CENTER FOR GLOBAL DEVELOPMENT **ESSAY**

Where are the BITs? How U.S. Bilateral Investment Treaties with Africa Can Promote Development

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ABSTRACT

This paper focuses on the role that bilateral investment treaties (BITs) can play in promoting development in sub-Saharan Africa. BITs defend and promote investment abroad by providing core protections to foreign investors, reducing investors' exposure to political riskand uncertain business environments. But despite their potential benefits, BITs have been almost completely missing from U.S. engagement in sub-Saharan Africa over the last twenty years.

The U.S. government should launch a new four-pronged investment strategy for Africa. First, the government should pursue development-focused BITs with a handful of African countries that have a track record of implementing business-climate reforms. Second, it should negotiate BITs with two strategic countries with high political risk profiles, Nigeria and Angola. Third, the U.S. should launch a new Africa Doing Business Facility to identify reforming countries and implement robust technical assistance programs that reinforce and advance business-climate improvements. Lastly, it should forget about Trade and Investment Framework Agreements, which have almost no impact on international trade, investment flows, or U.S. businesses. Such a strategy will promote growth in Africa while also supporting U.S. commercial policy interests.

The Center for Global Development is an independent, nonprofit policy research organization that is dedicated to reducing global poverty and inequality and to making globalization work for the poor. CGD is grateful for contributions from the William and Flora Hewlett Foundation and the Bill & Melinda Gates Foundation in support of this work.

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Overview

In June 2010, the Obama White House announced a new approach to advancing international development that emphasizes the importance of fostering the next generation of emerging markets through targeted U.S. government investments and by leveraging the U.S. private sector.[1] This new emphasis is both productive and timely: to achieve lasting, meaningful development results, the United States must use all appropriate policy tools at its disposal. This note focuses on the role that one of these instruments—bilateral investment treaties (BITs)—can play in promoting development in sub-Saharan Africa.

BITs defend and promote investment abroad by providing core protections to foreign investors, such as free movement of capital, access to international arbitration, and restrictions against government expropriation. These protections help to reduce investors' exposure to political risk (ex-expropriation) and uncertain business environments, thereby increasing their willingness to deploy scarce investment capital. But despite their potential benefits, BITs have been almost completely missing from U.S. engagement in sub-Saharan Africa over the last twenty years. The region remains one of the riskiest and most difficult for private investors.

The U.S. government should launch a new four-pronged investment strategy for Africa. First, the government should pursue development-focused BITs with a handful of African countries that receive significant U.S. aid and have a track record of implementing business-climate reforms. This will help lock in reform efforts and facilitate greater foreign investment flows, both of which will support long-term private sector–led development. Second, it should negotiate BITs with two strategic countries with high political risk profiles, Nigeria and Angola. Third, the U.S. should launch a new Africa Doing Business Facility to identify reforming countries and implement robust technical assistance programs that reinforce and advance business-climate improvements. Lastly, it should forget about Trade and Investment Framework Agreements, which have almost no impact on international trade, investment flows, or U.S. businesses.

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[1] See White House press release, "A New Approach to Advancing Development," June 25, 2010, http://www.whitehouse.gov/the-press-office/a-new-approach-advancing-development.

Overall, this strategy will leverage a neglected, yet important, development policy instrument to promote growth in Africa while also supporting potential win-win U.S. commercial policy interests.

What are BITs and Why Do They Matter for Development Policy?

What are BITs? BITs aim to ensure that investment abroad receives fair, equitable, nondiscriminatory, and transparent treatment. The U.S. Trade Representative (USTR) and the State Department share responsibility for U.S. BIT policy and negotiations. At a high level, BITs contain six core provisions: (1) right to national and most-favored-nation treatment for respective investors and investments; (2) protection against expropriation, and fair, timely, and adequate compensation when it takes place; (3) right to freely transfer capital and investment proceeds using market-based exchange rates; (4) limitations on performance requirements, such as export quotas; (5) access to international arbitration in the event of a dispute; and (6) authority to select top managerial personnel of their choice. In practice, BITs commit signatory governments to a range of policies that go beyond simply guaranteeing or increasing openness to investment. Protecting foreign investors means upholding the rule of law, respecting contracts relating to government-controlled assets, reducing corruption, promoting transparency, and allowing free movement of capital.

