely parallel the trend of "informal governance" (Stone, 2011) where opportunities for derogating formal rules are intentionally embedded to safeguard the interests of powerful states, although the "powerfulness" could be proxied in divergent ways. The discussion of exit threat would also lead to a dialogue with the body of research focusing on entry points for politics in other international economic institutions, namely the International Monetary Fund (Stone, 2008) and the World Bank (Malik and Stone, 2018).

Third, powerful states may have the leverage to push for their favored terms when designing international institutions. Once these institutions have been established with mechanisms in place to resist change, it is possible that less powerful nations may use these mechanisms to their own benefit. A longer period of sunset clauses can benefit capital exporters by locking in capital-importing states. However, it also allows host governments with limited power to take advantage of the economic connections that have developed over time. In a globalized world, interdependent relationships have made exerting power in one direction more challenging.

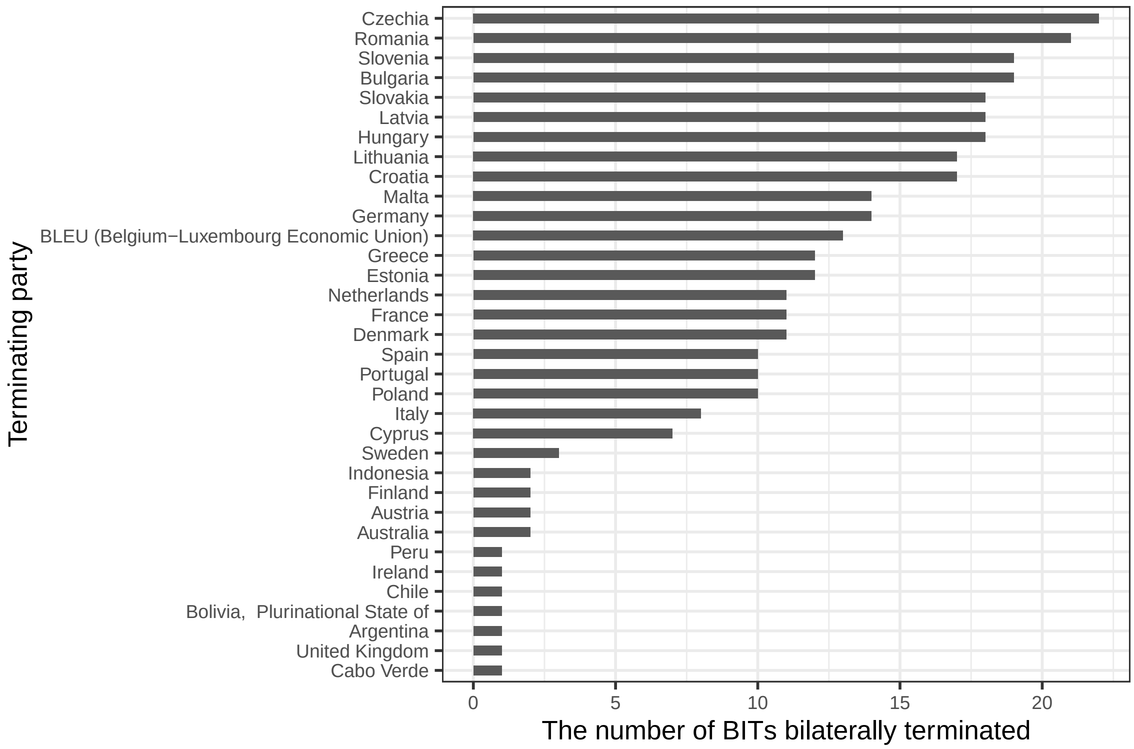
Fourth, as the scholarly discussion is abundant on the triangular relations between sovereign states, the market, and international institutions under globalization, the paper understands states' responses to the new dynamics of state-market relations under globalization not as a question of if but how. While institutions serve as a focal point and facilitate bargains between market actors and sovereign states (McAdams, 2015; Skovgaard Poulsen, 2020), states can opt to leave the table when their expectations are not met. Economic interdependence not only exposes sovereign states to new realities with empowered market actors but also provides governments with statecraft to adjust and adapt themselves to balance between domestic policy autonomy and international cooperation.

Appendix A



Unilateral 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`.

