

Endogenous Sources of Compliance with International Law: The Case of Investment Arbitration

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- From 1990 to 2014, foreign investors have sued (at least) 123 host states in international investment arbitration
- Unlike trade law, investment law is
 - Based on bilateral or regional agreements
 - Without an explicit enforcement mechanism

- Some say arbitration is the “nuclear option”
 - Will states ever comply with awards?
- Compliance is remarkably high (1990-2014):
 - Out of 427 arbitrations, investors won awards in 28%
 - Evidence that state failed to pay in only 33 instances
 - Investors must turn to secondary courts to (try to) seize state assets

- Why do states violate foreign firms' property rights, only to consent to arbitration and ultimately comply with rulings?
- Can a decentralized, piecemeal system of international investment law induce cooperation?
- Do rulings matter? How?

- Conventional explanations for “endogenous” compliance pull of international law:
 - Signals commitment (Simmons 2000, Guzman 2005, Kerner 2009)
 - Reveals information (Carrubba 2009)
 - Reputation (Tomz 2007, Guzman 2008)
- Our focus: **Induce reinvestment by the targeted firm**
 - Efficient breach (e.g. Urpeleinen and Pelc 2015)
 - Coordination mechanism (e.g. Johns 2012)

- A targeted firm likely does not want to see expropriation as the end of its relationship with the host state
 - Location-specific advantages
- A host state recognizes its time-inconsistent preferences
 - Willing to expropriate in the short term
 - Compensate later in order to return to mutually beneficial cooperation

- With arbitration: host state and firm condition on arbitration outcome
 - Quicker/more likely return to cooperation
 - Pareto-superior to a world without arbitration
 - Arbitration outcome = rule of law
- State complies to induce reinvestment by targeted firm
 - Holds whether or not aggregate FDI patterns change

- More reinvestment when state complies with rule of law
 - Evidence of state compliance
 - Investor win + state compliant
 - State win
 - Evidence of state noncompliance
 - Investor win + state noncompliant

Investor-State Dispute Settlement (ISDS) (1990-2014)

- At least 660 investment arbitrations filed against 123 host states by MNCs from 68 home states
 - Utilities, services, oil and gas, manufacturing, mining, finance, telecommunications, agriculture, real estate

Arbitration Outcomes (1990-2014)

| Outcome | Rate | Count |
|------------------|------|-------|
| Early settlement | 34% | 147 |
| Investor win | 28% | 118 |
| State win | 38% | 162 |
| Total resolved | | 427 |

Reinvestment Following Arbitration (1990-2014)

| Outcome | Rate | Count |
|-----------------------------------|------|--------|
| Early settlement | 48% | 70/147 |
| Investor win + state compliant | 42% | 37/85 |
| State win | 25% | 41/162 |
| Investor win + state noncompliant | 27% | 9/33 |

- (Even) foreign investors can use rule of law as a coordination device
- Arbitration as flexibility mechanism
- Speaks to popular backlash against ISDS: What is it good for?