Bounded Rationality and the Diffusion of Modern Investment Treaties[1]

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Given the considerable sovereignty costs involved, the adoption of modern investment treaties by practically all developing countries presents somewhat of a puzzle. Based on a review of leading explanations of investment treaty diffusion, the article advances a new theory using behavioral economics insights on cognitive heuristics. In line with recent work on policy diffusion, it suggests that a bounded rationality framework has considerable potential to explain why, and how, developing countries have adopted modern investment treaties. To illustrate the potential of this approach, the case of South Africa is studied in depth.

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Among the legal frameworks governing economic globalization, bilateral investment treaties (BITs) are some of the most significant but least understood. While emerging in the mid-twentieth century, the modern investment treaty network was not established until after the Cold War. At this point, the movement not only became a truly global phenomenon, most countries also began to include the defining feature of modern investment treaties: the broad consent to international investor-state arbitration. In recent years, foreign investors have realized the potency of this adjudicative mechanism and brought developing countries, in particular, on the respondent end of often costly claims concerning a wide range of regulatory actions. Here, the vague and broad constitution-like promises in investment treaties have given ad hoc tribunals considerable flexibility to determine, when and to what extent regulation of foreign investors requires compensation. This has raised the question, why developing countries adopted treaties that restrict their discretion to regulate and expose them to expensive compensation damages.

One explanation could be that once some countries began signing BITs, others had to follow to avoid losing much needed foreign investment (Guzman 1998; see generally, Gruber 2000). Other legal instruments could have alleviated investor concerns about political risks, however, yet allowed host states to moderate their commitments on a case-by-case basis. Investor-state contracts governed by international law can secure individual investments with the same standards as investment treaties, including recourse to international arbitration backed by the New York or ICSID Conventions (Yackee 2009; Alvarez 2011). Combined with the existence of other risk-mitigating instruments – including insurance and various market-based mechanisms – it is no surprize that foreign investors only rarely take investment treaties into account, when deciding where and how much to invest abroad (Yackee 2011). In practice, it is almost only after disputes have arisen that foreign investors and their insurance agencies begin caring about treaty-protections (Poulsen 2010). Although investment treaties occasionally have an impact on the legal structure of foreign investments, very few seem to have a tangible impact on their destination and size (Aisbett 2009; Allee and Peinhardt 2012). But while BITs were often promoted by international organizations, Western governments, and the private arbitration industry, developing countries signed them without any signs of coercion or significant side-payments. The question that presents itself, then, is why countries would constrain their sovereignty for the benefit of foreign investors, if the economic benefits are miniscule?

A second puzzle concerns the content – or design – of investment treaties. Even disregarding the effect of most-favoured-nation (MFN) clauses, developing countries have by and large signed up to treaties which exactly mirror models developed by capitalist-exporting states, despite having less wide-ranging templates available (see e.g. AALC 1983). This is largely the case also for BITs signed among developing countries themselves. Moreover, while 'incomplete contracting' is seen in other areas of international law (Aaken 2009; Abbott and Snidal 2000), why did developing countries agree to such broad and open-ended terms? This extensive delegation of interpretive discretion has occasionally resulted in arbitral decisions widely seen as overly 'investor-friendly' in sensitive areas of regulation, and is particularly puzzling given the absence of an appeal mechanism. Finally, while the practical implications of differences in investment treaty provisions are easily exaggerated (Legum 2006; Schill 2009), relevant systematic variation appears difficult to explain with the

'Rational Design'-paradigm in international relations (Allee and Peinhardt 2008). But if not rational cost-benefit analyses, what then explains their design?

To address these puzzles, this paper will advance a new theoretical framework to understand the diffusion of modern investment treaties from the early 1990s onwards. Following recent work on cognitive heuristics and policy diffusion (Weyland 2006, 2009, 2010), it will argue that while most developing countries competed for capital when adopting (most) BITs (Elkins, Guzman, and Simmons 2006), they were not as rational as often assumed. This builds on a recent study suggesting that bounded rationality insights could provide important value-added to understand part of the behavior of developing countries in the international investment regime. Here Poulsen and Aisbett (2013) show that developing country governments often entirely ignored the risks of BITs until their own country was hit by a claim. We explain this pattern with insights from behavioral economics, which shows that individuals often ignore low-probability, high-impact risks (like an investment treaty claim) until hit themselves. This provides an important first hint to a more general theory of the BIT-movement based on cognitive heuristics.

The Poulsen and Aisbett study focuses solely on the recent slow-down in BIT-adoption, however, rather than the initial upsurge and a comprehensive explanation should preferably be able to explain the entire (s-shaped) curve of policy-diffusion. Secondly, it looks only on the costs of BITs and does not provide an explanation for the overly optimistic view towards the investment promotion impact of BITs displayed by many developing countries. Third, the study does not focus on the actual content of BITs. This paper will begin to fill in these gaps and argue that, indeed, a bounded rationality perspective could be of more general use to understand why, and how, developing countries have entered into investment treaties.

This has broader implications for the international relations literature. For whereas studies drawing on organization theory have occasionally relied on bounded rationality insights (e.g. Allison and Zelikow 1971); the discipline has rarely applied the rigorous micro-foundation from behavioural economics in much depth, and particularly so in international political economy (IPE) (Odell 2000; Elms 2008; Hafner-Burton, Leveck, Victor, and Fowler 2012). Similarly, while sporadic references to bounded rationality can be found in studies on legalization of world politics (Abbott and Snidal 2000), the approach is generally considered unorthodox. For that literature too, then, the paper could potentially point to new avenues of research.

A second contribution lies in the methodological approach. Since negotiating histories of BITs are hardly ever documented (Schreuer 2006),[2] social scientists have mostly relied on econometrics to understand why, and how, developing countries entered into the treaties. This follows the dominant trend in policy diffusion studies. And while this empirical strategy has well-known merits, a general problem in the diffusion literature is the often considerable gap between underlying concepts, such as emulation or competition, and the quantitative indicators available (Gilardi 2012). The literature on BITs is no exception. Also, even if the necessary data is available, econometric studies are mostly useful to suggest causal effects based on patterns of co-variation, whereas they have difficulties in identifying underlying

[2] The exceptions are the ICSID Convention and BITs negotiated with the United States.

causal mechanisms. For that reason alone, the glaring absence of studies with inputs from officials themselves is problematic. To begin filling this gap, the paper will provide the first detailed case-study of how a developing country has engaged with BITs over time.

The paper is structured as follows. The first section will argue that while they have provided important insights, standard accounts of BIT-diffusion leave crucial questions unresolved. The second section will present key predictions from a bounded rationality approach. To illustrate the potential of this framework, the third and final section will provide an illustrative case study of South Africa. This is intended to offer a micro-level building-block for future studies seeking to understand what appear as irrational, yet predictable, patterns of investment treaty adoption.

A Quest for Legitimacy or a Rational Competition for Capital?

With thousands of BITs adopted by practically all countries in the world, any monocausal view on the BIT-movement is bound to ignore considerable variation and diversity. Nevertheless, two broad explanations for why (most) developing countries adopted (most) investment treaties stand out as intuitively credible: norm-emulation and rational competition.

The first argues that the spread of modern BITs during the 1990s was a result of a norm-cascade, where developing countries adopted the treaties without any strategic goal in mind, but rather as acts of political symbolism to signal adherence to the principles of the Washington Consensus (Jandhyala, Henisz and Mansfield 2011). This is backed up by statistical evidence indicating that the propensity of countries to adopt BITs during the 1990s was particularly driven by whether peer, or similar, countries did so. And indeed, a logic of appropriateness could also potentially explain why the content of the treaties so closely follow the models of Western capital-exporting states.

