

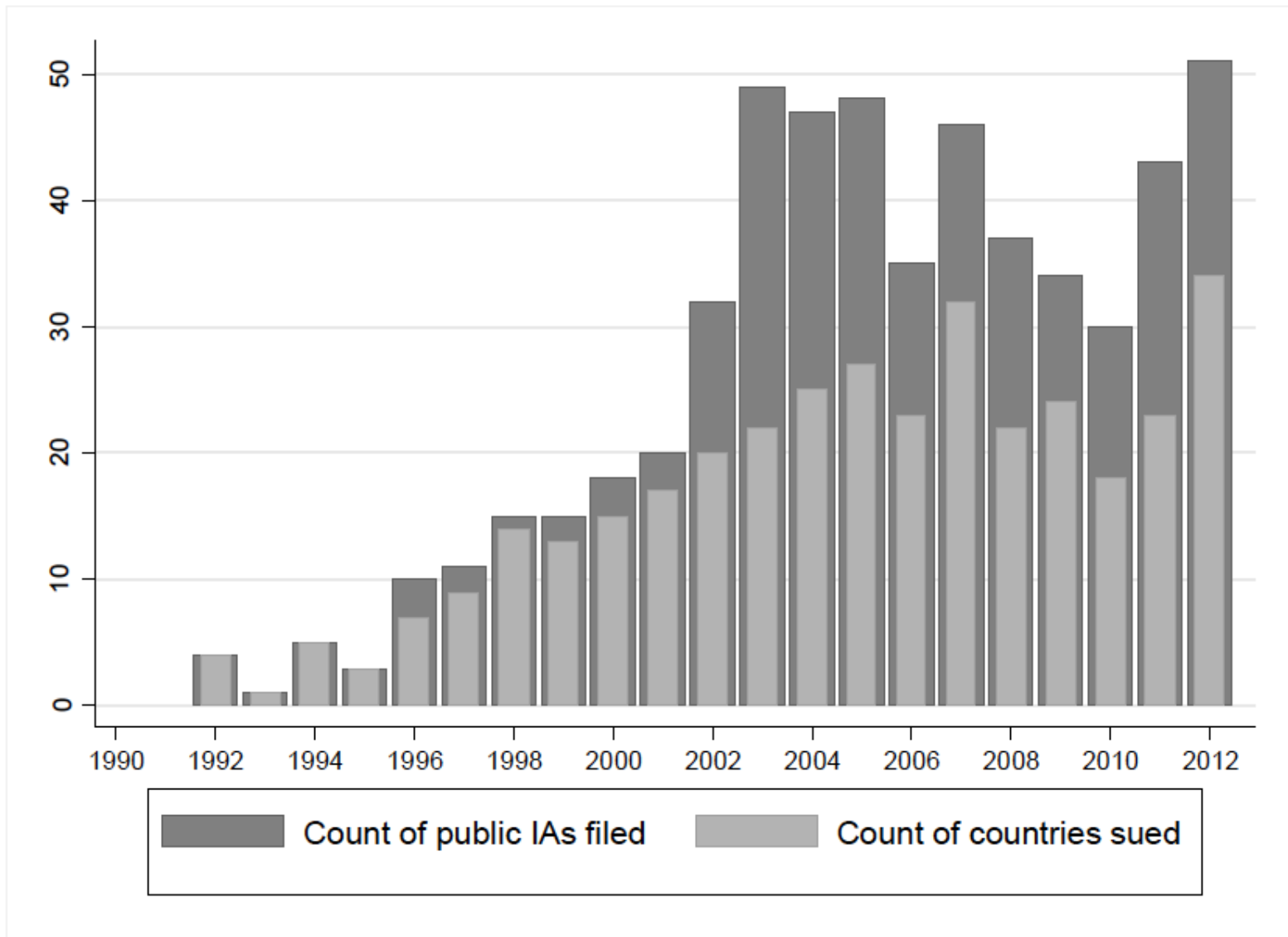
Bondholders v. Direct Investors? Competing Responses to Expropriation

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In this period at least 110 different countries have been sued in public IAs. *Sources:* Hajzler 2012, Minor 1994, ICSID, UNCTAD Database of Treaty-based Investor-State Dispute Settlement Cases, Author's records.

Do governments face punishments in sovereign bond markets as a result of expropriating FDI?

Property Rights v. Revenue

H1: Sovereign debt spreads should increase when the action behind an IA did not raise revenue for the government.

H2: Sovereign debt spreads should decrease when the action behind an IA raised revenue for the government.