Why Are BITs Important For Foreign Investors? In recent years, many African countries have implemented aggressive business-climate reforms to mobilize domestic investment and attract international capital. According to the World Bank's *Doing Business Indicators*, over 60 percent of African countries implemented at least one business-climate reform in 2009. In fact, Rwanda was the leading reformer among all developing countries worldwide. Despite this, sub-Saharan Africa remains one of the riskiest regions to do business.

- The cost of enforcing a contract is equal to nearly 50 percent of its underlying value. The OECD average is 19 percent. On average, it takes nearly two years to enforce a contract in sub-Saharan Africa.[2]

- Investor protections, on average, are lower than in every other geographic region.[3]

[2] Source: World Bank, *2010 Doing Business Indicators*

- Corruption is higher than in any other region—nearly three times higher than the average OECD country and twice the average East Asian country. African low-income countries with large extractive industry sectors, on average, perform even worse.[4]

- Over 50 investment disputes involving African countries have been submitted to the International Centre for the Settlement of Investment Disputes (ICSID) for arbitration.[5]

Collectively, these figures illustrate the imperative not only for augmented investment protections, but also the need to support further business environment reforms in targeted countries. In particular, BITs can be a very effective tool for providing core investor protections in countries with weak domestic institutions and high political risk.

Why Do They Matter for Development? Private investment—including foreign direct investment and portfolio capital—can be a significant driver of economic development and poverty reduction through several channels. These include (1) providing financial, technical, and human resources; (2) bringing new technology and management practices; (3) supporting local business suppliers; (4) reducing dependence upon foreign aid and external debt to support development-related activities; (5) financing local business activity and expansion through debt and equity instruments; and (6) expanding the country's tax base.[6]

Admittedly, the existing literature is somewhat mixed on the impact of BITs on developing countries. Many studies, including several recent ones, find that BITs have a robust positive impact on promoting FDI flows to developing countries.[7] For example, Egger and Pfaffermayr

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[3] *Ibid*
[4] Source: Transparency International, *2009 Corruption Perceptions Index*. Ten African countries with large extractive industries have an average score of 2.0 (out of 10) compared to an OECD average of 7.4. These countries include Angola, Cameroon, Chad, Republic of Congo, Democratic Republic of Congo, Cote d'Ivoire, Equatorial Guinea, Mauritania, Nigeria, and Sudan.
[5] Source: ICSID (see http://icsid.worldbank.org)
[6] See Theodore Moran, Edward Graham, and Magnus Blomström, *Does Foreign Direct Investment Promote Development?* (Washington, DC: Center for Global Development and Institute for International Economics, 2005).
[7] See Peter Egger and Michael Pfaffermayr, "The Impact of Bilateral Investment Treaties on Foreign Direct Investment," *Journal of Comparative Economics* 32(4): 788–804; Clint Peinhardt and Todd Allee, "The Multiple Effects of Bilateral Investment Treaties on U.S. Foreign Direct Investment" presented at the annual meeting of the American Political Science Association, 2007; Yoram Haftel, "Ratification Counts: US Investment Treaties and FDI Flows into Developing Countries," *Review of International Political Economy* 17(2): 348–377; Tim Büthe and Helen Milner, "Bilateral Investment Treaties and Foreign Direct Investment: A Political Analysis," in Karl P. Sauvant and

(2004), Peinhardt and Allee (2007), and Haftel (2010) find that BITs consistently increase FDI between the associated countries once they are signed *and* ratified. Separately, Savant and Sachs (2009) argue that foreign investors with exposure to extractive industries often rely on BITs because of the historical experience of host governments behaving in a discriminatory or even predatory fashion.[8] Relatedly, Busse, Königer, and Nunnenkamp (2010) find that BITs likely substitute for weak domestic institutions in developing countries.[9] However, several studies have found little or no explanatory power. For example, Tobin and Rose-Ackerman (2003) find a weak relationship between BITs and FDI.[10]

These differing empirical results appear to be driven largely by methodological challenges. First, BITs can vary substantially in terms of the quality of investor protections and industry sector coverage. An investment treaty with watered down provisions or large sector carve-outs arguably would have a smaller impact on promoting FDI flows. Second, it is difficult to clearly establish causality on whether BITs *promote* foreign investment or are negotiated after the fact to *protect* existing FDI stock. For the purposes of this paper, both aspects have concrete benefits for U.S. investors and by extension, African countries. Lastly, data and country coverage differences also may influence findings.

