Strategized Exit: Sunset Clauses and Unilateral Terminations of BITs*

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Abstract

Since peak enthusiasm in the 1990s, governments worldwide have increasingly renegotiated or terminated bilateral investment treaties (BITs). This paper examines the politics underlying this trend, asking how country performance indicators and choices of BIT design impact subsequent decisions of institutional exit. BITs' sunset clauses were designed to lock in capital-importing countries with treaty responsibilities. A long sunset period, however, may benefit host countries that enjoy an improved reputation in a way that contradicts the purpose of the clauses. Examining 473 BITs across 112 countries and 50 years, the paper demonstrates that a BIT party ranked higher in country performance indicators is more likely to unilaterally terminate its treaty when the invoked sunset clause can pose a longer-term threat to bilateral investment relations. The paper contributes to the emerging literature on institutional exit by indicating how particular forms of exit may be used by countries with an improved reputation to gain leverage in bargains.

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1 Introduction

After reaching a high point in the 1990s, international investment agreements have experienced a wave of withdrawals. Although there is a rising trend around the globe of revising international economic governance, few international economic institutions have sparked controversy as stark as investment regimes (Poulsen and Gertz, 2021). Bilateral investment treaties (BITs) are criticized for failing to block out power politics and for offering a means for private actors to impose exorbitant costs on sovereign governments. Some argue that the investor-state dispute settlement (ISDS) mechanism, which is the dispute settlement mechanism of BITs, is designed in a way that protects the interests of more powerful, capital-exporting states rather than the usually weaker, capital-importing states (Allee and Peinhardt, 2010). Others draw attention to the right that BITs endow foreign investors with to sue host governments at an international venue (e.g., (Miller and Hicks, 2015)). Facing threats of investment disputes, host countries would even reverse the policy decisions made in the public interest (Schram et al., 2018).

In recent decades, antagonism toward BITs has been spilling from the developing world to developed societies and has taken various forms, ranging from termination of BITs to withdrawal from the ISDS mechanism often embedded in BITs. Some governments have started to re-examine their policies toward BITs and question whether investment agreements with the ISDS are necessary or in the interest of host states. For example, Indonesia and South Africa, both large capital importers but also emerging regional capital exporters, have publicly stated that their domestic institutions have evolved to the point where existing ISDS provisions are now less relevant (Lester, 2016). In addition, important middle-power countries like India, Brazil, and South Africa never joined the ISDS mechanism, while Venezuela and Bolivia have officially withdrawn. In the existing stock of 3,000 investment treaties, the trend of terminations is increasingly noticeable. The yearly number of newly signed BITs has declined ever since its peak in 1996 and was exceeded by that of terminated BITs in 2017 for the first time (UNCTAD, 2022). Overall, more and more BITs are being terminated, and many major economies are reconsidering their policies toward BITs.

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

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

Rather than treating BIT terminations and renegotiations as independent, the paper theorizes that both arise from a similar causal process whereby governments struggle to implement preferred regulations in the face of rising lawsuits. I suggest that the unilateral termination of BIT is not a full exit but serves as a threat of exit, which is consistent with the fact that BIT exits are sometimes accompanied or followed by renegotiation.[1] States can unilaterally terminate their BITs for the sake of leverage in renegotiation with their treaty partners. What makes this particular form of exit a coercive means is a lock-in mechanism embedded in BITs which is called the "sunset clause." I argue that a capital-importing country will be both more willing and more able to wield the coercive means of BIT unilateral termination when its reputation as an FDI destination, indicated by global performance indicators, improves. While the literature suggests that an improved reputation can yield financial gains and enhance credibility, the increasingly interconnected global market introduces nuanced challenges. For corporations, countries with favorable reputations may present more attractive prospects as investment destinations. For capital-importing countries, heightened competition for market entry can strengthen their bargaining power. Drawing on accumulated knowledge and experience in managing investment relations, these governments may reassess their rights and obligations as defined by established investment treaties. Among the coercive strategies at their disposal, the threat of withdrawal from existing agreements emerges as a potent tool, albeit one not universally wielded by all governments. Countries that have improved their reputation on the global stage may choose to partially exit agreements as a means of advocating for institutional reforms.

I illustrate my argument by analyzing how sunset clauses correlate with BIT termination among 473 BITs, covering 112 countries and 50 years. Using logistic regression, I show that a larger improvement in a capital-importing country's rank in business climate indicators increases the odds of its policy decision to unilaterally withdraw from BITs. The results also provide support for a conditioning effect of the gap in growth rate between the treaty

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

parties on the relationship between changes in the host country's rank and the country's policy of unilateral withdrawal. Moreover, an improved reputation has the strongest effect on the likelihood of unilateral termination when the lock-in mechanisms embedded in the BITs at stake have a short-term validation.

This paper contributes to the literature by investigating how a state's reputation affects its engagement with international institutions. how institutional design choices correlate with subsequent policy decisions of institutional exit. While sunset clauses were designed to lock in capital-importing countries with treaty responsibilities, a long sunset period may benefit host governments in a way that contradicts the purpose of the clauses. The evolving policy stances on BITs may highlight the necessity of further exploring unintended outcomes of institutional design choices. Lock-in mechanisms can be used to increase bargaining leverage by initially weaker parties in economic exchange, especially when those parties experience declining growth and are short of channels that give them an upper hand in negotiations.

2 The Puzzle

Given the potential positive effects of foreign direct investment (FDI) on growth, national governments are often keen to attract investment flows. While tax incentives and regulatory policies are prevalent mechanisms under the control of sovereign states, international investment agreements are the cooperative regimes that states adopt in the international sphere. Countries concluding these agreements commit themselves to adhere to specific standards on the treatment of foreign investments within their territory. International investment agreements also define procedures for resolving disputes that occur when host governments do not fulfill their commitments. BITs are one of the most common and important types of international investment agreements.

Investment treaties experienced their high point in the 1990s. BITs signed between 1991 and 2000 account for over 50 percent of all BITs signed since 1959.[2] The enthusiasm of states toward BITs was attributed to the belief that BITs reassure foreign investors (Büthe and Milner, 2008). BITs benefit treaty signatories in two ways. First, countries sign BITs because treaty signing can serve as a signaling device. Since capital would turn into immobile assets once invested in the host market, capital owners would worry that the host government cannot credibly promise to refrain from interfering with foreign investment (Simmons, 2000). Investors from overseas are thus often concerned about the quality of domestic institutions and the enforceability of law in the host countries (Jensen, 2008; Staats and Biglaiser, 2012; Lee et al., 2014; Xu, 2020). Binding institutions are better than "cheap talk," as the former conveys the seriousness of the host government's intentions to protect foreign investment and treat equally domestic and foreign investors. In host states that ratified BITs, foreign investors are allowed to use international legal resort if they find domestic institutions incapable or biased (Ginsburg, 2005; Büthe and Milner, 2008; Malesky and Milner, 2021). Granting foreign investors access to the international judicial system signals that the signatory government consents ex-ante to yield its autonomy over the procedures and results of investment dispute settlement.

The second type of benefit countries can gain from signing BITs is realized through the ISDS mechanism that BITs grant access to. The ISDS mechanism is a dispute resolution system where two parties to a dispute agree to arbitrate or operate under the BIT that specifies that arbitration is the remedy. The ISDS mechanism, unlike state-to-state arbitration, allows private actors to formally sue sovereign states in the international jurisdictional

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

system.[3] The International Centre for Settlement of Investment Disputes (ICSID) is the ISDS mechanism to which BITs provide treaty parties with access. BITs and the ICSID are legally tied to each other. The ratification of BITs is a prerequisite for the application of the ICSID Convention. More specifically, if a state wants to forbid the use of the ISDS mechanism, simply denouncing the ICSID Convention is not enough. It will also need to break the BITs it signed. Otherwise, the parties of its treaties that are not terminated can still file cases at the ICSID against its government even if it is no longer an ICSID member.

Failure to comply with treaty terms should be costly enough to make host states' commitments credible to investors. A BIT constrains a state's behavior by imposing penalties in the case of non-compliance (Büthe and Milner, 2008). The ex-post costs, including financial and reputational loss, are triggered only when disputes are filed and/or awarded at international courts (Haftel, 2010; Allee and Peinhardt, 2010). The mechanism to achieve this is thus the ISDS system, which enables investors to seek compensation from host countries for failing to fulfill the committed protection. This is called "hands-tying" (Fearon, 1997) which imposes ex-post costs on an actor who does not follow through on a commitment. By tying the hands of signatory governments, a BIT provides informational value through its arbitration system. Correspondingly, the benefits that a state gains from signing or ratifying BITs are enhanced credibility which makes it more attractive as a host destination for FDI.