Seeing the BIT-movement from this perspective raises a number of questions however. First of all, BITs were rather poor public relations instruments until recently. Unlike human rights treaties or trade agreements, they were typically signed entirely under the radars of public discourse during the 1990s and received little attention by parliaments, the press, or the public at large (Montt 2009:43). So while numerous BITs were undoubtedly adopted as mere ‘photo-ops’, it seems peculiar if this should be the *main* driver of the BIT-movement, when the treaties received such scarce attention.

Secondly, if BITs were signed for normative reasons, we would expect this is also how they were justified. There should be a clear communication trail indicating that the treaties were adopted primarily to display a membership in a certain group of states, rather than merely expectations about their material or instrumental benefits, such as attracting foreign investments (see generally; Fearon 1999; Gurowitz 2006). But while some modern BITs were indeed adopted to display friendly diplomatic relations or show a commitment to economic globalization (Jandhyala, Henisz and Mansfield 2011), the primary driver has been the expectation that they are important strategic instruments to attract capital. This is indicated in the preambles of BITs,[3] it was the main justification when UNCTAD and the

[3] ICSID Case No. ARB/02/8, decision on jurisdiction, 3 Aug. 2004, par. 81.

arbitration industry promoted the treaties,[4] and with the notable exception of the United States (Vandevelde 2009), key developed countries also expected BITs not only to protect but also to promote 'their' outward investments.[5]

More importantly, the limited discourse trail available indicates that attracting investments was also the main justification amongst developing countries themselves. Take India for instance. Even while spearheading opposition to investment rules in the WTO, the government negotiated numerous BITs with one primary aim in mind: to "*boost investor confidence"* and thereby facilitate investment inflows (Ranjan 2010). Similarly, a former Sri Lankan judge noted in the early 1990s, that developing countries like Sri Lanka: "*... have come to realize that one of the best ways in which their economies can be developed is by encouraging foreign investments, and that the bilateral investment treaty is a fine instrument to achieve that objective"* (Gunawardana 1992:546). And in Chile, the adoption of investment treaties was due to an expectation that they would: *"permit foreign investors to obtain lower insurance premiums than those actually obtained in the normal situation [without a BIT, ed.]. Therefore, the accession of Chile to this type of treaties would permit the country to keep an advantaged position in order to attract foreign investment"* (quoted in Montt 2009:115). Finally, a selection of negotiators involved during the 1990s also reports that FDI-promotion was the primary purpose of their investment treaty programs (Table 1).

While of course not comprehensive, this does raise questions whether adoption of modern BITs was primarily the result of norm-emulation. Although some South-South BITs, for instance, were signed merely as part of a broader attempt to conform to a neoliberal development agenda or as diplomatic tokens of good-will (Jandhyala, Henisz, and Mansfield 2011; see also comments by Pakistani and Sri Lankan negotiators above), the expectation that the treaties would be important to promote investment flows seems an equally – if not more – important driver of the BIT-movement.

So perhaps we should accept the traditional explanation that BITs were the result of a careful, and rational, competition for capital. This sounds plausible. At the time BITs proliferated rapidly, international bank loans to developing countries had collapsed and many governments saw foreign direct investment (FDI) as a desperately needed alternative source of capital (Simmons 2011). And as we just heard, BITs were often seen as a useful tool to attract such investments. Yet, the aim of the treaties does not tell us much about the *process* with which they were adopted and standard rational choice accounts raise some puzzling questions.

[4] E.g.; UNCTAD (1999) (by "*signing BITs ... developing countries are sending a strong signal of their commitment to provide a predictable, stable and reliable legal environment for foreign direct investors, to stimulate investors´ confidence, and boost FDI flows"*). It should be mentioned that arbitrators have occasionally presented BITs as building blocks of an international rule of law, and thus more than mere investment promotion instruments; e.g. Schwebel (2008-2009).

[5] As one of the architects of the UK BIT program noted in 1973, for instance, "*Her Majesty's Government believe, as does the British Parliament and British industry and commerce, that a larger flow of British investment to the developing world would be facilitated by the conclusion of bilateral investment protection agreements*" (Kerr 1973a). Similarly, when negotiating with Singapore, "*bilateral investment protection agreements could assist significantly in the creation of a climate of confidence which would encourage further substantial investment*" (Kerr 1973b).

TABLE 1. Feedback from developing country officials involved in BIT-negotiations during the 1990s

Cambodia	*After 1993, when peace came, we had to rebuild the country [and] BITs add to the comfort for investors in post-war countries. ... They bring tranquillity of mind to foreign investors.*
Costa Rica	*(i) For a small country like ours, just a single foreign investment can mean a lot. And since we had already liberalised our domestic investment regime, the perception was that we could go ahead with bilateral treaties; (ii) We started because had an aggressive policy in attracting FDI. ... Initially, there was a general expectation that BITs were important for FDI. We no longer think they have such an effect, but several years ago there was such an expectation.*
Czech Rep.	*After the transition from the communist regime to the market economy, when no one was sure about the further development in the country, the BITs concluded first by Czechoslovakia and [later] the Czech Republic with main capital importing countries were the prerequisite for investors from those countries to come and invest in the Czech Republic.*
Ghana	*In 1980s we realized the need to enter into BITs, because we had much interference in ownership of companies, expropriations, and so on, which became an image problem, we wanted to address with BITs. The treaties were intended to push forward reform, keep politicians on their toes to tell politicians to refrain from doing things, and to assure foreign investors.*
Lebanon	*We started signing BITs after the war in the 1990s. Prime Minister Hariri wanted foreign direct investment, and one pillar was to sign as many BITs as possible. ... For while they may not be crucial to attract foreign investments, they play an important role ... They are also important for the provision of political risk insurance through MIGA.*
Pakistan	*At the time, Pakistan was looking for FDI ... So there was a climate that since we are providing the protections and liberalizing everything why not add some confidence to the investors with BITs. ...[South-South] BITs were signed to establish contacts and relationships, we were not expecting any substantial investment from these countries. So there it was political rather than economic reasons that we signed the treaties.*
Sri Lanka	*Sri Lanka was the first to liberalize in our part of the world. The BITs came immedeately after [since] it was felt that the creation of stable legal environment was important for foreign investors. But we didn't conduct surveys or analyses ... During the 1990s, embassies and political desks wanted to use investment treaties as photo-ops for political visits, but we took a firm negative position on this [and] that was followed.*
Source:	Interviews with lead BIT-negotiators during the 1990s; April 2009 - June 2010. All interviews were semi-structured with the overall theme being the countries' experiences with negotiating investment treaties. In the case of Costa Rica, the second negotiator was involved in the early 2000s.

There are a couple of variations over the rational competition hypothesis. One popular view is that BITs are crucial instruments to overcome problems of obsolescent bargaining (Guzman 1998). For without a treaty-based consent to international arbitration, the argument goes, many developing countries would be unable to make a 'credible commitment' that the assets of foreign investors remain safe post-establishment. Yet, as already noted, investment treaties may be helpful for some establishment decisions under some conditions, but they have never been a functional necessity to attract inflows of foreign capital given the availability of alternative risk-mitigating instruments (Yackee 2006; Alvarez 2011:chapter 2). Nor have they been crucial for the political risk insurance industry (Poulsen 2010). The expectations of developing countries and many commentators concerning the investment promotion potential of the treaties appear to have been overly optimistic.