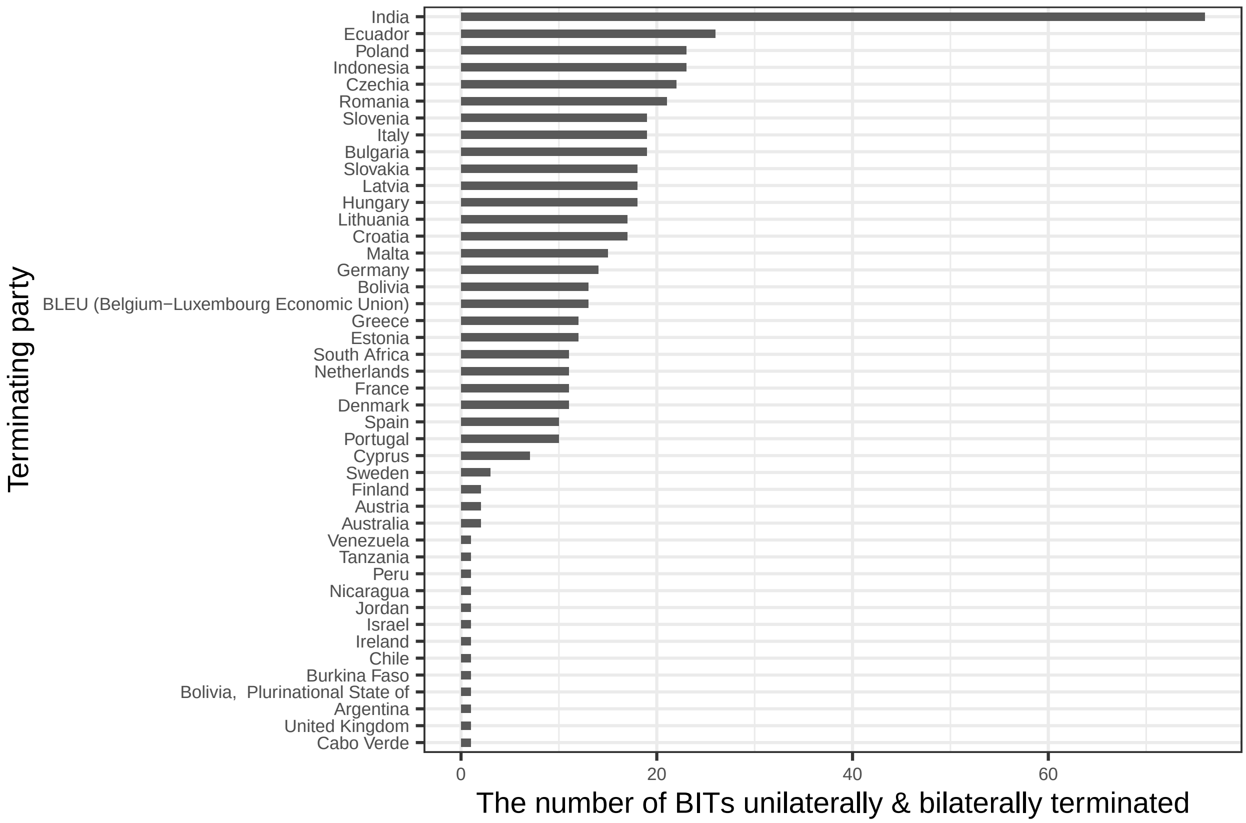
Appendix B



Bilateral 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`.