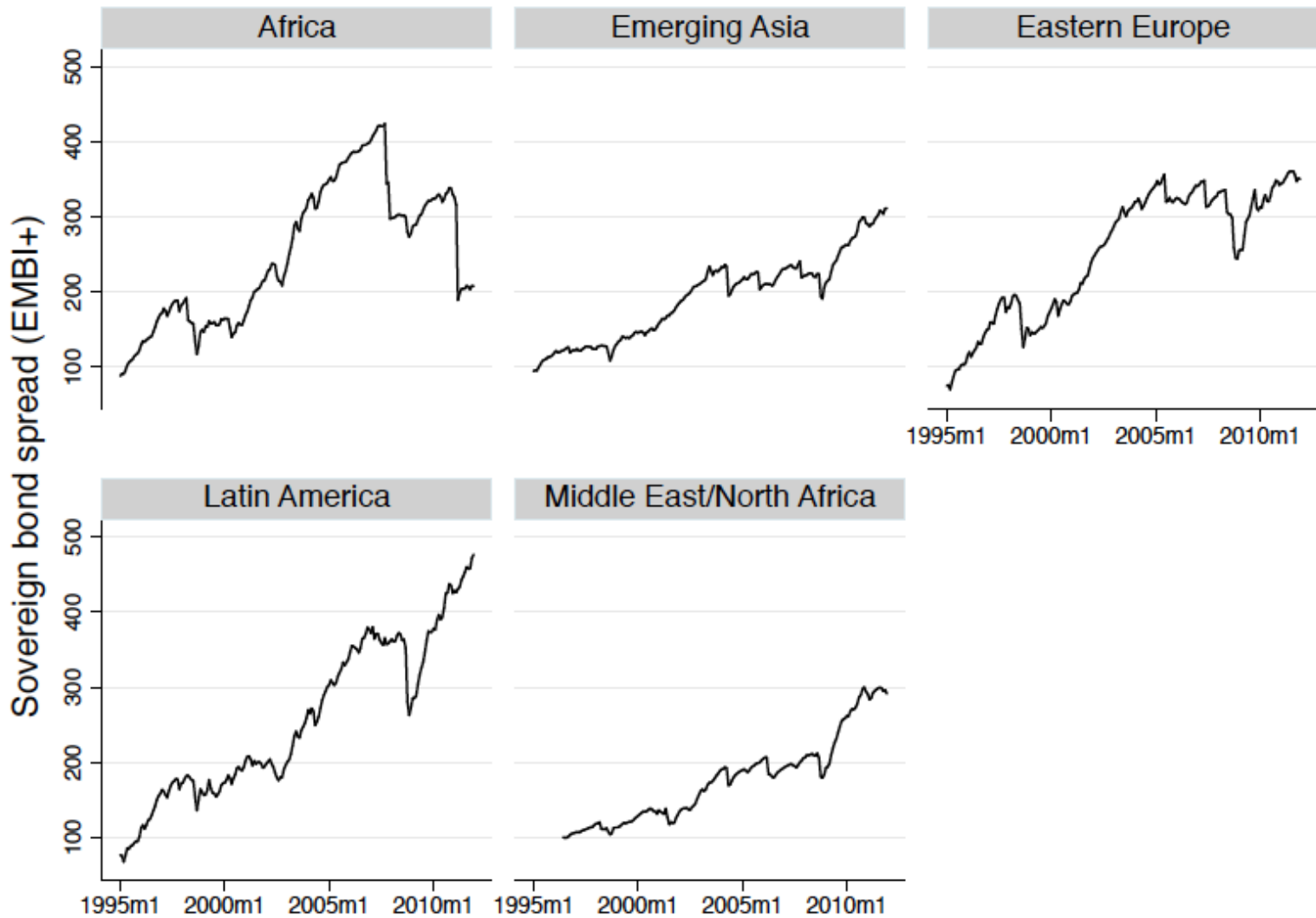
“If expropriation brings revenue to the government, it is positive for the government balance sheet. The negative impact is a loss on the corporate side, but there is a gain on the government side.”

- Emerging Market Fund Manager, Oct 2013

Approach

- Error correction models (ECMs) (De Boef and Keele 2008)
- DV and IV coded by month-year (1994-2011)
 - Sovereign bond spreads (JP Morgan EMBI+)
 - International investment arbitrations (IAs)
- Annual controls
 - Polity, Yrs since default, Rev/GDP, Debt/GDP, TOT
 - Country and quarter-year fixed effects

Figure 3. Sovereign bond spreads, by emerging world region (1995-2011)



Revenue IA: Generate cash/avoid liabilities

Host	Year	Home	Investor's Perspective	Case
Kazakhstan	2002	Cayman Islands	After taking over utilities in the city of Karaganda, Enrho argues in a BIT claim that Kazakhstan imposed unlawful taxes.	Enrho St Limited v. Republic of Kazakhstan (ICSID Case No. ARB/02/11)
Ghana	2007	Germany	Government suspended bean deliveries (from 2000) to a joint venture cocoa distribution firm, imposed a new price agreement (2001), placed an export ban on the JV's products, and is accused of engaging in harassment.	Gustav F W Hamester GmbH & Co KG v. Republic of Ghana (ICSID Case No. ARB/07/24)
Argentina	1998	USA	Houston Industries claims the Argentine government owes it US\$2.6 million to compensate for terms unmet in its privatization contract to distribute electricity in Santiago Del Estero province.	Houston Industries Energy, Inc. and others v. Argentine Republic (ICSID Case No. ARB/98/1)
Egypt	2011	United Arab Emirates	Post-Mubarak, the developers were asked to pay the Egyptian government both in kind and cash to offset the shortfall against a revised assessment of their land value. This follows government seizure of 30 million square meters (7,413 acres) of land on the Red Sea coast purchased by the firm in 2006.	Russain Sajwani, Damac Park Avenue for Real Estate Development S.A.E., and Damac Gamsha Bay for Development S.A.E. v. Arab Republic of Egypt (ICSID Case No. ARB/11/16)

Non-revenue IA: Regulatory taking, etc.