An extension of the rational competition argument is that developing countries adopted BITs in response to economic competitors signing them (Elkins, Guzman, and Simmons 2006). But while there is some statistical evidence to support this claim, it is puzzling that it disappears when BITs began to include a broad and binding consent to investor-state arbitration and thus became relevant for investors in practice (Poulsen and Aisbett 2013). Also, Yackee argues that the incentive to sign BITs should be highest for developing countries when *none* of their competitors have done so, as an increase in BITs among economic competitors will decrease the effect a BIT will have on winning investment projects (Yackee 2006). Finally, if BITs were used to divert capital away from competitors, one would think that their content should have become progressively more investor-friendly over time (Montt 2009:110). To stay 'competitive', developing countries could have gone further by including market access provisions or stringent standards on performance requirements, for instance, yet the content of the treaties has remained largely constant.

A third variation of the rational competition story is that developing countries used BITs as a costly signal to imperfectly informed investors about their commitment to foreign capital (Büthe and Milner 2009). In practice, however, the treaties were hardly ever relevant for investor-state relations until the late 1990s. As very few investors or developing country governments realized the potency of the treaties until recently (Poulsen and Aisbett 2013; see below), it is thereby doubtful they were perceived as a particularly costly signalling device when they spread like wildfire.

Notwithstanding their significant contributions, the leading explanations for the diffusion of BITs therefore leave us with a conundrum. Many developing countries were at least 'intended rational' (Simon 1957) when spreading their BIT-networks, as they typically followed a logic of expected consequences: "*BITs lead to FDI.*" But if this competition for capital was a careful and rational process by developing country governments, much of their behavior seems peculiar.

One solution could be to vary our explanatory frameworks over time (Risse, Ropp, and Sikkink 1999). This is the approach by Jandhyala, Henisz, and Mansfield (2011), who argue that while most BITs were signed as mere photo-ops during the 1990s, they were important in reassuring foreign investors up to the late 1980s. This is a controversial proposition, however, as investment treaties rarely included a comprehensive and binding consent for investor-state arbitration at this time. If investors wanted credible protections tied to international law, they had to rely on internationalized contracts – not BITs (Yackee 2006).

An alternative is to use different frameworks depending on dyad-characteristics. This is suggested by Elkins, Guzman, and Simmons (2006:842), who argue that while North-South BITs were the result of rational competition dynamics, many South-South BITs were not. This, however, does not solve the additional problems with a rational competition-based framework mentioned above - even for North-South agreements. Instead, the remainder of this paper will argue that an approach based on bounded rationality could provide a useful middle ground between the two traditional explanations.

Insights From Behavioural Economics

Bounded rationality insights are typically incorporated into variants of rational choice theory studying interest-based and goal-oriented behaviour while catering for cognitive constraints (Simon 1957; Jones 2003; Weyland 2006). This approach is useful here, compared with constructivists' application of these insights for instance (e.g. Herrera 2007), as most developing countries appear to have supported BITs primarily for instrumental reasons in their race to attract foreign investments.

Table 2 contrasts the main features of a bounded rationality account of the BIT-movement with the two other main frameworks just discussed. Two qualifications are in order. First, rationalist and constructivist perspectives can naturally lead to predictions other than those prevailing in existing literature, and any construction of ideal-types is bound to impose uniformity across subtle and rich contributions, but for simplicity I refer to these as the 'rational' and 'norm-based' models. Second, while the bounded rational model will be based on some of the most widely accepted heuristics of judgment, it too is limited by seeing inferential short-cuts as mostly constraining rather than enabling.[6] A pessimistic view on heuristics seems appropriate, however, when seeking to explain voluntary adoption of legal obligations that appear to have a net cost for host states.

TABLE 2. Three models of BIT-adoption

	Bounded rational model	Rational model	Norm-based model
National economic benefits	Important for adoption, but systematically overestimated.	Important for adoption and carefully considered.	Functional utility not important for adoption.
National costs	Low-probability risks ignored until they become 'vivid'.		
Content	Not carefully considered, but clear preference for easily adoptable templates. Anchoring to early treaties until risks become 'vivid'.	Carefully considered and, if necessary, tailored to specific circumstances.	Pure emulation.

Overestimating National Economic Benefits

Unlike in the norm-based model, bounded rational governments would find the economic efficacy of BITs important for their adoption. Yet, given the absence of comparable data on FDI flows in the 1990s, it is not until recently that policy-makers could make even simple correlation analyses to assess the economic benefits of investment treaties.[7] Rather than systematic and rigorous analyses, mostly anecdotes were available at the time. But instead of trying to compensate by conducting simple investor surveys, for instance, the application of inferential short-cuts may have led to overly optimistic views on the functional necessity of the treaties when competing for capital. This follows from a combination of the heuristics of representativeness and availability.

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[6] For a pragmatic discussion of this debate; see Kelman 2011.
[7] See comments in; MIGA 1991a:170. The first publicly available study on the economic impact of BITs came in 1998 (UNCTAD 1998).

The first refers to the fact that individuals tend to quickly extrapolate trends based on extremely small amounts of information, or even detecting patterns from random series of events (Kahneman and Tversky 1972). In the context of policy diffusion, this means that if a policy or institutional innovation shows early signs of success – even for entirely random reasons – it tends to speed up its diffusion process (Weyland 2006:48-50). Moreover, the availability heuristic make decision-makers often rely disproportionately on information that is easily available and 'vivid' (Tversky and Kahneman 1973). This means we would expect that during the 1990s the attention of policy-makers was inherently skewed towards confirming, yet anecdotal, information that BITs were important for investors' decision-making process. For although equally crucial information was available from all the investors that did *not* call for BITs to be signed, 'non-events' are less salient and thus often ignored when making inferences (Gilovich 1991:32). Akin to a 'drunkard's search', where information is gathered based on availability rather than efficiency (Jervis 1993), this could help explain the highly inflated expectations about the economic benefits of BITs among many developing country governments.

If we relax the unitary actor assumption, such optimism bias should be particularly prevalent among developing country officials or departments with an individual motive to promote investment treaties, such as embassies, investment promotion agencies, and negotiators themselves.[8] For although difficult to establish empirically (see below), pre-determined incentives often impact processing of information in ways individuals do not themselves realize (Kunda 1990; Dawson, Gilovich, and Regan 2002). This means that actors gaining from a policy themselves should be particularly susceptible to accept perhaps dubious claims that it is economically beneficial overall.

Ignoring National Costs

When modern BITs began to spread, information was available that the treaties were both potent and enforceable and international organizations often urged developing country governments to consider the scope of what they were undertaking (Poulsen 2011). Yet, only few investment treaty claims had been adjudicated, which led to considerable surprises when tribunals began interpreting key jurisdictional and substantive provisions (UNCTAD 2007). Whereas this is difficult to account for with the extant rationalist literature assuming a highly information-rich environment in the 1990s (Guzman 1998; Elkins, Simmons, and Guzman 2006:825; Büthe and Milner 2009), unanticipated consequences of international legal obligations are not inexplicable by rational choice theory as such (Martin and Simmons 1998).[9] There is an important distinction to be kept in mind here, however, between imperfect information and imperfect processing of information: while the first could have made rational policy-makers underestimate the costs of modern BITs in the early stages of their diffusion, the latter could make policy-makers ignore such costs altogether (Poulsen and Aisbett 2013).

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[8] My numerous interviews with developing country officials around the world confirm that these tend to be the usual supporters of BITs within developing country bureaucracies, in some cases for selfish reasons. Note that diplomatic representation raises the likelihood of BIT-adoption (Allee and Peinhardt 2010:ftn. 37; Elkins, Guzman, and Simmons 2006).