Given the benefits of BITs, states should be expected to preserve their BITs once they sign the treaties. However, what the standard narratives predict is inconsistent with the reality. In the existing stock of 3,000 investment treaties, the trend of terminations is increasingly noticeable, as shown in Figure 1. The yearly number of newly signed BITs has declined ever since its peak in 1996 and was exceeded by that of terminated BITs in 2017 for the first time (UNCTAD, 2022). If BITs provide informational value and benefit signatory states by

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

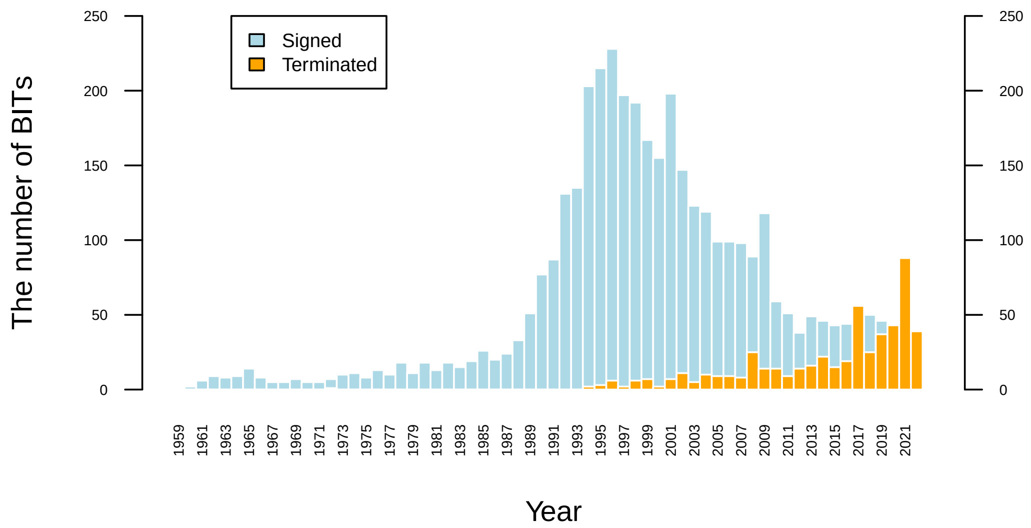


Figure 1: *Signed and terminated BITs, 1959-2022*
Data collected from UNCTAD Investment Policy Hub. Last updated in December 2022. Source: `https://investmentpolicy.unctad.org/international-investment-agreements`.

being costly, why do states exit BITs after paying the costs of joining these agreements? Do terminations of BIT reflect states' antagonism against investment regimes? Existing studies show that the shrinking gap of economic strength between BIT parties can encourage host governments to adopt revisionist policy by terminating the treaties that no longer serve their development goals (e.g., (Huikuri, 2023)). However, the variations in the forms of efforts that countries took to change the status of their treaties have not been sufficiently explored so far.

Particularly, many BITs allow signatory states to replace old investment treaties with new ones. While some states opt for replacement or mutual termination, many states opt for unilateral termination. In theory, this is puzzling. Compared to replacement or mutual termination, unilateral termination is costly – most BITs have "sunset clauses" (sometimes also referred to as survival clauses) that go into effect and bind countries together under

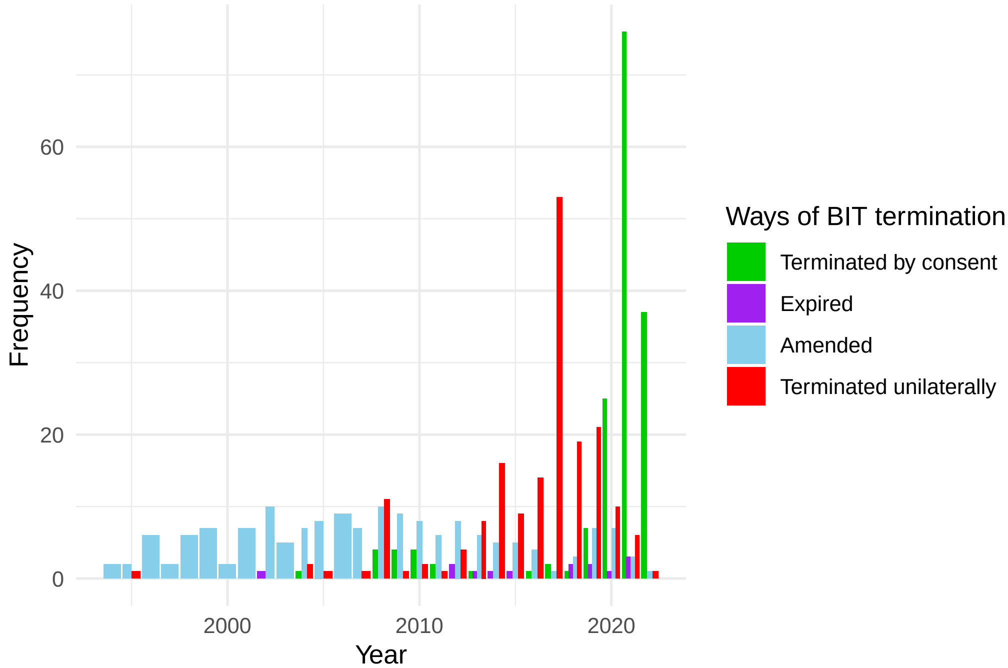


Figure 2: *Alternative ways of terminating BITs, 1990-2022*
Data collected from UNCTAD Investment Policy Hub. Last updated in December 2022. Source: `https://investmentpolicy.unctad.org/international-investment-agreements`.

the treaty's conditions for a certain number of years. Sunset clauses guarantee that all investments made prior to the termination of a BIT continue to be protected during a period that ranges from 5 to 20 years.

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

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

available? As either of the alternatives should theoretically be a better choice, it is puzzling why there has been a rising number of unilateral withdrawals in recent years.

3 Understanding BIT Terminations

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

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

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

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

4 A Theory of Strategized Exit

Conventional studies often consider states' withdrawal from cooperative mechanisms as a backlash against international institutions.[5] In contrast, I argue that unilateral termination of BIT is not necessarily a form of institutional exit. With sunset clause being included in BIT, policymakers face a trade-off between waiting for the partner country to agree to terminate the treaty and being constrained by treaty obligations for an extended period defined by the sunset clause. My explanation for the policy of unilateral withdrawal from BIT is deployed below in three parts. I first explain why unilateral termination should not be straightforwardly considered as an institutional exit resulting from states' backlash against BITs. I then analyze why sunset clauses could serve coercive ends. In the last two sections, I theorize the conditions under which host governments would use unilateral termination of BITs to coerce treaty partners.

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

4.1 Unilateral Termination More as a Means Than an End

In the scant literature on states' withdrawals from BITs, Thompson et al. (2019) operationalize BIT termination as a more drastic form of renegotiation than BIT replacement. However, their empirical investigation is based on an unproved assertion that BIT termination is part of treaty renegotiation. No efforts have been made so far in the literature on theorization or empirical testing. This paper would thus be the first attempt to address this theoretical void and provide empirical proof for the causal mechanism that underlies Thompson et al. (2019)'s claims about the effects of arbitration costs on states' renegotiation of BITs. It starts with discussing why unilateral termination can be more of a means than an end. In this section, I review the reasons why BITs were signed, provide empirical examples of the intertwined relationship between treaty exit and renegotiation, and explore the effects of sunset-clause invocation on different groups of investors.

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

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

In addition to the benefits or (sub-)optimal solution that BITs can provide to both home and host countries, the intertwined ways of exiting BITs make it necessary to reconsider whether unilateral termination and renegotiation of treaties should be treated as independent or related processes. In the real world, states' activities of replacing, unilaterally or mutually terminating treaties are often intertwined. Terminations rarely happen between treaty partners without initial rounds of renegotiation, and terminations sometimes follow treaty expiration or failures in renegotiations. For example, some states such as Indonesia would allow their existing BITs to expire so that they can renegotiate them (Trakman and Sharma, 2015). In the case of Indonesia, discontinuing BITs is the first step that the state takes in a bargaining process to increase leverage against its potential future treaty partners. Another example is India, which is among the few countries that have unilaterally terminated BITs with multiple treaty partners in a short time frame. The Modi government released a new model of BITs in the same period, which was followed by publicly announced requests for renegotiations with those partner states over treaty terms based upon the new model (Ranjan et al., 2018). Both cases of India and Indonesia are typical in demonstrating unilateral termination as one step taken by BIT signatories in a long process of attempting reform.

The third reason why unilateral termination should be considered as a means rather than an end is related to how investors from overseas will be affected by a host country's behavior of unilaterally withdrawing from the BIT that is signed with their home country. With sunset clauses being embedded in BITs, unilateral termination does not free host country immeidately from its treaty obligations. Once triggered, sunset clauses will extend the obligations of host states into a designated period, but these extended obligations will be only to existing investors, i.e., the investors who entered the host market from the partner country before the time of unilateral termination. This signifies that, existing investors from the home country can continue to file legal claims or make threats of claims against the host government after the BIT is unilaterally terminated until the conclusion of the sunset clause. This has two important implications. First, sunset clauses can allow a host country to discriminate against future investors from its treaty partner. Second, unilateral termination may not mean a full exit, as existing investors will remain protected by BIT provisions despite for a finite period.

In sum, states may challenge the BIT status quo by implementing piecemeal withdrawal (Peinhardt and Wellhausen, 2016) or pushing for reforms that help them preserve policy autonomy (Thompson et al., 2019) without breaking away from the BIT system wholesale. Lacking better options, states may not have incentives to quit the network of investment treaties for good. Even the most skeptical countries including India and Indonesia have been releasing new models of BITs serving as templates for future BITs and renegotiating for new

BITs that align better with their interests of regaining autonomy.[6]

4.2 Sunset-Clause Invocation as a Potential Coercive Strategy

The purpose of sunset clauses is to render the BITs resilient to change or termination; they serve as an "immune system" of investment agreements. Over the past decades, sunset clauses of longer duration have become prevalent. As shown in Figure 3 the number of BITs signed with a 10-year sunset clause increased sharply in the 1990s. BITs without sunset periods have been infrequent. As capital-importing states often have less influence over the design of BITs than capital-exporting governments (Alschner and Skougarevskiy, 2016), this trend would reflect home countries' intentions to make the treaties resilient to policy changes of their treaty partners. It is in the interest of the home country to extend the validity of treaty obligations of the host state beyond the time when the host government unilaterally decides to withdraw from BIT.