Another potential development-related benefit is that signing and ratifying BITs may increase the likelihood of concluding a free trade agreement (FTA) with the United States. Tobin and Busch (2010) find that BITs between developed and developing countries increase the likelihood that the pair of countries subsequently will complete a preferential trade agreement. [11] However, the impact is decreased if the developing country enters into a large number of BITs with developed

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Lisa E. Sachs, eds., *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Osford: Oxford University Press, 2009), 171–224.

[8] See Karl P. Sauvant and Lisa E. Sachs, eds., *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford: Oxford University Press, 2009).

[9] Matthias Busse, Jens Königer, and Peter Nunnenkamp, "FDI Promotion Through Bilateral Investment Treaties: More Than a Bit?" *Review of World Economics* 146(1): 147–177.

[10] Jennifer Tobin and Susan Rose-Ackerman, "Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties," William Davidson Institute Paper Number 587 (2003).

[11] Jennifer L. Tobin and Marc L. Busch, "A BIT Is Better Than a Lot: Bilateral Investment Treaties and Preferential Trade Agreements," *World Politics* 62(1): 1–42.

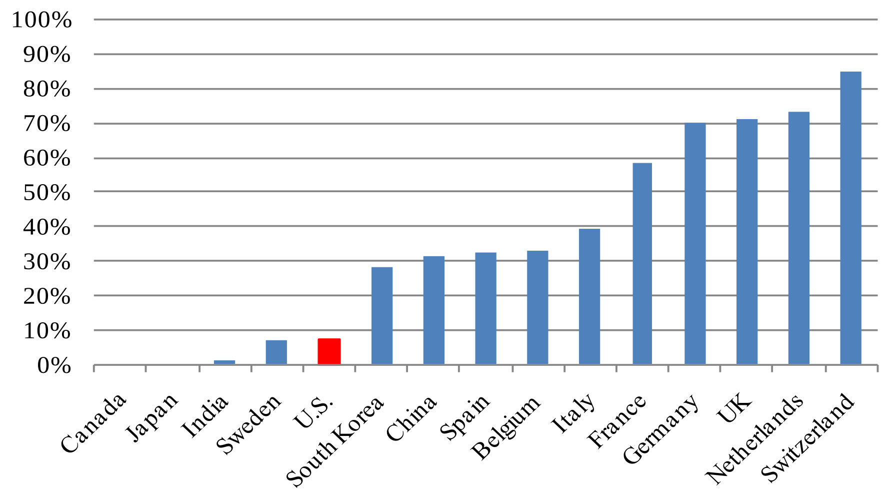
economies.[12] Depending on the underlying FTA terms, this could further contribute to the respective country's development efforts.

Possible Win-Win Commercial Relationships**:** Promoting long-term development does not preclude the U.S. government from facilitating win-win commercial relationships that provide short-term benefits to U.S. companies. Efforts to mobilize and protect U.S. investment interests in the near-term will support private sector–led development, increased economic opportunities, and greater prosperity in African countries over the long-term. Many developed and emerging economies have pursued aggressive strategies for protecting existing investments in Africa as well as promoting and securing access to markets and strategic resources. In this context, BITs and official assistance tied to specific investment projects have played an important role.

France has investment arrangements with 23 African economies.[13] Germany has BITs with 29 African countries, including 8 out of 11 economies with large extractive sectors. The UK has 10 arrangements, including with all three regional powerhouses (Angola, Nigeria, and South Africa). These agreements help to reduce private companies' exposure to political risks (i.e., expropriation, currency inconvertibility, etc.) and provide recourse to international arbitration in the event of an investment dispute. As a result, it has a positive impact on companies' willingness to invest. In contrast, the United States has one of the lowest BIT coverage rates, in terms of absolute number of agreements, percentage of regional GDP (see figure 1 below), and percentage of existing FDI stock (see figure 2 below). Even China—which entered the international investment game later—has greater BIT coverage.