[9] For a rationalist account of the BIT-movement catering for imperfect information, see; Montt (2009:chapter 2). See generally; Guzman (2008:91-100).

Decision-makers tend either to exaggerate or entirely to ignore low-probability, high-impact risks.[10] This follows from the availability heuristic and implies that unless a government has been subject to an investment treaty claim itself, it should not just underestimate the risks of BITs - as could be predicted by Bayesian frameworks - it should entirely ignore them (Poulsen and Aisbett 2013). Indeed, this is exactly what both qualitative and quantitative evidence suggests happened: decision-makers in many developing countries often ignored experiences in other countries, which in turn led to considerable risk-neglect until hit by their first claim (Poulsen and Aisbett 2013). So although the potential costs of the treaties were important for their adoption by developing countries, unlike in norm-based models (Jandhyala, Henisz, and Mansfield 2011:1053), information about these costs was not processed in ways predicted by rational choice models.

This means that stakeholders who may otherwise have had an interest in cautious BIT-strategies would not have realized this before it was too late. Examples could include law ministries, who would be blamed for unanticipated legal implications of investment treaty protections, or regulatory agencies whose discretion is curtailed by BITs. If cognitive heuristics, however, meant the risks of BITs were ignored, key interests of government actors would not necessarily be realized, and the treaties could have become completely 'de-politicized' in national policy-making processes until a country was hit by its first BIT-claim (Poulsen and Aisbett 2013). This would not be the prediction of a rationalist framework, where actors losing from a policy are expected to lobby against it (Lake 2009:226). So although motivational biases discussed above are difficult to test outside experimental settings since perfectly rational bureaucrats could choose to be disingenuous when asked about their views on the benefits of BITs - it would be strong evidence in favour of a bounded rational framework if actors with an incentive to be cautious towards BITs entirely ignored them until the first claim.[11]

Content

The observations above have implications for our understanding of the design of BITs. Here, the key insight is that even though bounded rational decision-makers are expected to consider whether provisions help achieve certain strategic goals – unlike in pure emulation models – their understanding of the potential implications should be less than assumed in rationalist models.

To illustrate, Figure 1 outlines a simple negotiation between developed country (A) and developing country (B) trying to strike a balance between investor protection and regulatory autonomy in a uni-dimensional bargain over the scope of the expropriation clause. The developing country negotiator is constrained by key veto-players concerned with maintaining regulatory autonomy. The developed country is the stereotypical capital-exporter seeking a high level of protection for 'its' investors abroad; though not unlimited protection as even developed countries can be subject to investment claims. In this particular case, a rational choice perspective would predict a breakdown in negotiations over the expropriation

[10] See contributions in Slovic (2000).

[11] For discussions on identifying causal mechanisms on bounded rationality without experiments; see Levy (1997:94, 99-100); McDermott (2004:26-28).

clause, since resistance points of the two parties (A_R,B_R) do not overlap (Raiffa 1982). Also, resistance points will remain equally far apart, even if shifted towards greater investor protection due to imperfect information about how tribunals will interpret the provision (A_{R2},B_{R2}).[12] If, however, stakeholders in the developing country entirely fail to appreciate the risks of a broadly drafted expropriation clause, and perhaps overestimate the benefits, this will shift their resistance point over and above what could be explained with expected utility theory (B_{R3}). In turn, this facilitates an agreement that can be ratified, where we would otherwise expect none.[13]

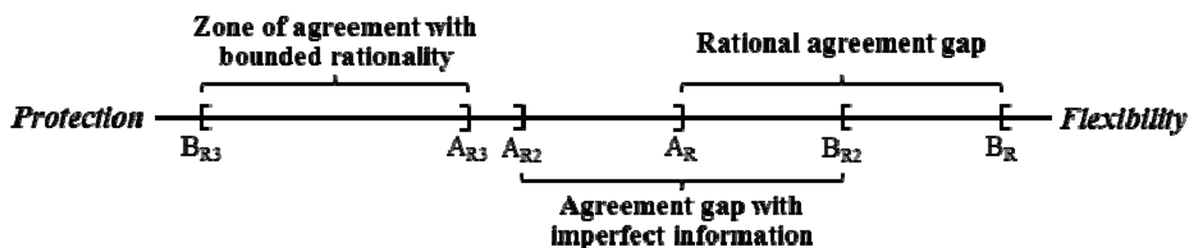

FIGURE 1. Bounded rationality and the zone of agreement

Note that the biasing impact of heuristics is assumed to be greater for the developing country (compare the distance between B_{R2} and B_{R3} with that of A_{R2} and A_{R3}). This is analytically useful for two reasons. First of all, developing countries often lack legal expertise in international investment law (UNCTAD 2008). And while experts are also prone to biased judgments (Wright, Bolger, and Rowe 2002), their prior knowledge make them better able than generalists to understand the plausible implications of what they are negotiating (Neale and Bazerman 1991:96; Conlisk 1996; Poulsen and Aisbett 2013). Secondly, bureaucratic realities in many developing countries make this difficult as staff turn-over is often exceptionally high, which obstructs learning and specialization (Busch, Reinhardt, and Shaffer 2009). So although experience is no guarantee against biased judgments either, bureaucratic conditions preventing officials from gaining domain-specific experiences are likely to decrease the quality of their decision-making (Weyland 2006:46-47). If legal departments fail to realize the implications of different clauses and regulatory agencies do not understand what investor-state arbitration even is, then they are more likely to accept provisions stakeholders with better information-processing skills would steer clear off.

One thing is the level of obligation in individual BITs; another is their puzzling similarity across countries and over time. Here, it follows from the availability heuristic that policies or institutional innovations based on a concrete and clear 'model' are particularly prone to diffusion, as they allow decision-makers to follow an already defined prototype

[12] Imprecise obligations combined with broad delegation to third-party adjudication can occasionally be a prudent way to solve problems of incomplete contracting (Abbott and Snidal 2000:433; Montt 2009), but it also increases the risk of unanticipated interpretations.
[13] A similar outcome could follow from prospect theory (Kahneman and Tversky 1979): if governments are concerned about losing FDI from competitors, loss aversion could lead them to take considerable risks by accepting obligations, which would not otherwise suit their national interest. Yet, the causal mechanism would be different as this would require actors to actually realize the risks involved.

rather than going through the hassle of 'tailoring' to local circumstances – however rational that may be (Weyland 2006:52-54).[14] This is relevant for the investment regime. BITs are largely standardized agreements, which provide a simple and short (typically less than 10 pages) blue-print for developing countries worried that political risks are keeping foreign investors away. So instead of an inherent functional superiority or legitimacy, the remarkable homogeneity in BITs could result from the simple fact that Western states and other actors selectively promoted them as easy and clear-cut instruments to adopt.

Secondly, by following the heuristic of anchoring and adjustment, decision-makers often rely excessively on their point of departure for future judgments and actions - even when it does not suit their interests and the status quo was initially determined randomly (Chapman and Johnson 2002). This is important for negotiations (Neale and Bazerman 1991:49-50, 90-92). It implies that the content of past BITs may function as a *de facto* model for future negotiations, even when available information suggests that alternative provisions would be more prudent. And unlike in Bayesian learning models, where additional information would lead to gradual re-consideration of treaty drafting when needed, it is not until risks of individual provisions become particularly 'vivid' that re-anchoring from the status-quo takes place.[15] In turn, this can lead either to agreements more in line with predictions of traditional rational models or, alternatively, an (irrational) agreement gap wherein parties forgo otherwise prudent deals based on a sudden overreaction to their risks.