I argue that unilateral termination is a potential coercive strategy implemented by states that seek to reform their BITs. My argument is consistent with the empirical clues that states' activities of replacing, unilaterally or mutually terminating treaties are often intertwined. Existing literature on bargaining and sanctions sheds light on how unilateral treaty termination may operate as a coercive threat. Sanctions are most efficient not when they are practiced but when they are threatened (Fearon, 1994; Drezner, 1999; Powell, 2006). Economic sanctions inflict costs indirectly through private actors and their economic activities, which contrast with a military force that imposes costs directly on the target government (Morgan and Bapat, 2003; Early, 2009). To impose costs on the target, the sender of the threat needs to create market imperfections that deter economic exchanges between market actors from the two parties (Stiglitz, 1989; Brewer, 1993). As more recent studies on sanc-

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

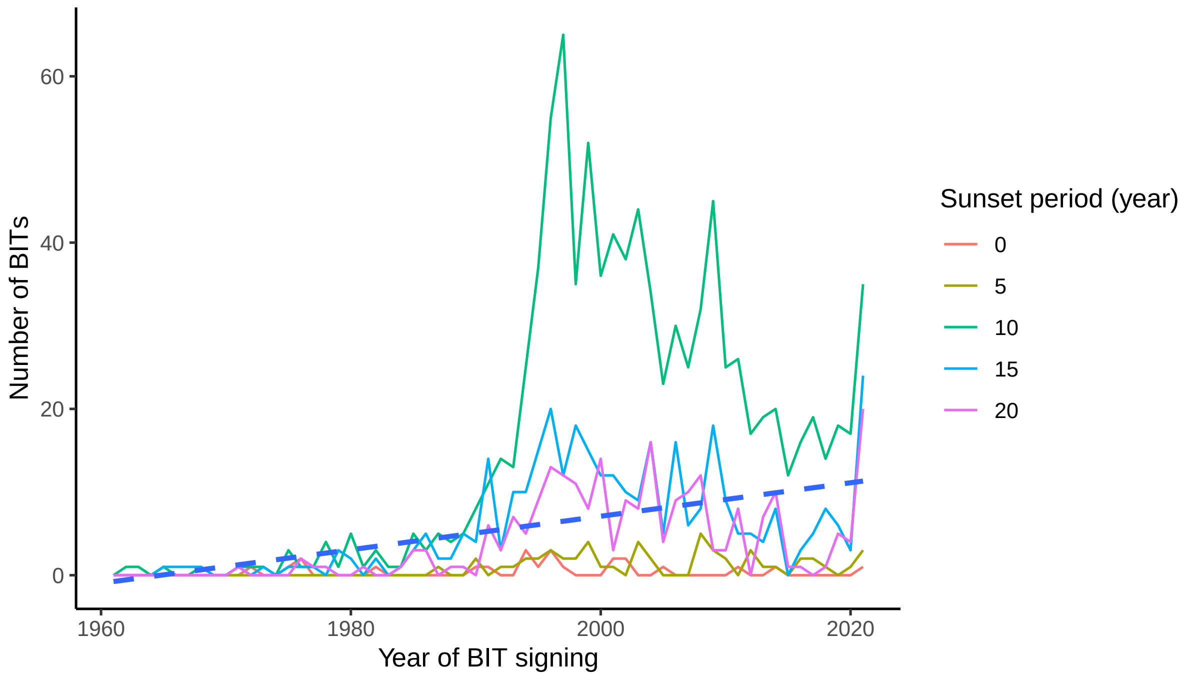


Figure 3: *BITs signed with sunset clauses of varying lengths (1962-2021)*

tions (e.g., (Bapat and Kwon, 2015)) begin to focus on how host states raise the costs of their firms to engage in economic activities with the target country, this paper demonstrates how host states can influence the behavior of partner countries by altering market perceptions of investment prospects.

Since transnational economic exchanges are, unlike military forces, not under the full control of state authorities, states would need to alter the incentives of market actors to continue the relationship by inflicting costs on those actors via international regimes. Threatening to exit an international institution can be useful to pressure the members to agree to reform the institution, especially when the threat is posed by a key player with either significant political influence or economic status (von Borzyskowski and Vabulas, 2023). A unilateral termination with the sunset clause being activated can serve as a threat of institutional exit. Since existing investors' privilege of remaining protected by BIT provisions will end when the sunset clause expires unless a new treaty has been signed before then, unilateral termination of a BIT by one party can signal its intention to challenge the status quo and accept the cost of interrupting the relationship with the other party.

Exit and renegotiation would thus arise from a similar causal process whereby host governments struggle to neutralize the financial loss resulting from arbitrations and implement preferred regulation in the face of rising lawsuits. With the presence of sunset clauses, unilateral termination would not signify a full exit but stand for part of host states' efforts to reform BITs. Knowing that unilateral termination will automatically trigger sunset clauses, the state could use unilateral termination, not as a resort to exit a BIT for good, but as a threat of long-term exit. The host government would have incentives to trigger sunset clauses for the sake of its leverage in renegotiation. Not all BITs contain sunset clauses, and the unilateral termination of only the BITs that contain them would be useful for host states to increase leverage in future renegotiations between the BIT partners. Once a sunset clause is triggered, it would be the duration of the clause that determines how long the absence of treaty protection will persist, and it will be the host state that decides whether the absence of protection will extend to affect existing investors from the target country when the sunset clause ends.

A host country would thus be more prone to coerce mutual concession or agreement by unilaterally terminating the treaty when the invoked sunset clause can, to a larger extent, undermine the investment relations between the treaty partners. The validation duration of the clause, which I refer to in the following text as "sunset period," would not affect how long future investors – that is, investors who have not yet invested in the host economy – remain protected or unprotected. The length of the sunset period would not affect how detrimental the unilateral termination of BIT is to future investors but would be at stake for existing investors. Once the unilateral termination of a BIT occurs and triggers the sunset clause, the host country will be immediately free from its treaty obligations to future investors. How soon future investors can regain treaty protection depends on how soon a new BIT will be signed between their home country and the host country rather than how long the sunset clause of the terminated treaty lasts.

In brief, I argue that unilateral termination is one step in a long process of renegotiation. The sunset clause signifies a partial form of treaty exit and could be used by TCIs as a coercive means to push for renegotiations between BIT parties. As the following sections will discuss both signatory countries of BITs, I use the term "traditional capital exporter" (TCE) to refer to the side where investors from home used to invest abroad. The TCE is thus usually the more powerful party in the negotiations over treaty terms when the BIT was initially signed. The term "traditional capital importer" (TCI) is, in contrast, usually the host country that receives investment from the TCE. The TCIs lie in the center of my theory as they are the BIT party that has been seeking to challenge the status quo that favors their treaty partners.

4.3 Reputation, Global Performance Indicators, and Coercion

If sunset clause invocation can serve as a coercive strategy, under what conditions would states be more likely to use this coercive strategy? The rationalist account (Huikuri, 2023) suggests that, with increased economic strength, TCIs would have more bargaining power to seek treaty terms that align better with their interests. While power constraint determines what states can do, it is insufficient to explain what states believe they can do. To answer when and why a TCI uses partial exit as a threat, we should first understand how the country decides if the treatment that it receives in the existing BIT matches the treatment that it thinks it deserves. I argue that changes in countries' reputation affect their decisions of unilateral withdrawal from BITs by shaping the beliefs of the market about what they are capable of. To capture reputation, I examine business climate indicators, a particular type of country performance indicators that evaluate national business environments and are intuitively most relevant to judgments about how investor-friendly the countries might be. The key business climate indicators of interest include the World Bank's Ease of Doing

Business (EoDB) index[7] and the World Economic Forum's Global Competitiveness Index (GCI).[8] In terms of both the number and market share of hits, EoDB and GCI are the two most dominant indicators, according to the reported statistics drawn from the Media Cloud Database[9] (Doshi et al., 2019). It is worth mentioning that the effect of business climate indicators on state policies of exiting BITs should differ from that of economic strength. In terms of theoretical framework, while the former builds upon a constructivist approach that actors and structures mutually constitute each other, the latter is based on a rationalist account that treats structures as an exogenous factor in determining how actors behave. Empirically, business climate indicators do not represent economic strength but focus on measuring business regulations and their enforcement.

How do business climate indicators shape countries' evaluation of their capabilities? Existing studies find that country performance indicators can change state behaviors by monitoring (Kelley and Simmons, 2015), punishing (Morse, 2019), and shaming (Weisband, 2000; Rotberg, 2004). The rationale is to change how others perceive the countries evaluated by country performance indicators and impose reputational costs on those that do not abide by the rules set by the international community Sharman (2009). Media coverage can amplify the effects of the indicators by broadcasting the achievements or failures of countries, which can lead to a social process in which public knowledge about the countries is constructed and, in turn, pressures states to improve their performance (Doshi et al., 2019). In brief, country performance indicators can change the informational environment in which countries, the general public, and relevant audiences interact.

Countries gain status from business climate indicators, and reputation comoves with

[7]Before the EoDB project was discontinued by the World Bank in 2021, it received a high attention and enjoyed a dominant market share among business climate indicators (Doshi et al., 2019).

[8]For robustness check, I will also investigate bond ratings as an alternative indicator of countries' general reputation and creditworthiness as debt issuers in the international financial markets.