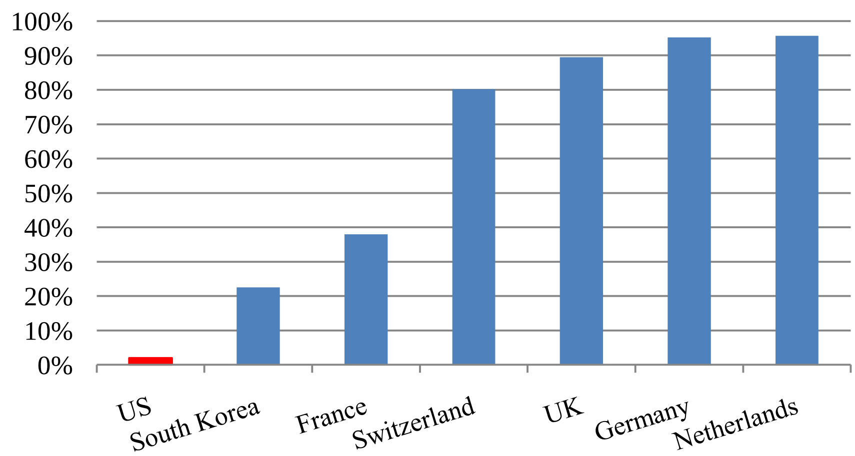
[12] This finding makes intuitive sense given the significant capacity, time, and resource requirements associated with negotiating preferential trade agreements.
[13] See International Centre for Settlement of Investment Disputes (http://icsid.worldbank.org/ICSID/FrontServlet)

Figure 1 – Percentage of Sub-Saharan Africa GDP Covered by BITs, Select Countries



Source: World Bank 2010 World Development Indicators, ICSID, author calculations

Figure 2 – Percentage of Existing FDI Stock Covered by BITs, Select Countries[14]

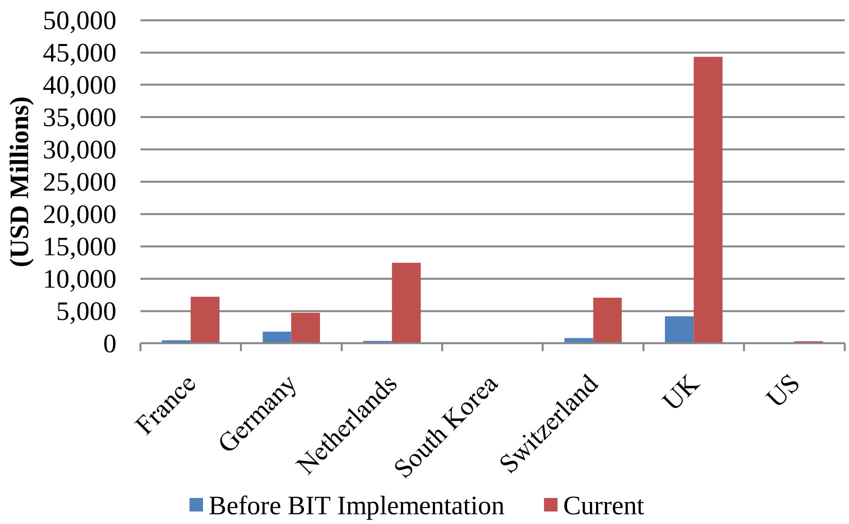


Source: ICSID, OECD International Direct Investment Statistics, author calculations

[14] Several OECD member or observer countries do not report FDI stock figures for all African countries. Therefore, figure 2 includes OECD countries with the most comprehensive reporting coverage.

Developed and recently industrialized countries' BITs appear to have helped to promote FDI flows to African economies over time.[15] Figure 3 below illustrates the aggregate FDI stock in African economies before BIT implementation and according to the most recent figures.[16] For example, UK FDI stock has increased from roughly $4.2 billion in countries before BIT ratification to over $44 billion in 2007. Six countries (South Africa, Mauritius, Nigeria, Ghana, Tanzania, and Cote d'Ivoire) account for the bulk of these post-BIT ratification changes. As noted previously, estimating the causal impact of BITs is difficult because of methodological limitations. While a number of factors contributed to increased FDI stock levels, such as business climate reforms and access to extractive resources, BITs likely also played an important contributing role.

Figure 3 – FDI Stock before BIT Implementation and Current Levels, Select Countries



Source: ICSID, OECD International Direct Investment Statistics, author calculations

U.S. BITs with African Countries—How Much Is Covered?