Host	Year	Home	Investor's perspective	Case
Chile	2004	Spain	Fisheries firm claimed discrimination in not allowing a fishing license for certain offshore waters.	Sociedad Anónima Eduardo Vieira v. Republic of Chile (ICSID Case No. ARB/04/7)
Lithuania	2005	Norway	Vilnius issued a tender for parking system and after much back and forth eventually canceled the contract.	Parkerings-Compagniet AS v. Republic of Lithuania (ICSID Case No. ARB/05/8)
Slovak Republic	2008	Netherlands	Legislative reforms to the insurance market allegedly prevented the claimant from distributing profits to their shareholders, lowering the value of these businesses to the claimant.	HICEE v. Slovak Republic (UNCITRAL)
Costa Rica	2007	Canada	Canadian individuals invested in a Ponzi scheme in Costa Rica and filed against the government once the scheme taken down by Costa Rican police, saying their loss caused by the Costa Rican government.	Alasdair Ross Anderson and others v. Republic of Costa Rica (ICSID Case No. ARB(AF)/07/3)

Table 1. Summary of Explanatory Variables of Interest in Sample

	Count of M/Y with new actions	Count of M/Y with actions outstanding	Countries experiencing action
Total IAs	130	1667	22
Revenue IAs	97	1280	17
Non-revenue IAs	33	779	14
State wins	47	N.A.	18
Investor settles/wins	77	N.A.	21
Mobile IAs	67	1199	14
Immobile IAs	88	1464	22
Underlying expropriation date [^]	84	N.A.	17
<i>Totals</i>		<i>4909 observations</i>	<i>35 countries</i>

[^]Expropriations in Argentina are excluded, as complications around the 2001-2002 financial crisis cause modeling issues.

Table 3. (Logged) Emerging Market Bond Spreads and IAs by Revenue Type

	MoM	YoY	% Change in spread [^]
Model 2			
Revenue IAs	-0.002 (0.002)	-0.084** (0.036)	-8.1% YoY
Non-revenue IAs	0.005 (0.007)	0.253*** (0.096)	+28.8% YoY
Polity	-0.001 (0.003)	-0.029** (0.015)	-2.9% YoY
Years since default	0.002 (0.001)	0.004 (0.026)	
Reserves per GDP	0.083*** (0.032)	0.310 (0.903)	+8.6% MoM
External debt	-0.042*** (0.016)	0.444 (0.395)	-4.1% MoM
Terms of trade	0.002 (0.005)	0.274 (0.255)	
Error correction term	-0.028*** (0.007)		
Constant	0.168*** (0.035)		

Quarter-year and country fixed effects. Standard errors clustered by country. *p<0.1 **p<0.05 ***p<0.01

[^]Percent change in the absolute value of the bond spread with a one-unit increase in the explanatory variable.

Table 3. (Logged) Emerging Market Bond Spreads and IAs by Revenue Type

	MoM	YoY	% Change in spread [^]
Model 4			
Revenue IAs	-0.003 (0.003)	-0.079** (0.034)	-7.6% YoY
Non-revenue IAs	0.004 (0.008)	0.252*** (0.094)	+28.7% YoY
State win	-0.000 (0.014)	0.404 (0.562)	
Investor settle/win	-0.003 (0.002)	-0.432* (0.251)	-35.1% YoY
Polity	-0.001 (0.003)	-0.029** (0.014)	-2.9% YoY
Years since default	0.002 (0.001)	0.003 (0.026)	
Reserves per GDP	0.085*** (0.032)	0.308 (0.892)	
External debt	-0.043*** (0.016)	0.417 (0.388)	
Terms of trade	0.002 (0.005)	0.257 (0.249)	
Error correction term	-0.028*** (0.007)		
Constant	0.170***		

Quarter-year and country fixed effects. Standard errors clustered by country. *p<0.1 **p<0.05 ***p<0.01

[^]Percent change in the absolute value of the bond spread with a one-unit increase in the explanatory variable.

Results Summary

- Moral hazard: Governments raising revenue via expropriation can find rewards in sovereign bond markets – and again when they lose IAs.
- Other results
 - No effects of IAs as a whole
 - No effects in sovereign debt CDS markets
 - No effects of industry type (by asset mobility)
 - IV = month-year of expropriation incident:
Punishment for non-revenue IAs but not sig. reward for revenue

Conclusions

- Investors participating in different capital flows can be at odds with one another.
- Effects are facilitated by the rise of IAs and diffusion of BITs.
- Moral hazard.