[9]Media Cloud Database: https://www.mediacloud.org.

status defined by widely observed or frequently used indicators. When a business climate indicator reports its conclusion about how well a country performs, the information it provides is a comparative judgment. Changes in any country's rank will affect the others' rank. When the ranking shapes how people and entities perceive a ranked country, it produces a first-order belief, which refers to how an actor thinks about another actor's characteristics or behavioral tendencies in the literature of political psychology (Dafoe et al., 2014). The ranking itself is a zero-order belief, as it does not involve social knowledge. I refer to a country's position in the ranking as "status," whereas the first-order beliefs about the status of a ranked country are referred to as "reputation" in this paper.[10]

As a state judges its capability based on the reputation brought by the observable hierarchy created by business climate indicators, any increase in rank would lead the state to believe that others think better about itself and correspondingly boost its confidence. Being aware that its reputation improves over time among both the general public and foreign investors, the TCI would expect more foreign investors to show continuous interest in developing business on its soil. Therefore, an improved reputation in the capital market would make the TCI perceive itself as a more popular FDI destination for investors from the target (i.e., the TCE) government. To be noticed, a country's reputation would affect mostly future investors. Existing investors would not be primarily subject to the rank or status of the TCI identified by business climate indicators, since they are already within the market and have developed insider knowledge about how the host country performs in rule-making and policy implementation.

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

What does TCI's improved reputation mean to investors and the government of its treaty partner country? This question is essential to understanding how reputation provides some countries with the incentives to use the partial form of exit, that is, unilateral termination of BIT, to threaten others to concede. To answer this question, I first explore the conditions under which an interruption of connections can serve coercive purposes. For economic sanctions to work, there must be a relationship to be interrupted (Hirschman, 1980; Keohane, 1977; Wagner, 1988). The effectiveness of sanction threats in extracting policy concessions from a target state depends on how costly the sanction can be to the target (Schultz, 1999). The costs of interrupted investment relationships are essential to the viability and effectiveness of the coercive strategy of unilateral exit. The higher the potential cost the interruption of the relationship can impose on the target, the more likely it is that the target will surrender (Keohane, 1977). For an exit threat to work, the TCI should thus generate potential costs that investors and the government of the treaty partner will have to burden when adapting to changes that the TCI threatens to impose. The availability of fungible outside options owned by foreign investors determines how high the costs of adaption will be. A decline in the fungibility of outside options for the investors from the TCE would raise their costs of adapting to potential changes and increase their vulnerability.

Once the TCI unilaterally terminates the treaty, investors from the treaty partner that intend to invest in the TCI have two options: they can either proceed with their plan of entering the TCI's market without BIT protection or invest in alternative destination(s) (i.e., switch to any fungible outside option) without having to bear the risk of failed negotiations in the future between their home country and the TCI. With more fungible outside options, these investors would be less likely to suffer from the lack of protection resulting from the unilateral termination of the treaty in the latter scenario. Only when outside options are limited – making the formal scenario ideal – would TCI's removal of treaty protection for future investors impinge on both the partner country (i.e., TCE) and investors from that country.

An improved reputation of the TCI can render outside options less fungible in two related ways. First, a good reputation would make the TCI an attractive FDI destination. It thus plays a similar role as the BIT itself, although this does not mean that business climate indicator and BIT are perfect substitutes. Second, a good reputation of an FDI destination would intensify the competition among foreign investors from different home countries that seek a satisfactory host market. As investors and countries around the globe are educated by the country performance indicators, the countries that are highly ranked or have an improved status in the ranking would be popular FDI destinations that do not lack candidates from the global pool of investors. Some would raise an alternative explanation for the lack of fungible outside options for future investors from the TCE: economically interdependent relationships between the treaty partners. However, economic interdependence would constrain the behaviors of both the TCE and the TCI because one cannot hurt the other without hurting itself. The effect of reputation, in contrast, should not be confined to dyadic relations. An increase in the TCI's reputation would mean fewer outside options for future investors from the TCE who are using the TCI as the benchmark destination. It can also lead to more fierce competition among investors around the globe who are looking for investor-friendly host markets.

After the BIT is terminated, the investors that have not yet entered the TCI market will remain unprotected by investment agreements until a new BIT is signed between the two treaty parties. As shown in 4, if there are fewer paralleled outside options and more competition over the market entry opportunities, these foreign investors would face increasing opportunity costs of not choosing the TCI market. This thereby increases the necessity of the home government of these investors (i.e., the TCE) to shorten the period during which future investors are not covered by treaty protections, and an evident solution would be to turn to the negotiation table and reach a new agreement sooner with the TCI government.

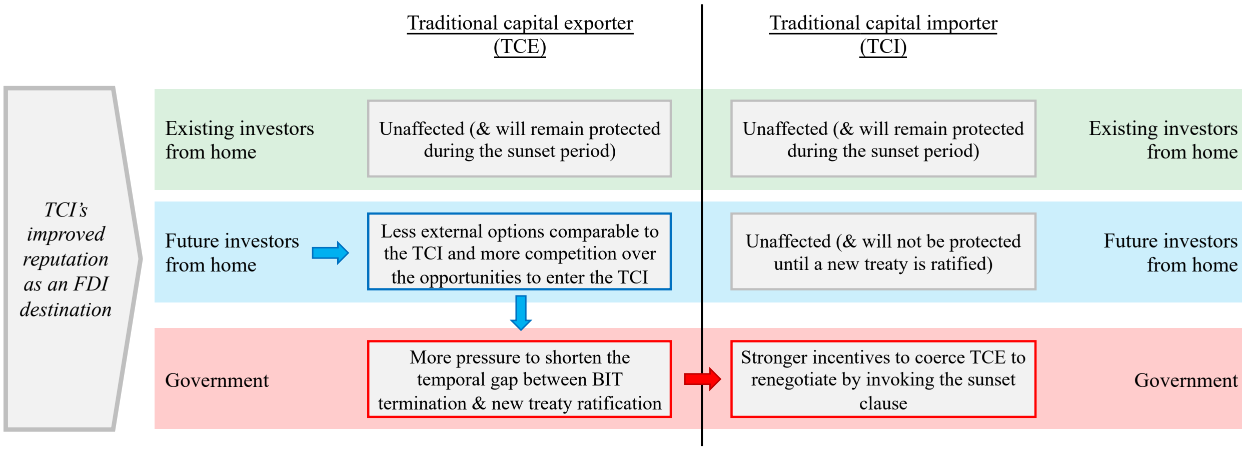


Figure 4: *How changes in TCI's reputation can affect both treaty parties after the BIT is unilaterally terminated*

In this way, a better reputation makes the TCI both more willing to coerce and more capable of coercing. I thus posit that a TCI with an improved reputation has strong incentives to challenge the status quo by coercing its treaty partner, and the coercive means in the context of BIT exit is unilateral termination given the presence of the sunset clause. The hypothesis is as follows:

> *H1: A host country should be more likely to exit BIT through unilateral termination as opposed to the approaches of replacement or mutual termination when the country's reputation experiences an increase in its rank in the global business climate indicator.*

The bargaining leverage provided by an improved reputation, however, may not be equivalent for all country dyads. For a global performance indicator to be able to shape the perceptions of market actors, it first needs to be considered credible and reliable. Due to the anchoring effect – that is, individuals make judgments or estimates by giving disproportionate weight to the first piece of information they receive, even if it is arbitrary or irrelevant – prior information about a host country's general economic performance can be influential to the perceptions and behaviors of investors. If a TCI caught up with and even surpassed the TCE in terms of economic strength in recent years, investors would be more likely to believe in the information that portrays the TCI as a promising investment destination. The market response to the improvement in TCI's reputation would be more significant if the country's economic performance had already improved. This improvement is usually publicly observable, quantifiable, and relative to the investors' home country. I thus posit that the gap of economic strength between the treaty parties would neutralize the association between changes in the TCI's reputation and its unilateral termination of BIT. The hypothesis is as follows:

H2: he relationship between the unilateral termination of a BIT and changes in the host country's rank in the global business climate indicator should be conditioned upon the difference in economic strength between the treaty parties. The larger the gap, the less the effect of changes in reputation on the unilateral termination of the BIT.

In brief, business climate indicators are theoretically significant because they affect the reputation of the countries that they evaluate by constructing social knowledge. Changes in the reputation of traditional capital-importing states can increase their attractiveness as investment destinations, shifting the landscape of outside options available to foreign investors. A host state with an improved reputation could thus put more pressure on its BIT partner whose outbound investors aim at the host market. This effect would be particularly strong when the host country's reputation was backed by the information that its economy has caught up with its treaty partner.