The United States is one of the largest foreign investors in sub-Saharan Africa. Between 1990 and 2008, U.S. foreign direct investment stock (*measured at historic cost*) increased from nearly

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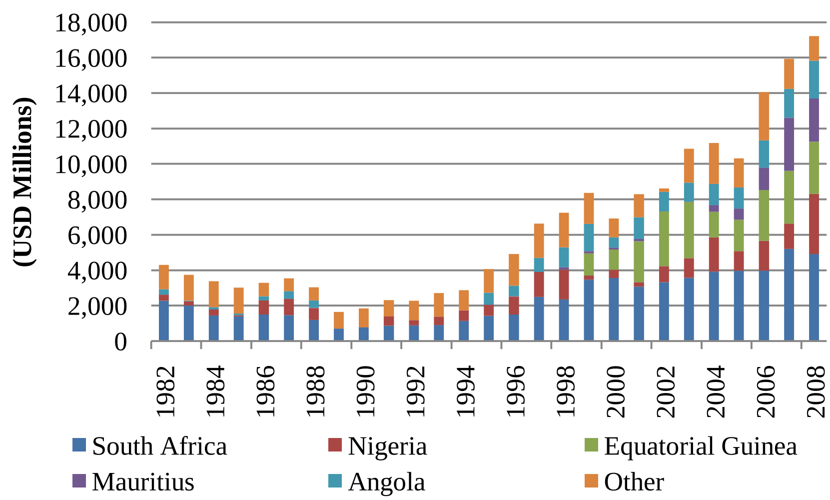
[15] Many additional factors help to explain the dramatic increase in FDI flows to African countries as well, such as business environment reforms and extractive industry opportunities.

[16] These figures are calculated by determining the FDI stock in individual African countries the year before BIT ratification and according to the most recent figures. For some countries, the time period elapsed may be up to 25 years. The most recent OECD data for countries (except Germany) is 2007. German FDI stock figures are for 2006.

$1.5 billion to over $17 billion, representing nearly a twelvefold increase (see figure 4).[17] Four countries with large extractive industry sectors (Angola, Equatorial Guinea, Nigeria, and South Africa) account for the overwhelming majority of U.S. FDI. Mauritius, which has worked to establish a diversified services sector, also has received a significant volume of U.S. FDI.

Figure 4 – U.S. FDI Stock in Sub-Saharan Africa, 1982–2008



Source: U.S. Bureau of Economic Analysis

The U.S. government has ratified BITs with only five African countries, Cameroon, Democratic Republic of the Congo, Republic of Congo, Mozambique, and Senegal. U.S. FDI stock totals only $273 million in these countries, equivalent to less than 2 percent of total regional investment.[18] While U.S. FDI to sub-Saharan Africa has increased substantially over the last twenty years, the U.S. BIT program has largely remained in hibernation. Arguably, U.S. FDI to Africa would have increased even more with BIT protections—again in those countries with higher risk profiles. During this time, the U.S. government has signed only three treaties, of which two have been ratified by the U.S. Congress. The Bush administration signed only one BIT during its eight years in office (Rwanda).[19] Currently, the United States has a BIT with only one of the 15 largest regional economies (Cameroon) and none of the top five.

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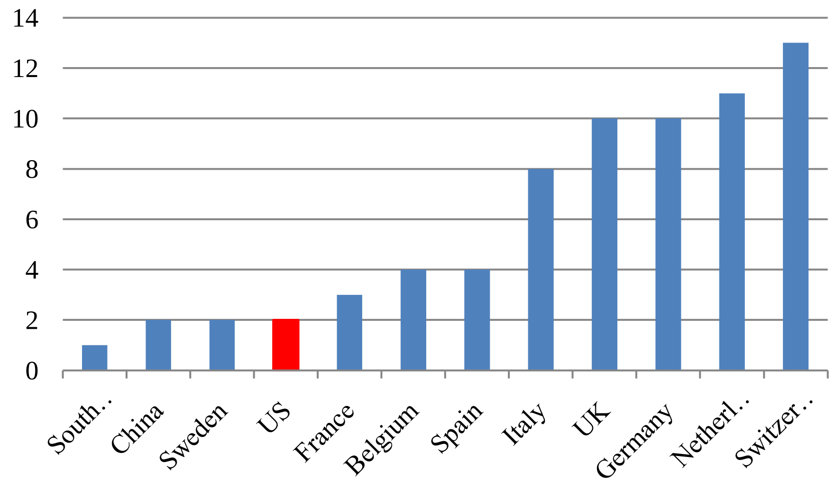
[17] Source: U.S. Bureau of Economic Analysis
[18] *Ibid*
[19] According to the U.S. Bureau of Economic Analysis, U.S. FDI stock in Rwanda totals only $1 million.