Through a range of mechanisms, then, cognitive heuristics may have been important for developing countries engagement with BITs, so to gain a deeper understanding of the potential of such a framework, the following section will provide a detailed investigation into how a developing country has engaged with BITs over time.

Bounded Rationality and the Diffusion of Modern Investment Treaties: An Illustration

The case of South Africa is useful for this purpose. As a relatively rich developing country with inward and, particularly, outward foreign investments playing a considerable role in its economy, South Africa has a considerable stake in the investment treaty system. This makes it a harder case for a bounded rationality approach than many other developing countries. Secondly, the country has a greater degree of expertise within its bureaucracy compared to many other developing countries. Stakeholders with an individual interest in cautious BIT-strategies were therefore in a better position to process information about BITs than stakeholders in some of South Africa's regional neighbours, for instance.[16] This too makes South Africa a difficult case for a bounded rationality approach.

Third, and most importantly, studying South Africa makes it possible to distinguish between imperfect information and imperfect processing of information more clearly than in many other countries. During the early 1990s, property rights protection took centre stage in

[14] For a general discussion of the (occasional) link between policy diffusion as a *process* and policy convergence as an *outcome*, see; Gilardi 2012.
[15] On bounded rationality and punctuated equilibrium models; see Jones and Baumgartner (2012).
[16] A Ghanaian official notes, "*We came across many countries that handled this in a very superficial level. .. We did not find capacity to negotiate in most places in Africa. It has to with an understanding and appreciation of what is involved. ... most negotiators on the other side of the table didn't actually negotiate.*" Interview, 28 May 2010.

South Africa's heated constitutional negotiations. This resulted in a careful compromise between the former ruling regime, concerned about redistribution of land without full compensation, and the African National Congress (ANC) wanting to redress economic inequalities resulting from Apartheid (see below). So although the exact meaning of key BIT-obligations was difficult to gauge at the time, the government had a considerable incentive to carefully consider the content of treaties which, under international law, could override the perhaps most sensitive constitutional compromise concerning compensation for expropriation. This is particularly the case, since the ANC government had a firm hold on political power during the 1990s and could safely assume to lead the country for considerable time to come – as indeed it did. This made the South African government less likely to constrain its long-term regulatory flexibility for (perceived) short-term benefits than governments with shorter time-horizons (Abbott and Snidal 2000).[17]

Combined, these characteristics make South Africa a particularly useful case. Suffice it to say that no country can be construed as being truly representative of the population of developing countries. Rather than suggesting that South Africa is a typical case, then, it is intended to complement recent quantitative and qualitative evidence on bounded rationality in the investment treaty movement (Poulsen and Aisbett 2013) by providing the first detailed investigation of how developing country officials engaged with investment treaties during the 1990s. As in many other developing countries, official documentation of BIT-negotiations in relevant ministries was scarce, but to allow sufficient micro-level insights I traced and interviewed almost all relevant officials involved in South Africa's BIT-program since its inception.[18]

The Crucial First Treaty

South Africa's BIT-program began in the early 1990s. As the Apartheid regime was crumbling, the United Kingdom approached the South African government to enter into an investment treaty. British firms were the largest investors in South Africa, and although the new ANC government was about to significantly liberalize the investment regime, ratify the MIGA Convention, and provide foreign investors national treatment, the Thatcher administration feared it would begin expropriating British assets.

The proposed English template was a six-page 'standard' European BIT-model. But while perhaps sounding harmless at the time, it included provisions potentially conflicting with South Africa's broader economic policies (Schneiderman 2009:16-29). The national treatment provision did not reserve to South Africa a right to give preferential treatment to South Africa's historically oppressed people groups, for instance, despite the fact that the interim Constitution of 1993 expressly encouraged affirmative action measures in order to advance black population ownership and participation in the economy. Similarly, after lengthy negotiations, the Constitution promised compensation for expropriation, but not necessarily according to the developed country norm of fair market value (Chaskalon 1994).

[17] For a rationalist take on time-horizons and investment treaty commitments; see Blake (2010).
[18] For the most part, feedback is from negotiators as well as senior officials in stakeholder agencies. Most are today retired and wished to remain anonymous. The few government files on South African BITs have been seen by the author on the condition they would not be distributed.

By contrast, the proposed BIT did not allow deviations from "prompt, adequate, and effective compensation" amounting to the "genuine value of the investment." Finally, the Constitution made a clear distinction between expropriation and mere deprivation, with no compensation due for the latter provided measures were taken pursuant to law. This again contrasted with the British BIT, where compensation was due for both direct expropriation and measures having an equivalent effect (indirect expropriation). In other words, this was not a treaty to be taken lightly. Conditions under which the government could expropriate were debated intensely at the same time, so a binding international legal document taking such protections further surely required equally rigorous deliberation.

This never happened, however, as no one realized the scope of the British proposal. Although legal literature and UN reports alerted developing countries that protection standards in BITs – such as those on expropriation – often went over and above national laws (e.g. UNCTC 1988), such important information was never sought. The key official in the investment promotion agency therefore did not find the BIT to be in conflict with any South African laws,[19] and neither did legal officers within the departments of justice and foreign affairs.[20] This was not a 'white man'-conspiracy led by the bureaucracy against the on-going Constitutional discussions. Rather, it was based on the misperception that the treaty simply followed the official investment policy of national treatment by stating that "*SA law would apply.*"[21]

The substantive investment protections in the draft were backed up by a general consent to international investor-state arbitration. This would be a first for South Africa, and was yet another area where the British draft offered protections to foreign investors above and beyond national treatment. But while the arbitration clause was discussed superficially, officials ultimately failed to appreciate its importance.[22] As noted by a legal official,

> "Obviously we did not consider it [the arbitration provision, ed.] an issue. … under our domestic legislation the state can be sued, and under our Constitution discrimination based on ethnicity and nationality is also outlawed. So it would merely place a foreign investor in the same position that he in any case had."[23]

Again, this analysis was faulty and it exposed the legal officers to criticism for neglect of professional duties, if investors began using an enforceable treaty they had vetted to undercut constitutionally enshrined social policies.[24]

Of course, only one investment treaty claim had been made public at the time.[25] Yet the risk of disputes was not only considered low – as would be predicted by a Bayesian approach - it was thought to be zero. As officials did not have a specific instance of a major investment treaty claim 'available' on their radars, they followed the availability heuristic by

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[19] South Africa (SA) official I.
[20] SA official III.
[21] 'Parliamentary Committee approves investment agreement with UK,' *BBC Monitoring Service: Africa*, March 3, 1998.
[22] 1994 South African government file on UK BIT.
[23] SA official III.
[24] Note that as these officials were not subject to departmental rotation-schemes, their time-horizon should have been relatively long.
[25] ICSID Case No. ARB/87/3.

completely disregarding the risks of such claims. "*The risk of claims was not present. ... No departments raised such concerns at all.*"[26]

This was also the reason hardly any relevant government stakeholders got involved in the process, despite the fact that their regulatory authority would be restricted by the BIT. As Weyland also found in his study of bounded rational policy diffusion (2006:62), inferential shortcuts meant key stakeholder interests were never realized. According to a veteran BIT negotiator, one reason South Africa so willingly accepted the British draft despite its contradictions with the interim Constitution was evidently *"due to ignorance or a failure to appreciate the significance of the provisions they ... accepted"* (Robinson 1993:9).