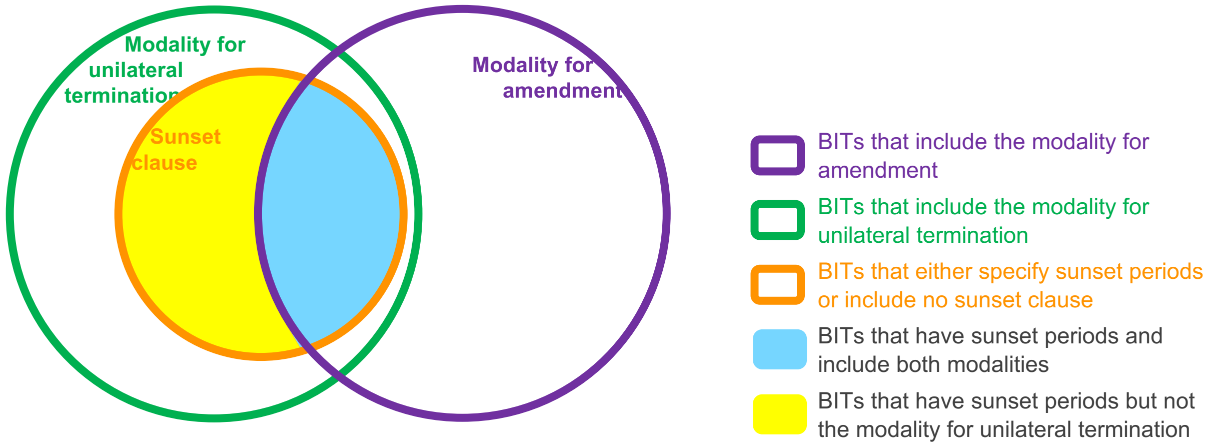


Figure 5: *The scope of the sample*

5 Empirical Approach

I examine 473 BITs across 112 countries and 50 years for the purpose of empirical testing. All these BITs fit two criteria. First, each of them includes a provision for unilateral termination, meaning that the treaty parties are allowed to unilaterally terminate the old treaty. A BIT that does not include this provision for unilateral termination prohibits treaty parties from unilaterally terminating the treaty. Second, the BITs that are examined either specify the length of the sunset period or do not include a sunset clause at all. The sunset clauses that last until the conclusion of prior investments are considered indeterminate and excluded from my sample. I visualize the selection criteria in Figure 5, and the circle in green represents the scope of my sample. Among these 473 BITs, 160 were unliterally terminated, accounting for 33.8 percent of the dataset.[11]

There are two analytically distinguishable groups of BITs in my sample. One group includes sunset clauses and the provisions for both unilateral termination and replacement, as marked in blue in the diagram. Another group includes sunset clauses and the provision of unilateral termination only, as marked in yellow in the diagram. As indicated previously, the

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

former allows the signatory states to change their BIT status by either one of the three means: unilateral termination (with the sunset clause invoked), mutual termination, and amendment (i.e., direct replacement). The latter, in contrast, allows two alternative means: unilateral termination (with the sunset clause invoked) and mutual termination. The difference in the range of choices provided to treaty partners is not theoretically important for hypothesis H1, since all policy decisions to change BIT status other than unilateral termination are the counterfactuals that my theory considers. As long as the treaty is not unilaterally terminated, its sunset clause will not be invoked and thereby cannot contribute to the bargaining leverage of the host government.[12]

The dataset is built upon the UNCTAD IIA database,[13] which provides information on the attributes of BITs and sunset clauses. The unit of analysis is treaty-year. Each country dyad in the dataset can have more than one treaty due to BIT replacements or re-entries.[14] For example, Finland-Bulgaria BIT (1997) and Finland-Bulgaria BIT (2022) are included as separate treaties which belong in the same dyad of Finland-Bulgaria. Each BIT has observations from its ratification – i.e., the year when the treaty entered into force – until the year it gets terminated or amended, or until 2023 in case the BIT does not experience either event. Given the asymmetric origins of the BIT regime, the treaties disproportionately favor the signatory parties that were initially stronger and able to push for their favored treaty terms (Alschner and Skougarevskiy, 2016). I thus code the party whose gross domestic product (GDP) was higher in the year of BIT signature as the TCE country and the weaker party as the TCI country. I use logistic regression model and cluster standard errors by

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

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

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

country dyad.[15]

5.1 The Main Dependent and Independent Variables

The main dependent variable, *unilateral termination*, is binary. I score 1 for the onset of clause invocation (i.e., unilateral termination of the BIT) and 0 for other ways of changing treaty status that do not trigger the sunset clause. I have two independent variables of interest. The key independent variable is the *change in EoDB rank*, measured as the difference between the TCI's EoDB rank in year 1 and year 0. A positive value of this variable means that the rank improved, while a negative value suggests the opposite. The second key independent variable is *GDP gap*, measured as the annual GDP growth rate (%) of the TCE minus that of the TCI. I lag this variable by two years to capture the pre-existing information about how far the host country is from the home country in terms of economic strength.

Figure 6 shows the average gap in annual GDP growth rate between home and host parties in the year of BIT ratification. Overall, the gap remained positive, meaning that the TCE country in all BITs had a higher annual GDP growth rate than the TCI party when the treaties were ratified. The gap was narrowing over the years. Figure 7 demonstrates the distribution of the change in EoDB rank across the varying intra-dyadic gap in annual GDP growth rate.

I also measure a country's record of participation in investment disputes as a respondent. Thompson et al. (2019) suggest that states learn from their experience of being involved in investment arbitrations. Their studies find an association between the efforts of a state to reform BITs and the number and outcomes of legal disputes that the state experienced. I will control for this identified relationship with *host ISDS respondent cumulative* which captures

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

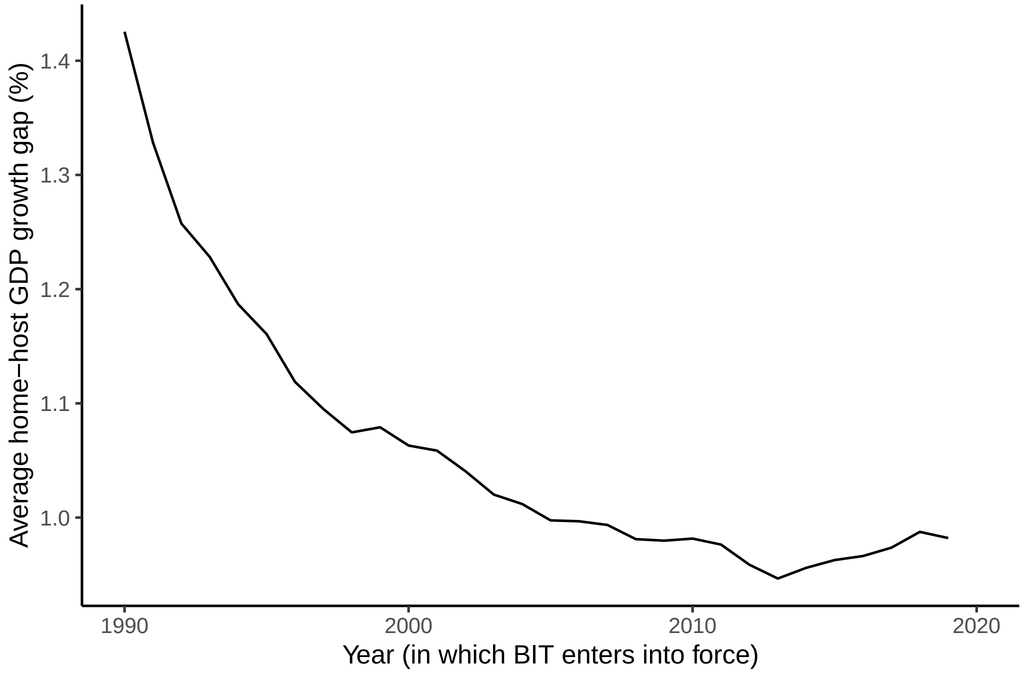


Figure 6: *The average gap in GDP growth rate between BIT parties by year of treaty ratification (1990-2020)*

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

The other two variables I control for are *home growth* which captures the economic development pace of the home state. It is lagged by two years, as a policy decision to exit BITs would have a medium or even long effect on investment flows and should not be highly responsive to temporary shifts in economic performance. Huikuri (2023) finds that states initially in a weaker position in bargaining have stronger incentives to change the BITs that they previously signed. The revisionist logic emphasizes that a rise in relative power can increase a country's demand for BIT reform. Urpelainen (2011) identifies economic development as the source of bargaining power for countries that seek to attract FDI. The control variable is thus operationalized as the difference within the treaty dyad in GDP.

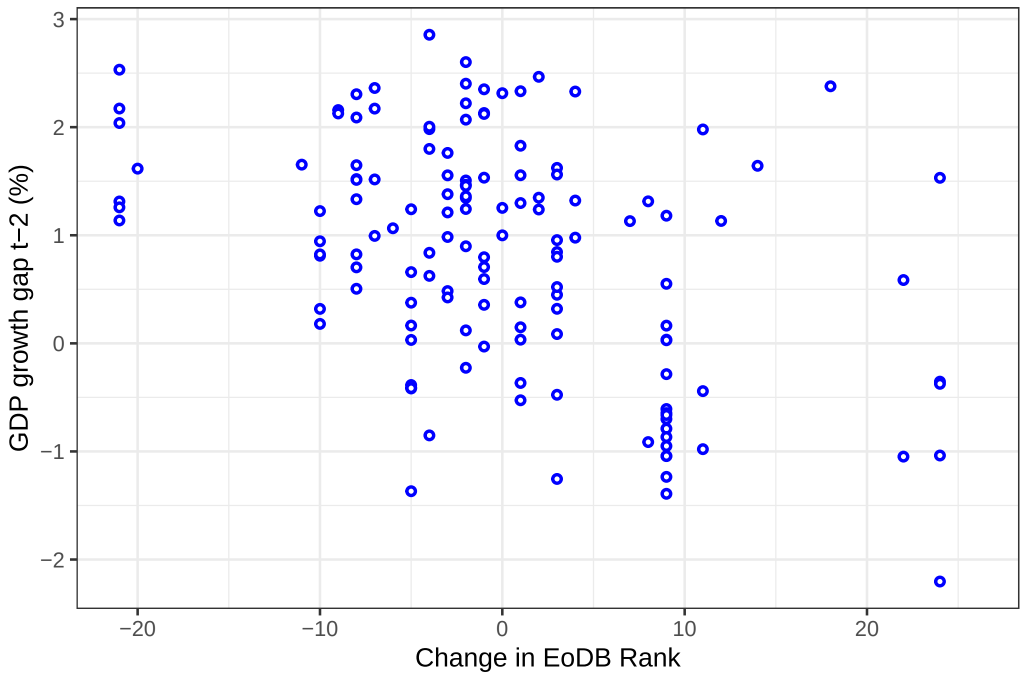


Figure 7: *The change in EoDB rank and the gap in GDP growth rate between BIT parties*