Figure 5 – Number of African BITs Ratified Since 1990, Select Countries



Source: ICSID

What Should the U.S. Government Do Going Forward?

The U.S. government should take a four-pronged approach to promoting investment in Africa, both from a development and commercial policy perspective.

1. View Foreign Investment as Development

The U.S. government should begin by viewing BITs as a development tool. Development policy is more than just pumping aid monies into poor countries. Donor governments are most effective when they take a holistic approach spanning trade, investment, aid, remittances, migration, and technology. As noted previously, foreign investment can provide an important contribution to economic growth and poverty alleviation if channeled appropriately. To date, the Overseas Private Investment Corporation (OPIC) has led U.S. investment promotion activities. It supports 16 existing private investment funds that expect to deploy nearly $5 billion in equity and debt capital in Africa.[20] OPIC also has supported numerous investment transactions through risk insurance instruments. USTR and the State Department should expand upon and complement these activities through development-focused BITs.

[20] See http://www.opic.gov/investment-funds/africa

In this context, the U.S. government may need to pursue a more innovative approach. First, it may need to explore a new BIT instrument that maintains the core investor protection provisions, but has somewhat more streamlined requirements and language than the existing U.S. Model BIT.[21] Second, some African governments may require direct or indirect assistance to address insufficient negotiating capacity. For the Central American Free Trade Agreement (CAFTA), the U.S. government mobilized capacity building assistance through the Inter-American Development Bank and USAID. A similar approach likely will be required for many prospective African BIT candidates.

The U.S. government should actively consider countries that meet the following three key criteria:

- *Existing U.S. Development Initiatives:* The U.S. government should consider negotiating BITs with countries currently receiving large-scale assistance through signature aid initiatives, including: (1) Millennium Challenge Corporation compacts; (2) Feed the Future; (3) President's Emergency Plan for HIV/AIDS Relief; and (4) President's Malaria Initiative. Based on this criterion, the following countries would be prioritized: Ethiopia, Ghana, Kenya, Malawi, Mali, Tanzania, Uganda, and Zambia.[22]

- *Business Climate Reforms:* The U.S. should target those countries that also demonstrate a commitment to establishing an enabling private sector environment. There are several possible ways to gauge government commitment. For the purposes of this paper, I set a very modest threshold: that a respective African country implemented reforms positively impacting at least one of the World Bank's *2010 Doing Business Indicators*. Of the aforementioned countries, only Tanzania would fail to meet this criterion.

- *Economic Size:* The U.S. government has a fixed number of BIT negotiators and limited capacity to pursue multiple agreements simultaneously.[23] Therefore, there should be

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[21] The existing U.S. Model BIT is a platinum-standard text that represents the ideal investor protections. It is the result of U.S. congressional requirements and guidance as well as several years of U.S. government interagency discussions and negotiations. In practical terms, the standard is set so high as to make it difficult for some developing countries to conclude a BIT with the United States. Therefore, a new development focused BIT instrument may be required.

[22] These countries currently are eligible for at least three U.S. signature development initiatives. Mozambique, Rwanda, and Senegal meet this criterion as well. However, they already have a BIT with the United States.

[23] This can be partly mitigated by redeploying capacity away from other less-productive uses of USTR and State Department staff (see suggestion 4 below).

further country prioritization to ensure appropriate uptake by U.S. investors. For this purpose, I again utilize a country's economic size as a proxy for investment opportunities. According to this criterion, the following aforementioned countries would be prioritized (in order of importance): Kenya, Ethiopia, Ghana, Uganda, and Zambia. [Note – each country has a GDP of greater than $10 billion.]

Based upon this methodology, five African countries would be candidates for development-focused BITs: Kenya, Ethiopia, Ghana, Uganda, and Zambia. Collectively, the U.S. government disbursed over $1.9 billion in development assistance to these countries in 2008 and $8.5 billion since 2000.[24] This massive commitment of U.S. taxpayer resources should be complemented, at a minimum, by an increased focus on mobilizing U.S. investment activity.