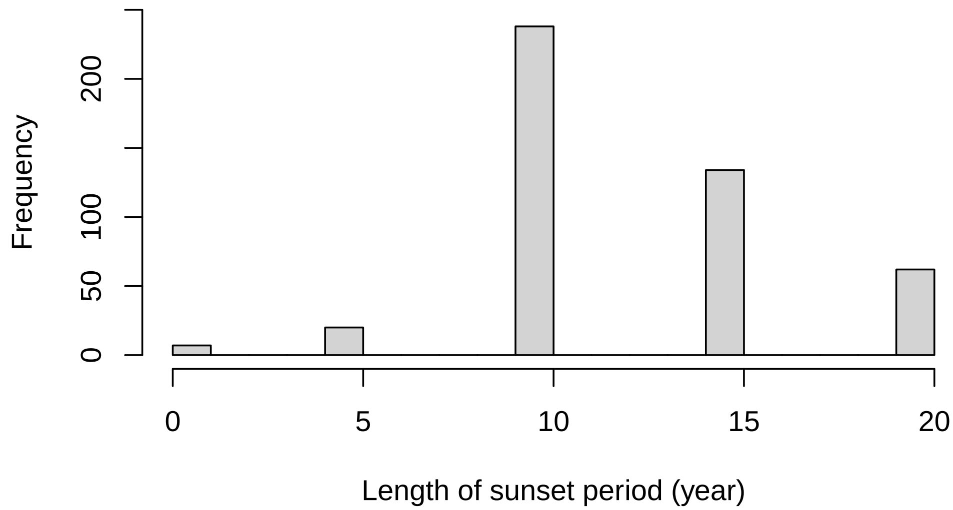
Appendix C



Terminations of BITs by terminating party

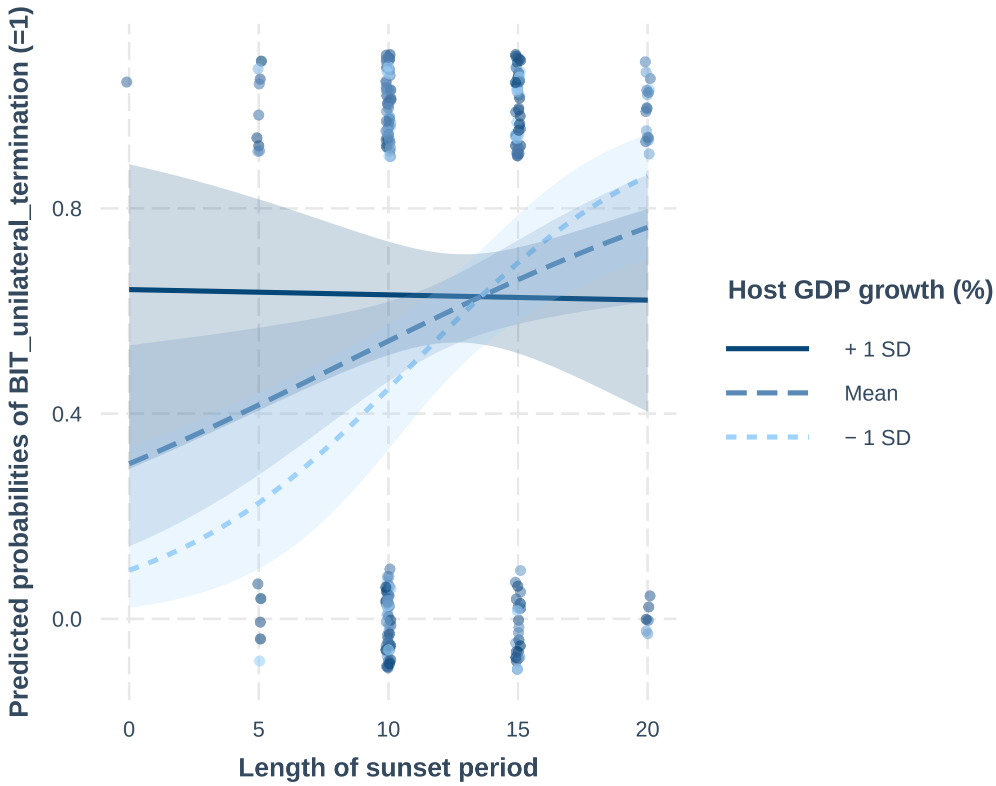
Data collected from UNCTAD Investment Policy Hub. Last updated in December 2022. Source: `https://investmentpolicy.unctad.org/international-investment-agreements`.

Appendix D



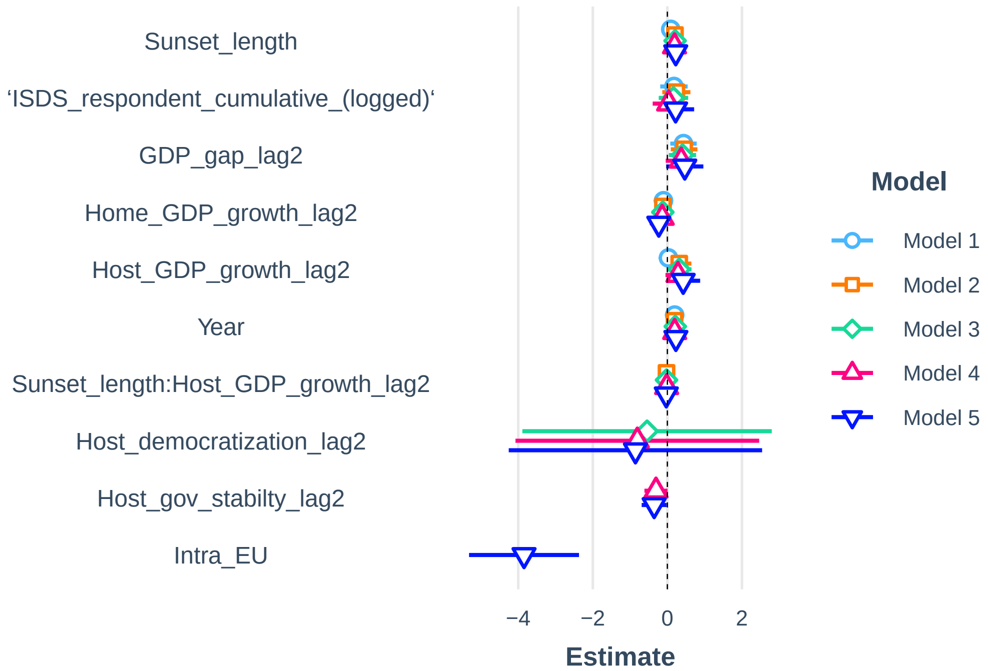
The distribution of the sunset periods in my sample

Appendix E



The marginal effects of sunset period at different levels of host economic growth

Appendix F



The effects of all explanatory variables on the odds ratio of BIT unilateral termination

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