5.2 Confounders

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

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

6 Findings

The results provide support for both hypotheses 1 and 2. TCI countries that experienced larger improvements in EoDB rank are more likely to be unilaterally terminated than those with smaller improvements in the rank. Table 8 reports the results from the main logistic regression models on the host government's policy decision to unilaterally withdraw from its BIT. Models 1 and 2 serve as a baseline for the effects of the sunset period and economic growth without controlling for any political factors for either or both of the treaty parties. Model 1 tests the effects of the change in the EoDB rank of TCI countries on the unilateral termination of BIT as opposed to alternative approaches of treaty exit (Hypothesis 1), whereas Model 2 tests the interaction effects of the change in the EoDB rank with the gap of GDP growth between the two treaty parties (Hypothesis 2). Model 3 tests the interaction effects and adds controls for the host country's democratization and the stability of the host government.

There are two key findings of this analysis. First, an improved rank has a positive and statistically significant effect on the likelihood of unilateral termination of BIT across

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

	Dependent variable:		
	Unilateral termination of BIT (=1)		
	(1)	(2)	(3)
EoDB rank change	0.072^{**}	0.126^{**}	0.126^{**}
	(0.034)	(0.049)	(0.053)
EoDB rank change * GDP gap_{t-2}		-0.078^{**}	-0.092^{**}
		(0.036)	(0.041)
GDP gap_{t-2}	0.634^{**}	0.607^{**}	0.837^{**}
	(0.299)	(0.300)	(0.381)
Host ISDS resp cum (logged)	0.382	0.267	0.251
	(0.261)	(0.271)	(0.341)
Home GDP growth_{t-2}	-0.043	-0.047	0.003
	(0.091)	(0.093)	(0.111)
Host GDP growth_{t-2}	0.026	0.016	0.061
	(0.051)	(0.056)	(0.059)
Host $\text{democratization}_{t-2}$			14.465
			(1,455.398)
Host gov stabilty			-0.344
			(0.442)
year	-0.261^{*}	-0.214	-0.398^{*}
	(0.143)	(0.147)	(0.205)
Constant	526.760^{*}	431.772	806.069^{*}
	(288.325)	(295.122)	(413.605)
Observations	138	138	121
Log Likelihood	-59.538	-56.573	-42.886
Akaike Inf. Crit.	133.076	129.147	105.771

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

Figure 8: *Change in EoDB rank, growth gap, and BIT termination: Logistic regression models for the full sample*

all models. The effect is stronger when the economic and political factors are considered. Second, the decreasing gap in annual GDP growth between treaty parties consistently the change in EoDB rank on the unilateral termination of BIT. In other words, the intra-dyadic difference in economic growth is found to condition the impact of a host country's improved reputation on its government's behavior of clause invocation. The change in EoDB rank has the largest effect on a host government's decision to unilaterally withdraw from BIT when the intra-dyadic gap of GDP growth is negative, as is shown in 9.[17]

To assess the robustness of the results, a number of alternative models are employed.

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

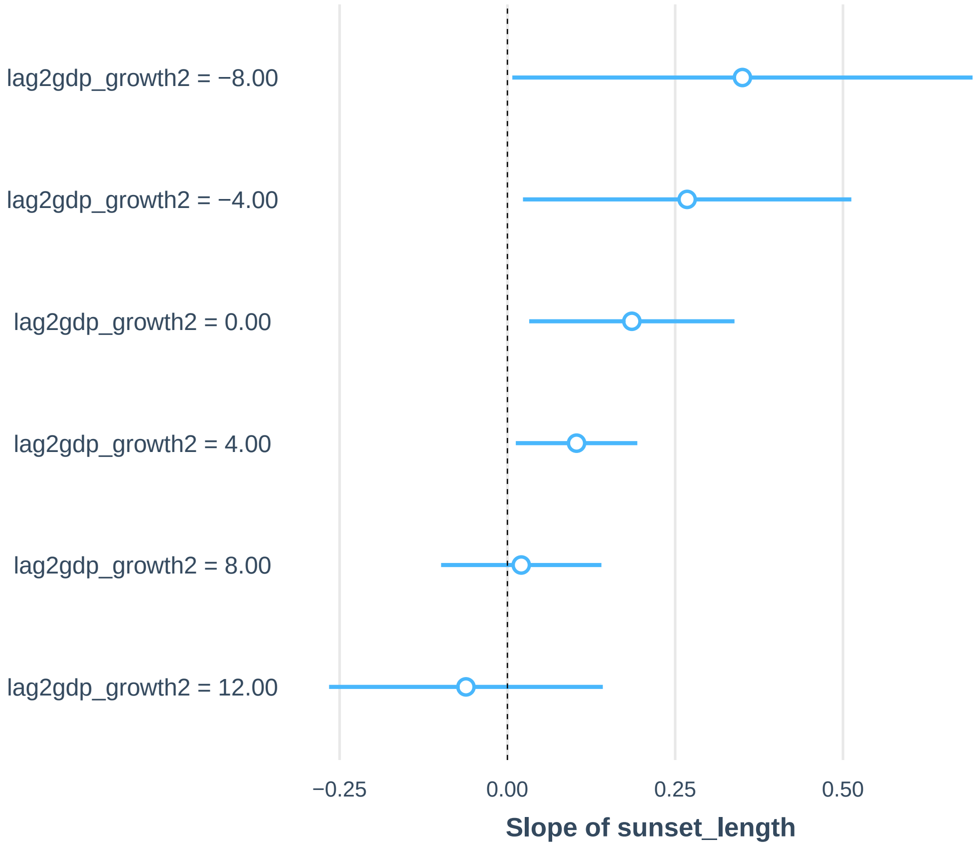


Figure 9: *Growth gap diminishes the effect of the change in EoDB rank on the unilateral termination of BIT*

These include a country fixed effects model, a linear regression model, and a multinomial logistic regression model. The effects of the key independent variables remain significant and robust across all these alternative models.

7 The Case of Singapore-Indonesia BIT

In May 2015, Indonesia announced that it would not renew its BIT with Singapore which was signed in 2005 and due on June 20, 2016. By then, Indonesia has signed more than 60 treaties. The 2005 BIT with Singapore is only one of the dozens of investment agreements that Indonesia has withdrew since 2014.[18] The Indonesia-Singapore case provides evidence in line with my theoretical proposition that interdependent investment relationships between treaty parties are the precondition for sunset-clause invocation to become coercive. Only when the home country cares enough about the partial interruption of investment protection would the host country be assertive enough to make the threat.

Given the bilateral economic and political relationships, it is counterintuitive that Jakarta unilaterally terminated its BIT with Singapore in the mid-2010s. In 2014, Singapore was by far Indonesia's biggest foreign investor, with its companies getting approval to put in $5.83 billion.[19] Additionally, the two parties established numerous connections in different domains in the 2010s, showing no sign of deteriorating or weakening economic relationships.[20] There were Memoranda of Understanding (MoUs) that aimed to foster collaboration, exchange knowledge, and promote mutual development in various sectors including trade and investment, transportation, education, and environmental protection. In terms of the development of the local economy, Singaporean firms have been investing in the Batam-Bintan-Karimun (BBK) Special Economic Zone in Indonesia ever since 1990s. In November 2016, Kendal Industrial Park (KIP), the first major industrial investment by a Singaporean firm outside the BBK, was inaugurated in Central Java, Indonesia. KIP was a joint venture between the two countries, with 51% owned by Indonesia's Jababeka and 49% by Singapore's Sembcorp. The news about the KIP project was officially announced by the Prime Minister of Singapore as early as 2014. Given all these examples of bilateral cooperation, it seems that stable and strong interdependent economic relations parallel the decision of Jakarta to exit its BIT

[18] The other countries with whom the BITs were unilaterally terminated by Indonesia include Netherlands, China, Spain, and the United Kingdom.

[19] (June 9, 2015 Tuesday). Treaty revisions will not deter Singapore investors in Indonesia. Jakarta Globe. https://jakartaglobe.id/business/treaty-revisions-will-not-deter-singapore-investment-indonesia-minister.

[20] I looked at the relationships between Indonesia and Singapore starting from 2010 despite that the termination of their BIT was announced in 2015, as it is likely that the decision to exit BIT might have been discussed for several years before the actual announcement.

with Singapore. Meanwhile, there is no evidence showing that the government of Indonesia closely communicated with domestic industries or adjusted policy decisions to align with private interests.