Moreover, no one within the government made an analysis, based on a survey or otherwise, of its potential economic implications. Without any analysis to sustain it, the discussion with the British government led to the perception that the treaty was "*an important value-added enhancement that could add to the peace of mind for foreign investors*" and "*prove to foreign investors ... that South Africa was an investor friendly country.*"[27] While this view was not shared with British investors themselves (MIGA 1991b:89,91), officials came to believe that *"the moment a BIT was signed with a country, capital would start flowing from there."*[28] Remarkably, the protection of South African investors was also considered crucial as the BIT: "*reduced their capital risks and hence their insurance costs when doing business in Britain.*"[29]

The two-day negotiations were therefore more than amicable. The only provision thoroughly discussed was the transfer clause,[30] where a protocol devised by the Reserve Bank on South Africa's foreign exchange restrictions was included. Otherwise, the two texts matched up almost word for word, and the treaty was subsequently signed when John Major made his first visit to South Africa in 1994.

Anchoring to the British Model

The type of treaty the British had brought to the attention of South African officials seemed a useful legal tool to assist in attracting foreign investment,[31] so the investment promotion agency was put in charge of an actual BIT program. The officials put in charge did not have backgrounds in international law or experience with negotiating investor-state contracts, for instance in the mining sector. They did, however, receive inputs from the departments of foreign affairs, justice, trade and industry, as well as the Reserve Bank and the office of the President. Following standard practice in treaty negotiations, other departments were also invited to provide inputs in cross-departmental discussions.

[26] SA official IV.
[27] SA official I.
[28] SA official I.
[29] Quote by SA official in 'Parliamentary committee approves investment agreement with UK,' *Business Day,* 26 February 1998.
[30] South Africa file on UK BIT.
[31] SA officials I, III, and V; South African government file on Italian BIT. The subsequent Dutch BIT, for instance, was seen as an agreement to "*strengthen economic ties and stimulate capital and technology flow between South Africa and the Netherlands.*" Cape Times, 10 May, 1995. Dutch investors themselves, however, rarely saw the treaties as important for establishment decisions (MIGA 1991b:170).

The team decided to use the brief, but very far-reaching, British template as the starting point for South African negotiations. This was not as a result of a careful consideration of its provisions, but rather because it was the first that had come to their attention.[32] "*Obviously the US and Canada have their own models, which we were confronted with at a later stage, and there were some South-South agreements, but the first treaty was with a European country so we gravitated to those types of treaties.*"[33]

South Africa was not alone in seeing BITs as a risk-free instrument to attract investment. When negotiating with the Koreans, for instance, the attitude was similar and today Korean officials note that since they also failed to appreciate the implications of BITs, they anchored to "*the same simple provisions as in previous investment agreements*" (Kim 2011:68). This made negotiations with Korea straightforward. Apart from Korea, the first five BITs were with other European countries and South African negotiators had no problem in relying on their models, as they did not depart significantly from the British text.[34] The Dutch and Swiss treaties, for instance, almost exactly followed the two countries' models word for word.[35] For the Netherlands, this was not a unique experience during the 1990s, since developing countries like South Africa "*often asked what even basic provisions meant*."[36] Neither was it for Switzerland, where a negotiator from the time has doubts whether developing countries "*actually knew what they signed.*"[37]

With negotiations rarely taking more than a day, a considerable number of treaties were finalized in a short span of time (Table 3), and no South African stakeholders found cause for concern. This was despite the politicization of expropriation policy once again. During the Constitutional review in 1995 land restitution and reform had begun, which led to calls to reopen the delicate 1993 compromise over the property clause (Klug 2000). As a result, the new Draft Bill of Rights stated that the amount of compensation had to reflect a balance of interests between those affected and the public, including "*the nation's commitment to land reform, and to reforms to bring about equitable access to all South Africa's natural resources*."[38] No such carveouts were included in BITs signed at the time.

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[32] SA official I; Communication from Department of Trade and Industry (DTI) to South African Embassy in Rome, 3 November, 1994.
[33] SA official III.
[34] SA official III.
[35] See models in; Dolzer and Stevens (1995), UNCTAD (1996).
[36] Interview with negotiator, 1st July 2009.
[37] Interview with negotiator, 23rd April 2009.
[38] 25(4)(a).

Partner	Signed	Ratified	Partner	Signed	Ratified
United Kingdom	20-Sep-94	27-May-98	Czech Republic	14-Dec-98	17-Sep-99
Netherlands	09-May-95	01-May-99	Uganda	08-May-00	.
Switzerland	27-Jun-95	29-Nov-97	Nigeria	29-Apr-00	.
Korea, Rep.	07-Jul-95	06-Jun-97	Turkey	23-Jun-00	.
Germany	11-Sep-95	10-Apr-98	Algeria	24-Sep-00	.
France	11-Oct-95	22-Jun-97	Rwanda	19-Oct-00	.
Canada	27-Nov-95	.	Brunei	14-Nov-00	.
Cuba	08-Dec-95	07-Apr-97	Benin*	02-Feb-01	.
Denmark	22-Feb-96	23-Apr-97	Burkina Faso*	02-Feb-01	.
Austria	28-Nov-96	01-Jan-98	Chad*	02-Feb-01	.
Mozambique	06-May-97	28-Jul-98	Mauritania*	02-Feb-01	.
Italy	09-Jun-97	16-Mar-99	Tunisia	28-Feb-02	.
Iran	03-Nov-97	05-Mar-02	Libya	14-Jun-02	.
China	30-Dec-97	01-Apr-98	Yemen	01-Aug-02	.
Mauritius	17-Feb-98	07-Oct-98	Qatar	20-Oct-03	.
Sweden	25-May-98	01-Jan-99	Eq. Guinea	17-Feb-04	.
Senegal	05-Jun-98	.	DR Congo	31-Aug-04	.
Ghana	09-Jul-98	.	Israel	21-Oct-04	.
Argentina	23-Jul-98	01-Jan-01	Angola	17-Feb-05	.
BLEU	14-Aug-98	14-Mar-03	Tanzania	22-Sep-05	.
Finland	14-Sep-98	03-Oct-99	Congo	01-Dec-05	.
Spain	30-Sep-98	23-Dec-99	Madagascar	13-Dec-06	.
Egypt	28-Oct-98	.	Sudan	07-Nov-07	.
Chile	12-Nov-98	.	Ethiopia	18-Mar-08	.
Greece	19-Nov-98	05-Sep-01	Zimbabwe	27-Nov-09	.
Russia	23-Nov-98	12-Apr-00			

* Neither UNCTAD or the South African Department of Foreign Affairs have a full list of the treaties signed, and while these 4 treaties do not appear in official lists, their signature is confirmed by both South African officials as well as in; UNCTAD 2002.

Sources: UNCTAD and South Africa's Department of Foreign Affairs.

