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
Motivation

- 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
Motivation

- 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?
Our Contribution

- 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
Empirical Implications

- 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
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)

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Rate</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early settlement</td>
<td>34%</td>
<td>147</td>
</tr>
<tr>
<td>Investor win</td>
<td>28%</td>
<td>118</td>
</tr>
<tr>
<td>State win</td>
<td>38%</td>
<td>162</td>
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<tr>
<td>Total resolved</td>
<td></td>
<td>427</td>
</tr>
</tbody>
</table>
## Reinvestment Patterns

### Reinvestment Following Arbitration (1990-2014)

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Rate</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early settlement</td>
<td>48%</td>
<td>70/147</td>
</tr>
<tr>
<td>Investor win + state compliant</td>
<td>42%</td>
<td>37/85</td>
</tr>
<tr>
<td>State win</td>
<td>25%</td>
<td>41/162</td>
</tr>
<tr>
<td>Investor win + state noncompliant</td>
<td>27%</td>
<td>9/33</td>
</tr>
</tbody>
</table>
Conclusions

- (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?