2. Pursue Win-Win Commercial Relationships in Strategic Countries

Second, the U.S. government should aim to facilitate win-win commercial relationships with strategically important countries. This approach would aim to support long-term private sector–led development while simultaneously promoting U.S. business interests in the near term. The Obama administration recently committed to increase commercial diplomacy and advocacy activities worldwide. It should expand upon this to actively pursue BITs with countries that meet three key criteria:

- *Preexisting U.S. Investment:* The U.S. government should seek to protect preexisting U.S. economic interests overseas. According to this criterion, the following countries would be prioritized (in order of importance): South Africa, Nigeria, Equatorial Guinea, Mauritius, and Angola. [Note – U.S. FDI stock exceeds $2 billion in each country.]

- *Economic Size:* Country GDP illustrates the size of the domestic marketplace, and by extension, economic opportunities for U.S. businesses. According to this criterion, the following countries would be prioritized: South Africa, Nigeria, Angola, Sudan, Kenya, and Ethiopia. [Note – each country has a GDP of greater than $25 billion.[25]]

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[24] Source: OECD-DAC
[25] Source: World Bank, *2010 World Development Indicators*

- *Political Risk:* BITs reduce government practices that restrict, distort, discriminate against, or place burdens on foreign investment. These types of protections provide important benefits in countries with poor rule of law, corruption, and regulatory quality. As measured by the World Bank, all of the previously countries mentioned above have significant institutional deficiencies, with the exception of South Africa.

On the basis of this methodology, Nigeria and Angola would be top candidates for commercially focused BIT negotiations. Both countries have ratified BITs with other developed countries over the last decade, which illustrate their willingness and capacity to conclude investment agreements.[26] South Africa is an attractive candidate in terms of existing investment exposure and economic size; however, its domestic institutions provide much greater protection for foreign investors than other African countries. Nigeria and Angola together account for roughly one-third of existing U.S. FDI stock in sub-Saharan Africa. Both countries perform far below global averages in terms of contract enforcement and corruption. Lastly, Nigeria and Angola also offer large domestic markets with a combined GDP of nearly $300 billion. In fact, their economies together are larger than 17 developing countries with ratified U.S. BITs *combined*.[27]

3. Launch an Africa Doing Business Facility

The third investment prong entails providing targeted technical assistance to support doing business reforms. The Center for Global Development recently issued a working group report calling for the creation of an Africa Doing Business Facility.[28] The Facility would provide technical and financial assistance only to those countries with a strong track record of addressing business-sector constraints. Third-party data, such as the World Bank's *Doing Business Indicators*, would be used to ensure transparency, broad country coverage, and accountability. Similar to the U.S. Millennium Challenge Corporation, the Doing Business Facility would use performance-based filters to identify a few reforming countries each year and then implement program agreements to reinforce and advance additional business climate improvements. This

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[26] For example, Nigeria negotiated a BIT with Switzerland in 2003 and Angola signed BITs with Germany (2007) and the United Kingdom (2000).

[27] These countries include Albania, Armenia, *Bahrain*, Bolivia, Estonia, Georgia, Grenada, *Honduras*, Jamaica, *Jordan*, Kyrgyz Republic, Latvia, Moldova, Mongolia, Panama, Trinidad and Tobago, and Uruguay. Italics indicate that the country also has a ratified free trade agreement with the United States.

[28] See http://www.cgdev.org/content/publications/detail/1423783

approach would help to ensure that the Facility targets assistance on countries that will use it effectively as well as create reform incentives for countries on the threshold.

4. Lastly, Forget About Trade and Investment Framework Agreements

In recent years, the U.S. government has focused almost exclusively on Trade and Investment Framework Agreements (TIFAs). It now has 11 of these non–legally binding agreements, which essentially just provide an official forum for discussing bilateral or regional trade and investment issues.[29] They provide no investor protections and do not open up new markets for trade. As such, they have very little incremental impact on U.S. investors and businesses. Some may argue that TIFAs help to build the foundation for BITs and free trade agreements (FTAs) down the road. However, the track record does not bear out this argument. The U.S. government should refrain from negotiating new TIFAs with African countries and focus exclusively on BITs as well as FTAs where appropriate. This also will free up finite USTR and State Department staff time to focus on BIT negotiations rather than time-consuming and ultimately unproductive TIFAs.

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[29] By illustration, see the U.S.-Angola TIFA at http://www.ustr.gov/webfm_send/1055.