TABLE 3. South Africa's BITs

The first treaty raising concerns among South African officials was the one suggested by Canada. But although market access provisions in the Canadian model made it stand out,[39] they were not subject to investor-state arbitration and its post-establishment provisions were actually more 'development-friendly' than European-style agreements. From the perspective of South African negotiators, however, its lengthy and complicated appearance compared to the brief and vague European models meant Canadian negotiators were being difficult: "*These were people who took BITs as real and serious legal instruments with teeth … why be*

[39] Liberalization provisions have always been more controversial in investment treaty negotiations as their implications are relatively clear (Wälde 1998:32-33), which in turn makes the political economy of North-American treaties different than the bulk of BITs. The contentious nature of market access is also partly the reason South Africa was more hesitant in trade negotiations (Baccini and Urpelainen 2012:235).

so pedantic and difficult in worrying so much about the legal details?"[40] With this level of understanding, the outcome of the negotiations was curious. While preferential measures towards *Canadian* aboriginal peoples were allowed, South African negotiators did not make this carveout cover their own constitutionally enshrined affirmative action policies. By anchoring to their British-inspired template, South Africa thereby ended up agreeing to more stringent standards than the Canadians. Had it been ratified (see below), the treaty would probably have allowed Canadian mining companies to bring claims based on South Africa's redistributive policies in the natural resource sector; yet there was no opposition to the treaty from any regulatory agencies.[41]

The paradoxical situation of negotiators having difficulty accepting treaties more aligned with their Constitution was not unique. During negotiations with Malaysia, for instance, South Africa was asked to exclude a national treatment clause due to Malaysia's infant industry protection policies and preferential treatment of its indigenous peoples (the bumiputra).[42] But while this would have been sensible given South Africa's own affirmative action measures – at least compared with a clause without such carveouts - negotiators did not want to depart from their initial British model.[43] Although this may appear irrational, particularly since there were no South African investors to protect in Malaysia, the anchoring heuristic reminds us it was not entirely unpredictable.

Bilateral v. Multilateral Obligations

During the OECD-based talks for the Multilateral Agreement on Investment (MAI), South African BIT negotiators went as observers. But as many others, they were dismissive of the project because of its take-it-or-leave-it approach.[44] When investment protection rules were to be included in the WTO – a more inclusive forum – South Africa was also sceptical (Wall 1996). The exact explanation remains unclear, even for officials present at the time, but it was not a result of careful considerations of the negotiating dynamics at the bilateral and multilateral levels, as expected by Guzman (1998) for instance. Instead, ignorance was the deciding factor again. Within the Department of Trade and Industry (DTI), WTO negotiators never coordinated their position with the bilateral unit. And while coordination problems are of course not unique to the investment regime (e.g. Allison and Zelikow 1999), biased information processing was also important: key trade officials wrongly thought that BITs simply re-stated existing WTO commitments and were therefore content with bilateral deals "*as they did not have any risks*."[45]

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[40] SA official II. The South African experience was not unique: *"...it is a big challenge to convince developing countries that they are not being tricked by the detail of the post-establishment and dispute settlement provisions, but that our* [Canadian, ed.] *model is actually more balanced in terms of preserving regulatory flexibility* [than European models, ed.]." Interview with Canadian negotiator, 25th June 2009.
[41] SA official II; SA official IV.
[42] SA official II.
[43] Ibid.
[44] SA official IV.
[45] SA official V.

An Intended Rational Approach

Initially BIT partners were simply which-ever government South African leaders met with, which corresponds with predictions of a norm-emulation approach. Eventually, however, this was perceived as too chaotic and random a strategy and a targeted two-track approach was agreed upon instead: South Africa would continue to accept invitations from capital exporting states that were major trading or investment partners so as to attract foreign investment, but also pursue South-South BITs with countries where South African companies had, or were planning, investments.[46]

By 1997, the investment promotion agency also began making certain exceptions to treaty-protections in order to safeguard affirmative action policies. As is often the case in developing countries' BIT programs, however, the adaptations remained entirely inconsistent, even if discounting the role of the MFN clause. Although exceptions to promote equality were included in treatment provisions, expropriation clauses remained without such carveouts. Also, a number of treaties did not include exceptions even in the treatment provisions, despite being signed during exactly the same period. So while South African negotiators did obtain a better understanding of BITs than in the early-1990s, it remained superficial with treaty differences considered to be "*mostly about cosmetics.*"[47] The perception that reservations to treaty protections based on constitutionally enshrined policies "*would never become an issue in practice*"[48] meant BITs were still considered *"no-sweat agreements."*[49]

When negotiating with other developing and transition economies, South African negotiators often encountered a similar approach. In the Czech Republic, for instance, officials also entirely failed to appreciate the implications of BITs,[50] which meant negotiations were finalized without significant engagement from either side. The same was the case with Chile, where a negotiator today notes that: "*like most countries in the 1990s, we signed a lot of treaties not knowing sometimes what we were committing ourselves to*."[51]

Just as the revisited design of the treaties was inconsistent and legal officers continued to sign off on treaties contradicting their own Constitution, the attempt of a targeted strategy did not last either. Because of their low priority, BIT negotiations were eventually delegated to regional desk officers within the foreign office, many of which had never heard of the treaties and saw absolutely no risks involved.[52] Some desk officers even boasted about BITs as "*proud examples of their accomplishments.*"[53] Politicians were equally thrilled about this

[46] The Spanish BIT, for instance, was seen as key to "*boosting Spanish investments in South Africa*" and the BIT with Argentina was similarly justified as encouraging "*greater investment flows between the two countries"; Business Report,* 24 July and 30 Sep 1998. Note, that unlike the predictions of a public choice approach, it was the negotiator with most to benefit from promoting as many BITs as possible who suggested the more careful approach.
[47] SA official II.
[48] Ibid.
[49] SA official V.
[50] See quote by Czech official in Poulsen and Aisbett (2013): "*Negotiators really didn't know that the treaties had any bite in practice. They were neither aware of the costs or the fact that it could lead to arbitration*."
[51] Interview with Chilean negotiator, 30th April 2010.
[52] SA officials VIII and IX.
[53] SA official II.

new instrument at their hands, as they "*wanted to be seen doing something constructive.*"[54] Finally, ambassadors saw BITs as, *"an achievement for them during their tenure. … They get a request from local authorities and they push it forward. It is seen as a legacy."*[55]

The guiding principles of South Africa's BIT policy were thereby left almost entirely to chance. A bizarre example occurred with Mali, where senior officials agreed to a draft presented by the South African foreign minister, but the process went so fast that the document sent back to the foreign office was just a copy of the South African model without the two countries' names on it.[56] Agencies with an incentive to promote a more cautious negotiation strategy, such as the Department of Justice, remained oblivious to the potency of the treaties and thus their own interest in deliberating over them.[57] So they kept silent.

Ratifications went equally smoothly.[58] Legal advisors from departments of justice and foreign affairs still saw BITs as executive agreements merely endorsing existing Constitutional obligations. So even if political factions within parliamentary committee on Trade and Industry had been critical of the treaties – which they never were – it was widely believed that Parliamentary approval was not required for ratification and no bureaucratic agencies raised any concerns.[59]

So while on the surface, this stage of the South African BIT-program corresponded to the predictions of a norm-emulation model, the haphazard strategy resulted from a combination of imperfect processing of information among stakeholders on the one side and embassies, regional desk officers, and politicians using the treaties for their own individual benefits on the other.

Narcissistic Learning

On this background, the South African government gladly accepted an invitation from UNCTAD in 2001 to join one of the organization's BIT-signing sessions, which had been initiated to "*stimulate investors´ confidence, and boost FDI flows*" (UNCTAD 1999).[60] Due to a cancellation at the last minute, a legal officer from the trade negotiations unit went along to Geneva.[61] With a degree in international economic law as well as a background as a practicing lawyer, this officer had a more informed legal understanding than many of his colleagues. What he saw in Geneva took him by surprise. "*The OECD model was actively promoted during this session, and no real negotiations actually took place. Treaties were just signed off in a rush in two or three hours.*"[62] While puzzled, he could not object at the time and South Africa signed four BITs at this one session alone (with Benin, Burkina Faso, Chad, and Mauritania).

[54] SA official II.
[55] SA official VIII.
[56] Ibid.
[57] Ibid.
[58] Ratification delays in the early years of the BIT-program were due to changes in foreign exchange regulations as well as the on-going constitutional negotiations.
[59] Maupin and Langford (2009); SA official II.
[60] In the early years of the BIT-program, South African negotiators went to some UNCTAD events, but the organization never had a substantial impact on the policy of the country; SA official II.
[61] SA official VIII.
[62] Ibid.

