Investor-State Treaty Regimes and Arbitral Processes

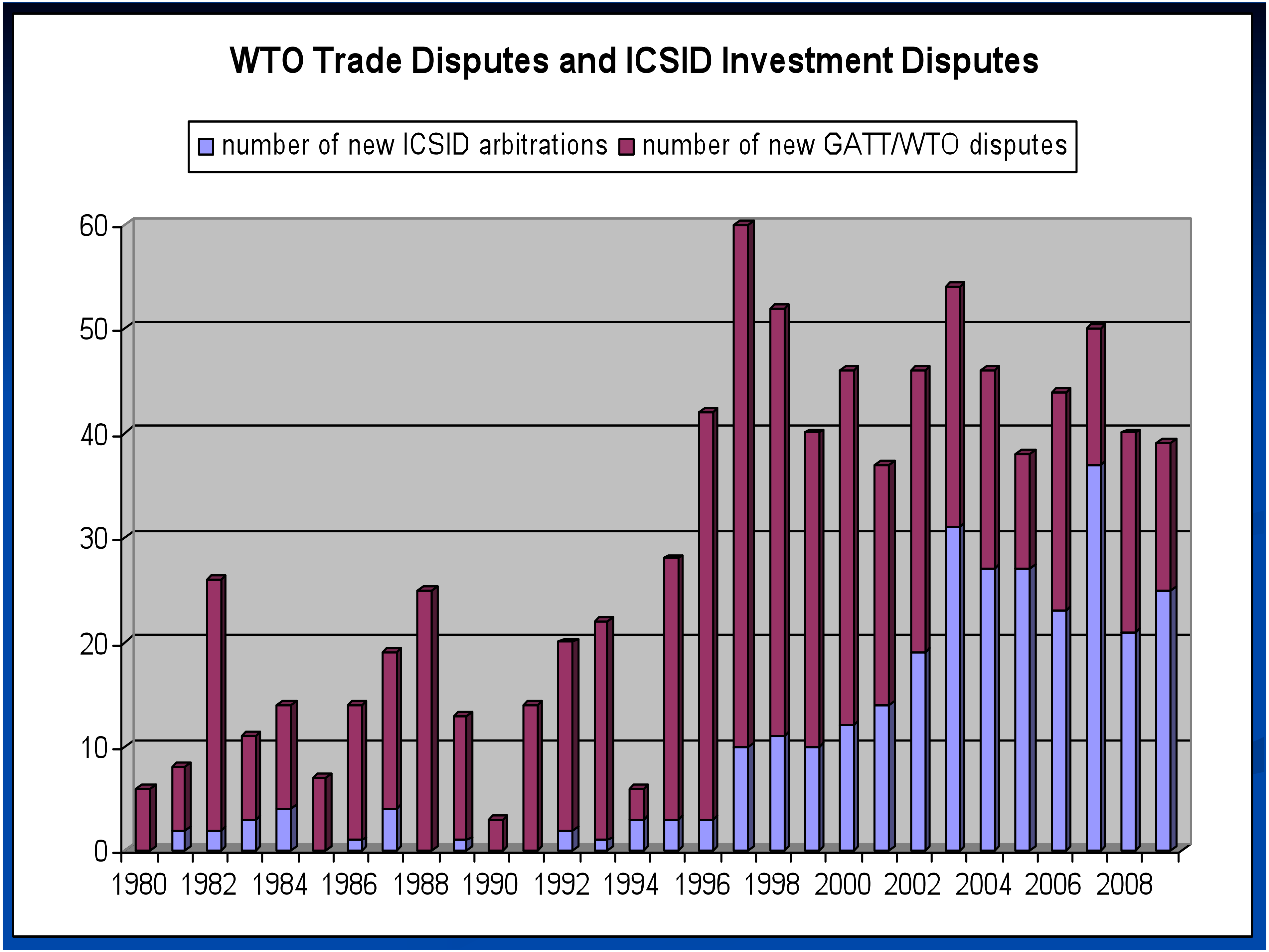
Exploratory Research

Beth A. Simmons

Straus Institute, 2009-2010

Introduction to the Topic

- Characteristics of the emerging “regime” for the facilitation and protection of FDI
- Uniqueness of the emerging system
  - Largely bilateral
  - Largely North-South
  - Special status of investors in dispute settlement
- Growing questions of legitimacy
  - Asymmetrical aspects
  - Not especially transparent
  - Law BIT by BIT? Law through litigation?
  - Increasingly, state actors are resisting: exit and voice
- My purpose: to develop a theory of the way this system works