The rhetoric on the Indonesian side demonstrates the intertwined relationships between state behaviors of unilaterally terminating BITs and expectations of renegotiating treaty terms. According to the government of Indonesia, it intends not to withdraw from BITs permanently but to renegotiate the treaties concurrently with the terminations.[21] By the time when Jakarta announced its withdrawal from its 2005 BIT with Singapore, the government had been screening all the BITs that were potentially "lopsided and not mutually beneficial to Indonesia."[22] Coordinating Economics Minister Sofyan Djalil publicly suggested that both sides can suffer from "acts of bad faith" and that BITs should "protect both parties in a fair manner"[23] and that future BITs should reflect improvements in domestic laws of Indonesia and ensure equitable rights for both treaty parties.[24]

Unilateral termination of the BIT was further portrayed as a necessary precursor to renegotiation by the government of Indonesia. "If they want to extend [treaty obligations], they have to negotiate a new BIT," said Azhar Lubis, deputy chairman of investment monitoring and implementation at the Indonesia Investment Coordinating Board. This delivers two messages. First and straightforwardly, a renegotiation of BIT could be the real purpose

[21] "What is Going on with Indonesia's Bilateral Investment Treaties?"

[22] Zubaidah Nazeer Indonesia Bureau Chief In Jakarta. (May 13, 2015 Wednesday). Jakarta to revise investment pacts; Some bilateral treaties outdated, others lopsided, it says. The Straits Times (Singapore). https://advance-lexis-com.proxy.library.ucsb.edu/api/document?collection=news&id=urn:contentItem:5FYX-D0W1-DYX4-02CX-00000-00&context=1516831.

[23] Zubaidah Nazeer Indonesia Bureau Chief in Jakarta. (May 13, 2015 Wednesday). Jakarta to revise investment pacts; Some bilateral treaties outdated, others lopsided, it says. The Straits Times (Singapore). https://advance-lexis-com.proxy.library.ucsb.edu/api/document?collection=news&id=urn:contentItem:5FYX-D0W1-DYX4-02CX-00000-00&context=1516831.

[24] (May 11, 2015 Monday). Indonesia: Government to review bilateral investment treaties. Antara News. https://advance-lexis-com.proxy.library.ucsb.edu/api/document?collection=news&id=urn:contentItem:5FYN-4SC1-JDKC-R0JG-00000-00&context=1516831.

of treaty termination. Second, Treaty partners would unlikely take renegotiation seriously unless Indonesia's exit from BIT could generate costs for them. This implies Jakarta's understanding that its treaty partners cared as much about investment relationships as it did. The Minister Sofyan Djalil, for example, emphasized that treaty revisions of Jakarta will not deter investment flows from entering Indonesia which has already been one of the largest economies in Southeast Asia.[25] Jakarta's assertion did not come from nowhere. Indonesia played an important role in global production and commercial exchanges, and its image as a host destination significantly improved during the 2010s. The World Bank's EoDB index shows that Indonesia was among the top five most improved nations in 2016, together with Brunei, Kazakhstan, Kenya, and Belarus,[26] which was frequently cited in the speeches of Indonesian officials addressing the economic prospect of the country. Indonesia's performance was thus consistent with its government's confidence in the country's economic prospects and correspondingly in other countries' willingness to continue cooperating.

The reaction of treaty partners to Jakarta's unilateral withdrawal proves the importance of the Indonesian market and the influence of its move. After Indonesia announced its decision to exit the BIT, Singaporean authorities made efforts to reassure their outbound investors. When being interviewed, a Ministry of Trade and Industry spokesman stressed that existing Singaporean investors in Indonesia would remain protected despite treaty termination. "Singaporean investments made in Indonesia before June 20 next year will continue to be covered for a further 10 years, until June 20, 2026," he said. This might not be sufficient to reassure all investors, however, as for Singaporean firms that intended to and had not yet invested in Indonesia, the removal of protection under the validity of the sunset clause would mean a worsened business climate in which they expect to operate. The government of Sin-

[25] "Treaty Revisions Will Not Deter Singapore Investment in Indonesia: Minister"

[26] World Bank Group. 2015. Doing Business Economy Profile 2016: Indonesia. World Bank, Washington, DC. http://hdl.handle.net/10986/23272License:CCBY3.0IGO.

gapore expressed concerns over the halt of protection for outbound investments flowing to Indonesia and the increased uncertainty facing *future* investors.[27] "The sooner Indonesia can sort out the BIT revision with individual governments, the better it will be for investor confidence," said Singapore-based OCBC economist Wellian Wiranto.[28] Lee Hsien Loong, the Prime Minister of Singapore, took a similar stance. He emphasized the importance of BIT protection in providing "reassurance and confidence" to Singaporean investors. Although aware that the sunset clause continued to protect their existing investors in Indonesia, Singaporean authorities sought to deliver a message to their counterpart in Indonesia that BIT protections were indispensable and should be in place sooner rather than later.

In the case of Singapore-Indonesia BIT, Jakarta emphasized the country's improved performance in the business climate and kept citing the World Bank's EoDB appraisal. On the Singaporean side, this traditional capital-exporting side in the treaty displayed a high interest in pulling Indonesia back to the negotiation table. The rhetoric and behaviors of both treaty parties provide support to the argument of this paper.

8 Conclusion

This paper addresses the conditions under which a state would withdraw from a BIT by triggering costly sunset clauses. Rather than treating treaty terminations and renegotiations as independent, it theorizes that both arise from a similar causal process whereby governments struggle to implement preferred regulation in the face of rising lawsuits. Examining 473 BITs

[27]Similar concerns were raised by the European Union in 2017 when India unilaterally terminated its BITs with many European countries. Geoffrey Van Orden, the chair of the European Parliament delegation for relations with India, said that the European Union would want India to extend the validity of the BIT beyond the termination date so that fresh investors would enjoy the same protection as existing investors in Indonesia.

[28]Zubaidah Nazeer Indonesia Bureau Chief in Jakarta. (May 13, 2015 Wednesday). Jakarta to revise investment pacts; Some bilateral treaties outdated, others lopsided, it says. The Straits Times (Singapore). `https://advance-lexis-com.proxy.library.ucsb.edu/api/document?collection=news&id=urn:contentItem:5FYX-D0W1-DYX4-02CX-00000-00&context=1516831`.

across 112 countries and 50 years, the paper demonstrates that a BIT party is more likely to use unilateral termination as a strategy to exit the treaty when its reputation improves. The underlying logic for this finding is straightforward: a positive change in reputation provides additional negotiating leverage to host countries. The paper also identifies a conditioning effect of the intra-dyadic gap of economic strength: a country's status in the global ranking on business climate is most associated with the likelihood of BIT unilateral termination when the divergence in economic strength between the two treaty parties is smaller.

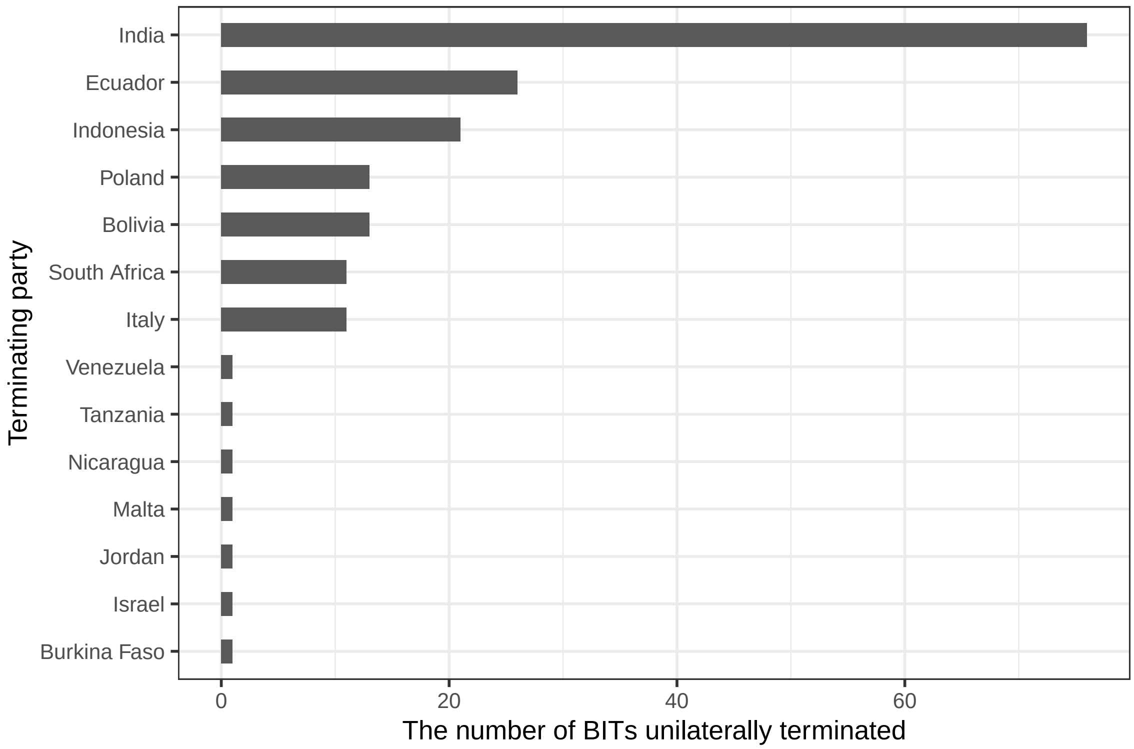
The paper contributes to our understanding of international institutions in four ways. First, in today's world, where we have access to a variety of information channels, reputation stands as a cornerstone of trust and cooperation among states. A state's reputation not only influences its power projection and diplomatic standing but also shapes its strategic decision-making. Such decisions can lead to a change in its status quo policies, especially when it comes to institutional engagement. In this process, global performance indicators play an important role in channeling the effect of reputation on a state's bargaining leverage through market actors. My research also sheds light on which states value reputation the most. A state can benefit most from an improved reputation when it has caught up with its economic partner in terms of economic strength.

