Political risk and investment arbitration: An empirical study

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Introduction

- Investment arbitration has become a regular phenomenon and seems to be on the rise with the highest ever number of claims filed in 2012 (58); in total we have now more than 775 cases of investment arbitration;
- Yet, arbitration is heavy, and very costly, ammunition leading to quasi economic war situations between host countries and international investors;
- Are those quasi economic wars mostly the result of incomplete information, as argued by Elkins, Guzman and Simmons (2006)? We think that this is worth revisiting

Overall argument in short

- If arbitration is very heavy ammunition, we expect it to be used in last resort and thus that the filing of an arbitration claim may reflect the « hopelessness of the case; »
- We link « hopelessness of the situation » to certain types of think political risk - political risk is a proxy for impossibility of negotiation
- We hypothetically argue that situations of impossible negotiations with host states are more likely to occur with countries presenting certain types of political risk and as a consequence arbitration claims are more likely to be targeting those countries.

Linking political risk and investment arbitration

- Arbitration claims are more likely to target states with poor/bad institutional conditions than those with good institutional conditions
  - Poor/bad institutional conditions:
    - Rule of law ignored/absent
    - Governmental disarray
- Arbitration claims are more likely to target states that experience severe economic slowdowns or crises (economic hard times)

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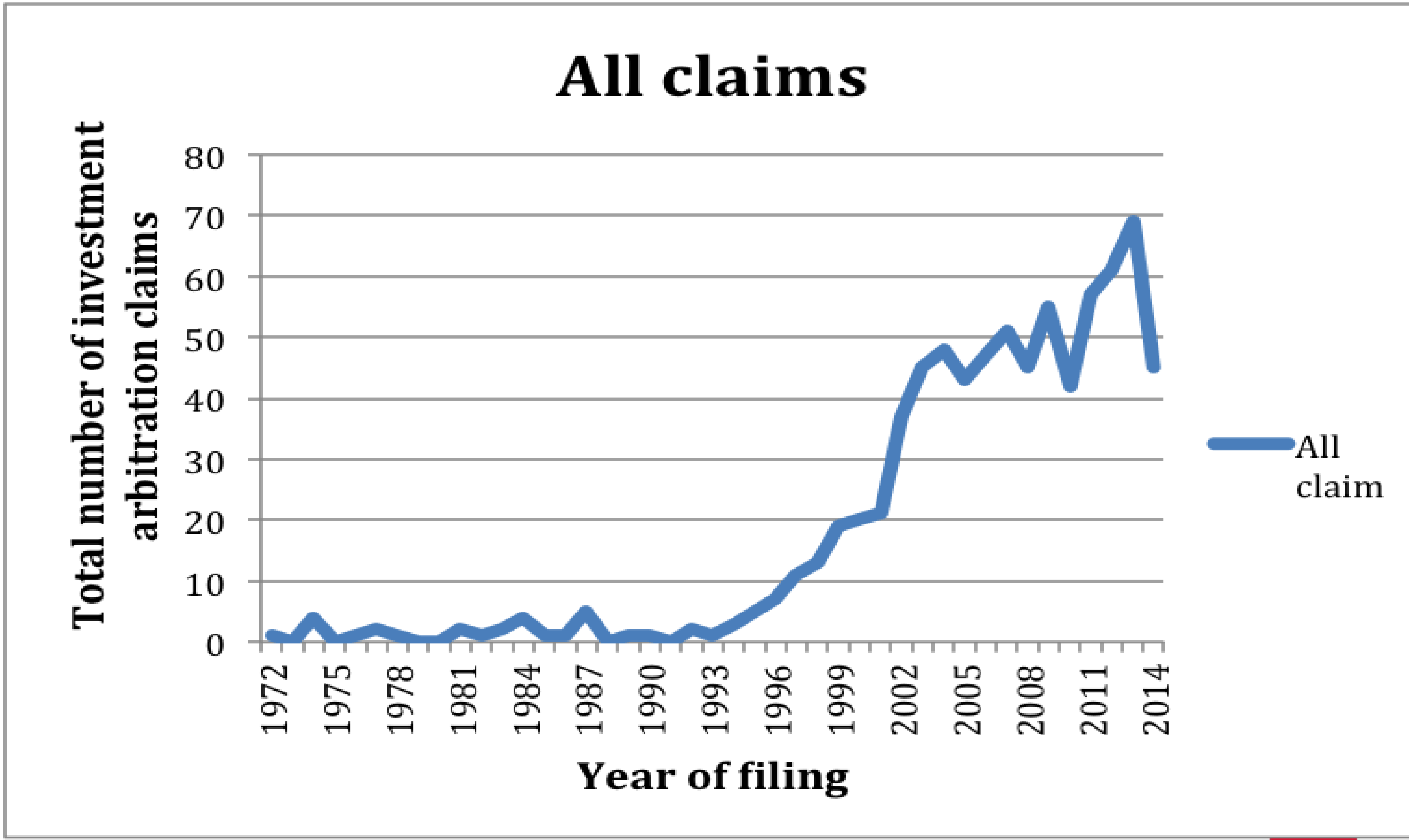
Research design

Our data set on investment arbitration

- Period covered: 1972-2014.
- Includes 775 investment awards.
- Includes investment awards regardless of the jurisdictional basis of the arbitration:
  - investment arbitrations based on a treaty (typically a BIT, but also regional/bilateral trade agreement as well ECT);
  - investment arbitrations based on a contract between the host state and the investor,
  - investment arbitrations based on the domestic legislation of the host state, when such legislation unilaterally allows the investor to file an arbitration against the government.
- Includes institutional investment arbitration (ICSID mainly, but also Stockholm Chamber of Commerce, International Chamber of Commerce, etc) and ad hoc investment arbitration (mainly under the arbitration rules of UNCITRAL).

Investment arbitration 1972-2014



Dependent variable

- Number of investment claims targeting a country per year
- Given the distribution of claims over 1972-2014, we restrict the focus on 1995-2012
- To account for the long tail of distribution of number of claims per country/year, we use a categorical variable with three values for the logistic regression:
  - 0 for country/year observations without any claim being filed (1720 for the largest set used)
  - 1 for country/year observations with one or two arbitration claims being filed (270)
  - 2 for country/year with three or more arbitration claims being filed (44)

Independent and control variables

- Independent:
  - Economic hard times: GDP growth (both current and lagged by 3 or 4 years); (UN National Account Main Aggregates) and inflation (International Financial Statistics data)
  - Governance: Polity IV and International Country Risk Law and Order scores, as well as WGI Corruption, Regulatory Quality, Rule of Law indeces
- Control:
  - Country borrowing from the Fund: 0/1
  - Income category of the country: World Bank four-fold classification: Low/Lower-Middle/Upper-Middle/High
  - Latin American (including Caribbean) country: 0/1

Results

- Our two theoretical propositions do not receive empirical support (using ordinal logistic regressions and negative binomial regression)
- Most of the variables used are significant under some model (and dataset) specifications but not consistently so
- Regarding our predictor variables:
  - WGI Corruption and Rule of Law scores are negatively correlated with the number of investment claims;
  - GDP growth is negatively correlated with the number of investment claims; however, its coefficient is not statistically significant in most of the models, and stays significant at .1 level only in some of our models

Conclusion

- Our preliminary investigation allows us neither to question the informational asymmetry explanation on investment arbitration, nor to dispel the idiosyncratic view on it.
- But we will try further and better in future work:
  - Most obviously, be less simplistic on indicators of economic hardship
  - Better sort out the combination of past and current triggers behind the filing of arbitration claims
  - Investigate a possible third type of political risk, i.e. resource/economic nationalism