WTO Trade Disputes and ICSID Investment Disputes
number of new ICSID arbitrations
number of new GATT/WTO disputes
0
10
20
30
40
50
60
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008

Introduction to the Topic

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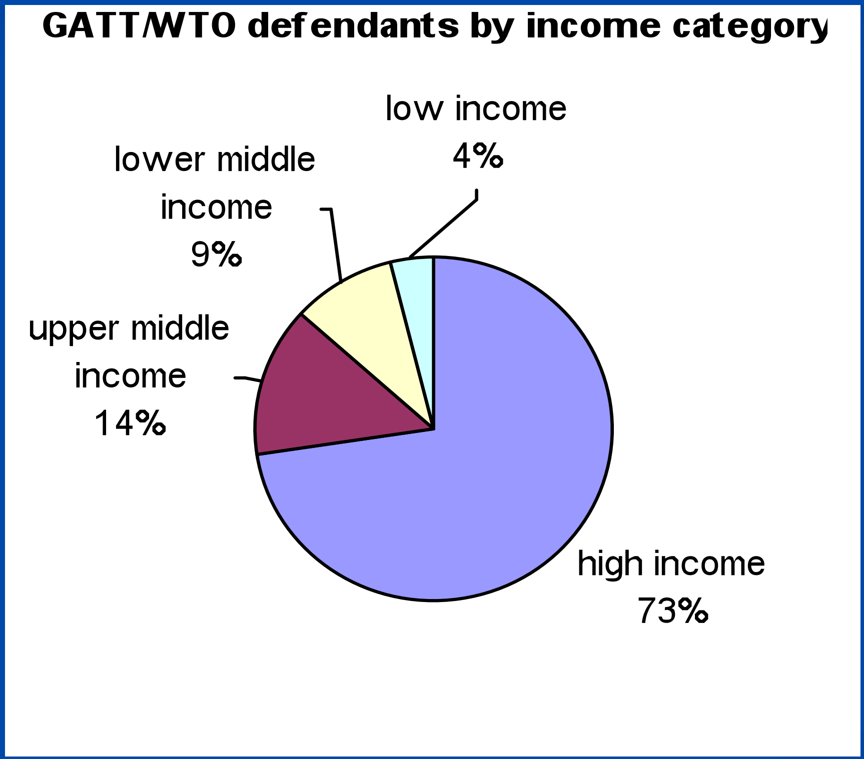
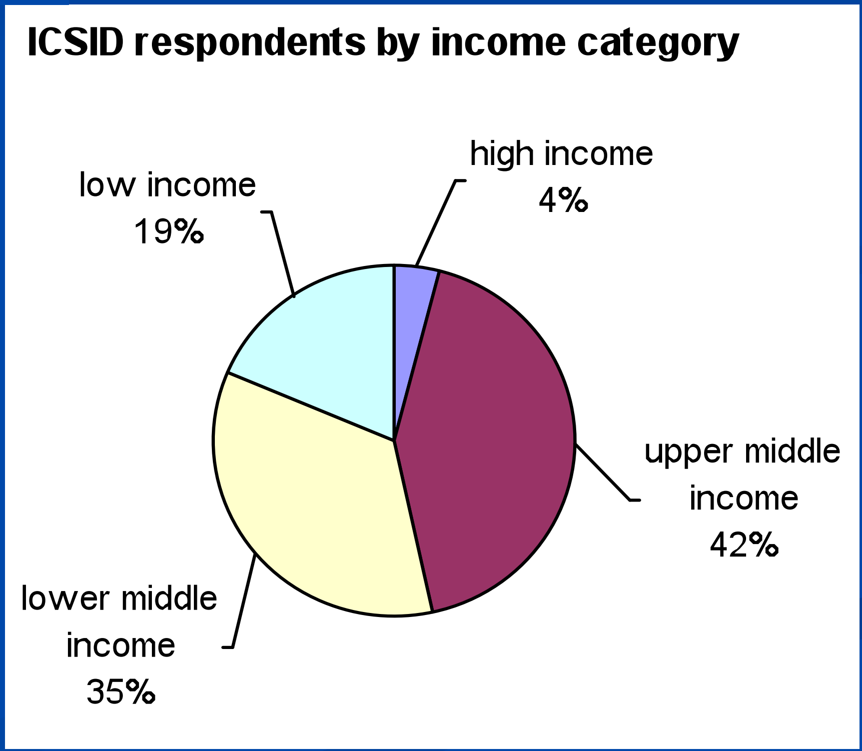
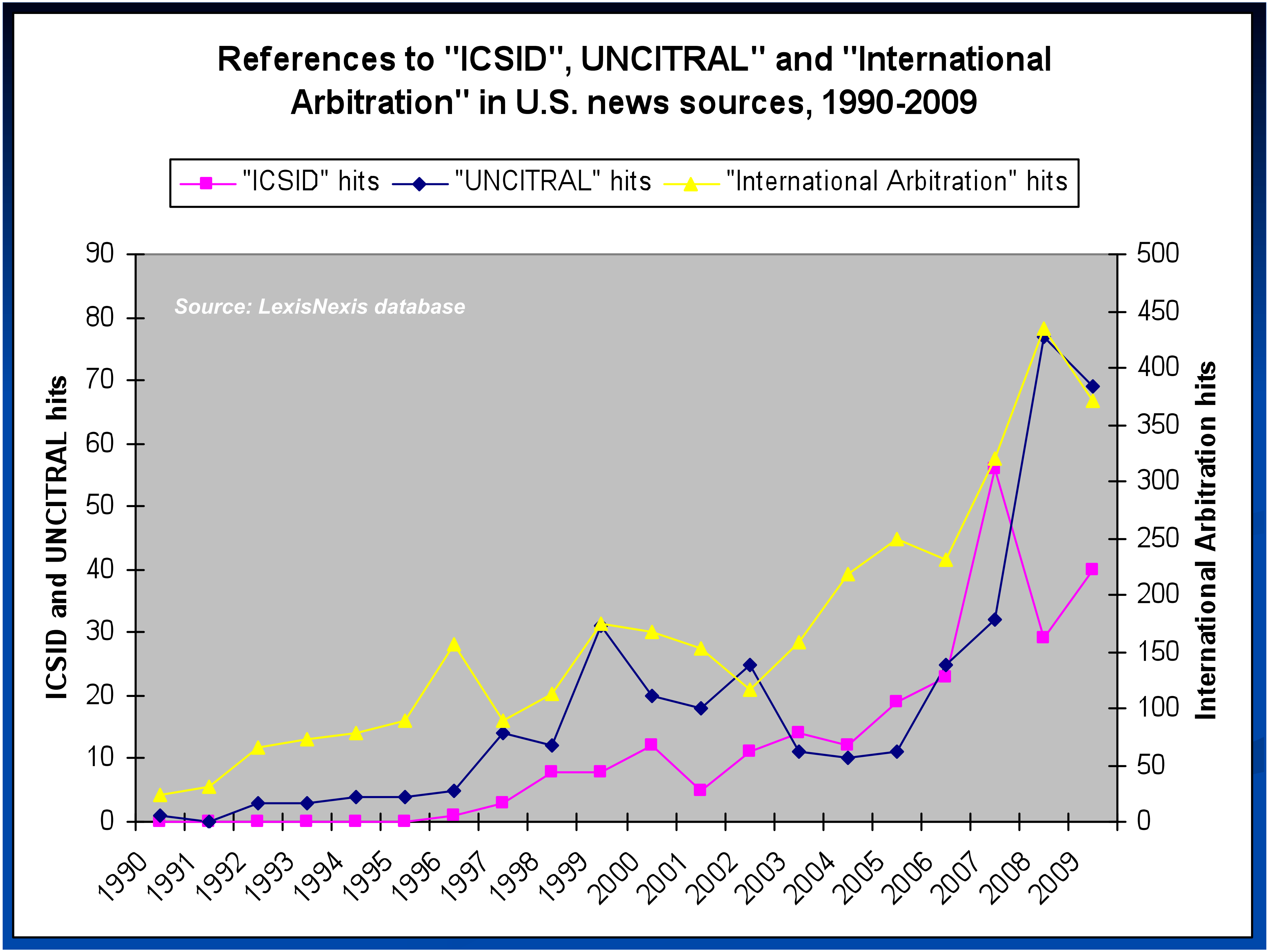
Comparison of defendants in trade and investment disputes