Later that year, however, the same DTI officer was put in charge of South Africa's investment negotiations, and when investigating what South Africa had signed up to over the last eight years he raised concerns about the lack of understanding among both negotiators and stakeholders and urged the government to take a more conservative approach.[63] A policy-decision was taken not to enter into any more BITs with developed countries and to sign BITs with developing countries only after a proper policy had been put in place. This new and more hesitant approach led to some renegotiations as well as a stop to the ratification of numerous BITs - including the one with Canada. As is clear from Table 3, however, the South African web of BITs continued to spread. Yet again, South Africa's investment policy was plagued by poor coordination, as some of the regional desks continued their negotiations despite the imposition of the moratorium. One of the regional desk officers saw it like this:

> "Taking a legalistic perspective on these treaties is a bit problematic because then they become very difficult to negotiate. When legal people meet, they have all their jargon, which is a bit boring. So since the other side was typically not very legalistic either, we did not always involve the South African lawyers."[64]

The leadership therefore had to block ratification of a number of agreements with North African countries as well as Israel, for instance, which took place behind its back.[65] In short, the South-African BIT-program was in disarray: different agencies with different agendas and levels of expertise pushed the treaties right, left, and centre, to the frustration of officials trying to analyse the complexities and potential liabilities involved.

The real change in the South African BIT-program, therefore, did not happen until South Africa ended up on the respondent end of a large investment treaty arbitration based on its affirmative action policies. Along with a group of Belgian investors, Italian miners initiated a BIT claim arguing that the affirmative action measures in the new mining legislation were tantamount to discrimination, unfair treatment, as well as expropriation, and asked for US$350 million in compensation.[66] If successful, the claim had the potential to open the flood-gates for similar claims questioning the re-distributive efforts of the post-Apartheid regime, which could result in "*a significant – and potentially unquantifiable - liability for the South African government*" (Ryan 2005). This was exactly the type of claim the founders of South Africa's BIT-program had thought impossible.

The government therefore started a review of its investment treaties - the first in the country's history - and the claim gave the legal officer the necessary support to block proposed investment rules in on-going FTA negotiations with the US and EU. It also prevented South Africa's accession to the ICSID Convention, which was considered around the same time. As the policy review was finalized in late 2010, DTI made its concluding recommendations to Cabinet. South Africa should not sign more investment treaties allowing investor-state arbitration clauses, and existing BITs should be renegotiated on these terms, or allowed to expire.[67] Although in favour of providing necessary legal guarantees to attract

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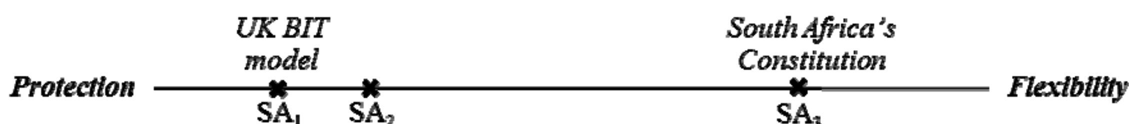
[63] SA official VIII.
[64] SA official X.
[65] Ibid.
[66] ICSID Case No. ARB(AF)/07/1.
[67] SA official VIII.

foreign investment at home and protecting South African investors abroad, investment treaties in their most potent form should no longer be used as a tool.[68] A rationalist approach would have expected this adjustment to come much earlier, as many other countries had been subject to investment treaty disputes by this point. The availability heuristic, however, meant it took a major claim against South Africa itself before stakeholders would realize the scope of the agreements. As stated by one senior official: *"it was not until we got sued, we truly realized that we should have had red flags up when signing these treaties."*[69]

To summarize: South Africa began signing BITs simply because they were readily available to adopt after a capital-exporting country had made the government aware of the treaties' existence. Based on inflated expectations about their economic benefits and ignorance about their risks, the BIT-program anchored almost entirely to the first treaty, despite the fact that it had been determined more or less randomly and future BIT-parties introducing alternative BIT-models more in line with the South African Constitution (Figure 2). The rise in investment treaty arbitrations against other developing countries was ignored, which meant some of the most powerful international legal instruments adopted by South Africa during this period remained entirely un-politicized with no government stakeholders asking questions until the first major claim hit.



Notes: Misperception about implications of BITs meant South Africa willingly accepted the UK BIT model (SA_1), which provided investment protections over and beyond those in its Constitution as well as the stated policy objective of national treatment. Anchoring led to only minor adjustments in subsequent treaties (SA_2), and major adjustment did not take place untill first major claim against South Africa (SA_3) .

FIGURE 2. Bounded rationality in South Africa's BIT program

Conclusion

Rather than promoting lofty ideals of international justice or signalling their adherence to neoliberal ideals, most developing countries have seen BITs as strategic instruments to attract foreign investments. Yet, the adoption of investment treaties to compete for capital seems less rational than often portrayed. To make sense of this puzzle, this paper advanced a new theory of BIT-diffusion based on experimental insights from behavioural economics.

A three-step diffusion-process was predicted. First, developing country governments began adopting BITs because they were presented by developed countries or other BIT-

[68] South Africa proceeded to enter into a BIT with Zimbabwe, yet this had a specific background in the expropriations of South African property there, see; DTI (2010). More generally, while as of 2012, when this article was accepted, South Africa had begun allowing its BITs with European countries to expire and invited international organizations to assist with revising its model BIT, it remains to be seen if notices of termination are continued in the absence of renegotiation, or the policy might be reversed as a result of staff-rotations in the South-African trade bureaucracy.

[69] SA official XI. Another official notes: "*It was the Foresti claim that made Cabinet realize that we really had to review what these treaties were all about*" (SA official XIII). See also; DTI (2009).

proponents as easy instruments to adopt. Second, governments systematically overestimated the economic benefits of BITs and ignored their costs. While most adhered to the principles enshrined in the treaties – protection of foreign investments – only few have realized the power granted to third parties to determine the meaning of those principles in practice or the fact that some protections went over and above domestic investment regimes. As a result, agencies with an individual interest in promoting the treaties were given free reign by stakeholders until hit by their first claim. And rather than carefully considering the costs and benefits of different provisions, developing countries anchored excessively to early Western BIT-models simply because they were readily available to adopt. Finally, it was not until a country was hit by a claim itself, the potency of the treaties became apparent.

Unlike traditional studies of international policy diffusion, considerable qualitative evidence was used. Complementing survey and econometric evidence (Poulsen and Aisbett 2013), the case-study showed that imperfect processing of information can make governments fail to engage carefully with investment treaties despite considerable public policy incentives to do so. While tracing the role of cognitive heuristics is difficult without recourse to experiments, it provided one of those cases, where *"bounded rationality, like elephants in a living room, [is] just too much to ignore"* (Conlisk 1996:691).

Future research could complement suggestions made here. For instance, is it only different levels of bureaucratic expertise and experience that explain cross-country variation in information processing about investment treaties? Also, while most developing countries may have been 'intended rational' when adopting BITs, fundamental questions arise about the relationship between cognitive heuristics, economic ideas, and national identities in the investment regime. Although some constructivists have begun studying BITs in recent years, much more work is needed. Finally, rationalist scholars interested in the political economy of investment treaties could do more to cater for the roles of uncertainty and bureaucratic politics. Such lines of research could help clarify under what circumstances a bounded rationality framework has predictive qualities in the investment regime and, perhaps, other areas of IPE.

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