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

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

Fourth, powerful states may have the leverage to push for their favored terms when designing international institutions. Once these institutions have been established with mechanisms in place to resist change, it is possible that less powerful nations may use these mechanisms to their own benefit. The lock-in mechanism of sunset clauses can benefit capital exporters by locking in capital-importing states. However, the economic connections developed over time can also empower host governments with limited economic might, particularly when the market perception favors the host countries. In a globalized world characterized by a proliferation of informational devices, interdependent relationships have made exerting power in one direction more challenging.

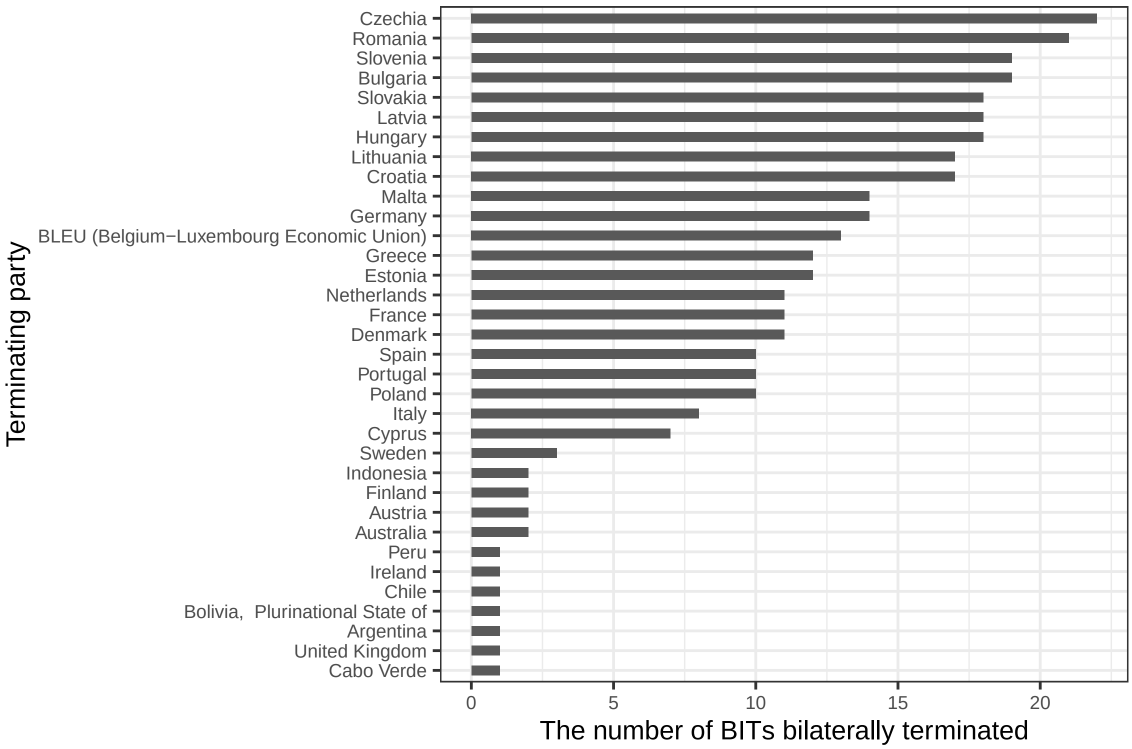
Appendix A



Unilateral terminations of BITs by terminating party

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

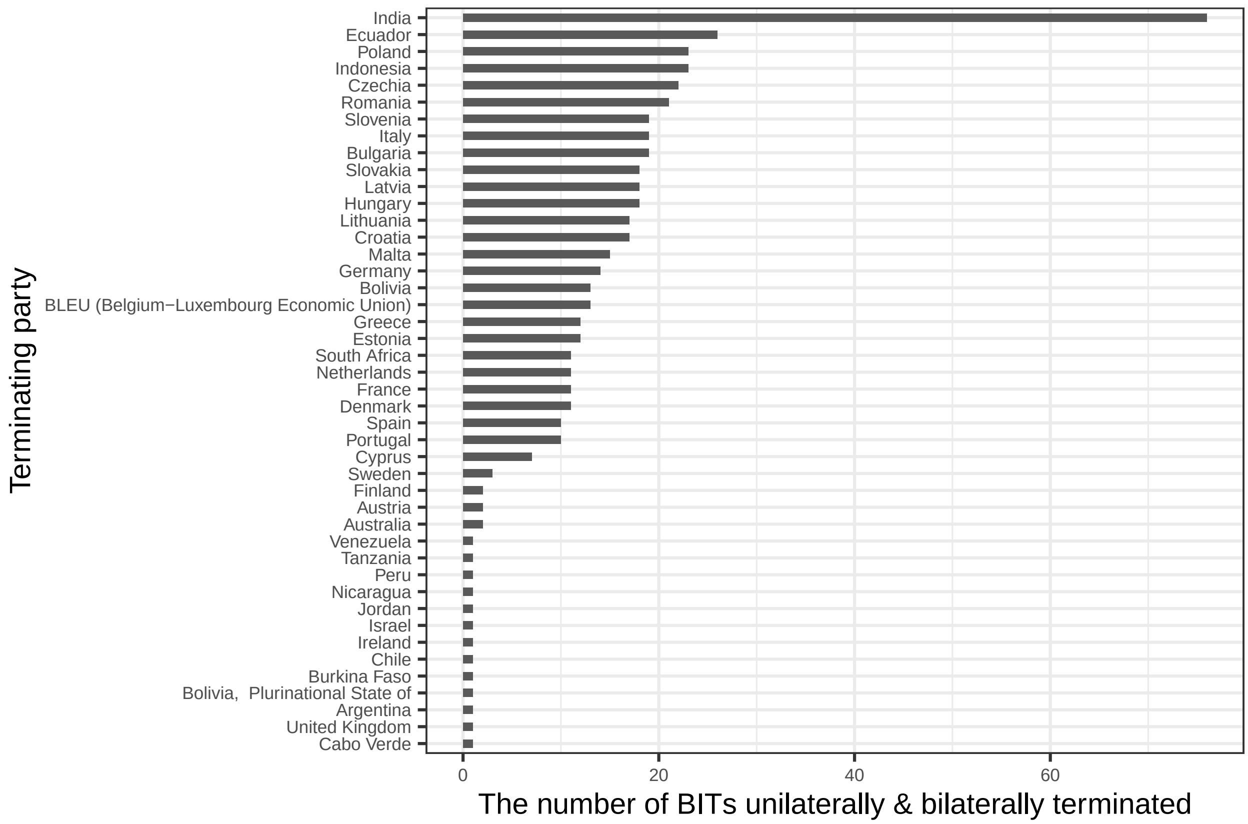
Appendix B



Bilateral terminations of BITs by terminating party

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

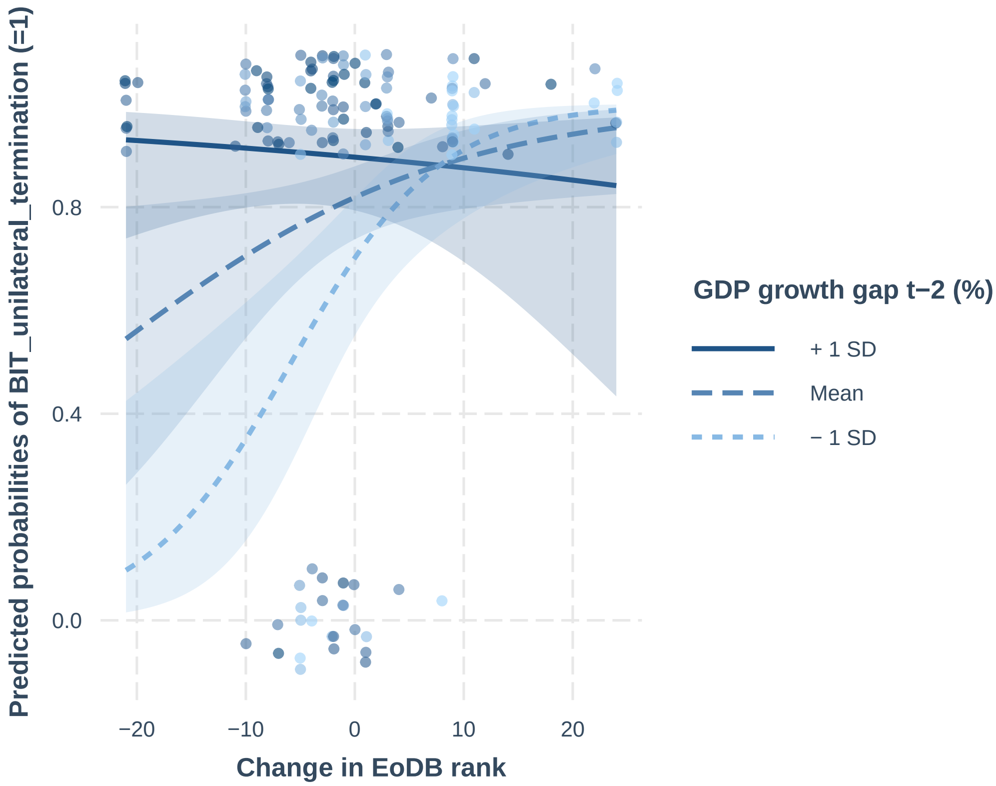
Appendix C



Terminations of BITs by terminating party

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

Appendix D



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

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