References to "ICSID", UNCITRAL" and "International Arbitration" in U.S. news sources, 1990-2009
"ICSID" hits
"UNCITRAL" hits
"International Arbitration" hits
Source: LexisNexis database
ICSID and UNCITRAL hits
International Arbitration hits
0
10
20
30
40
50
60
70
80
90
0
50
100
150
200
250
300
350
400
450
500
1990
1991
1992
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1994
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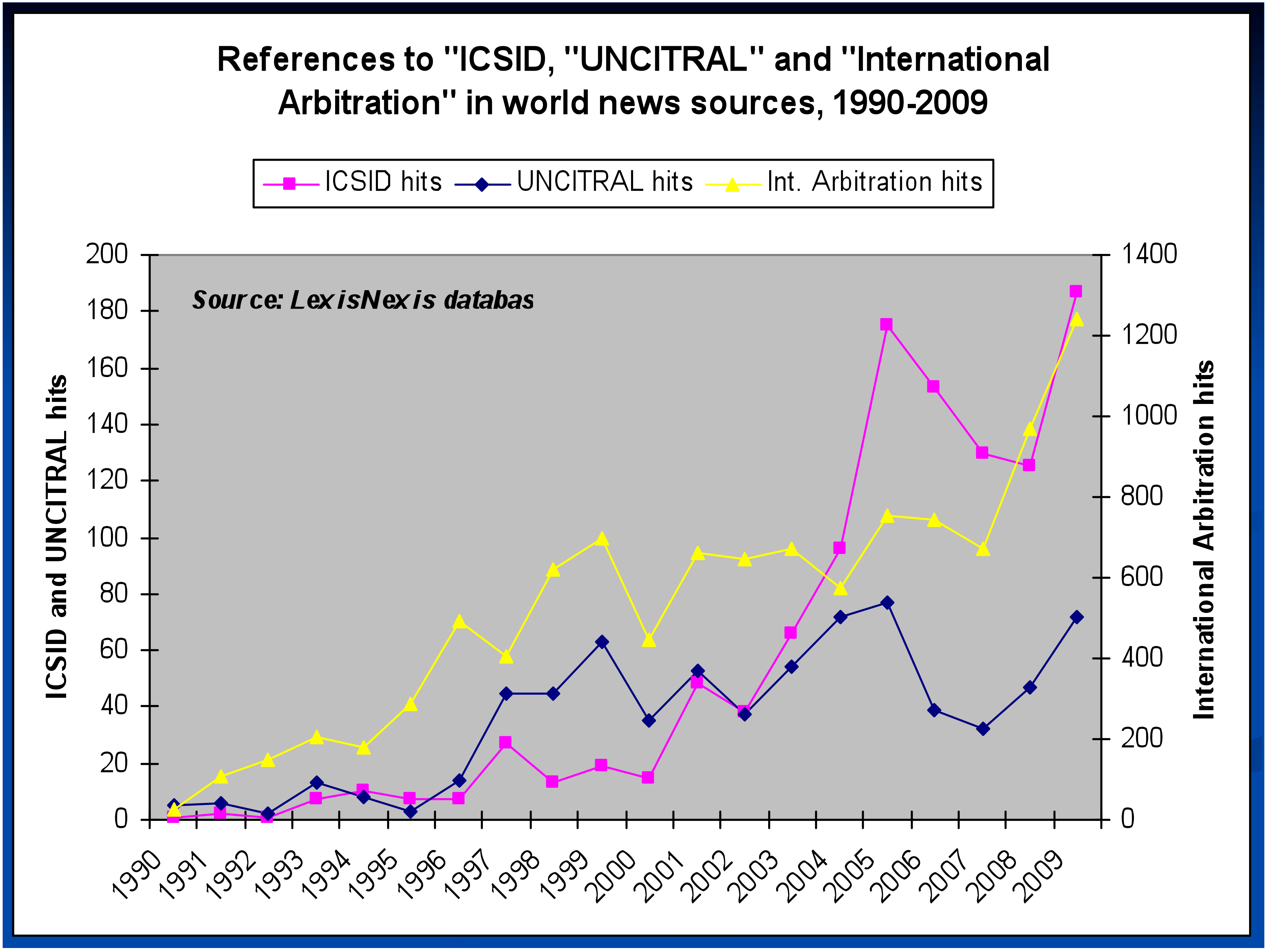
2004
2005
2006
2007
2008
2009

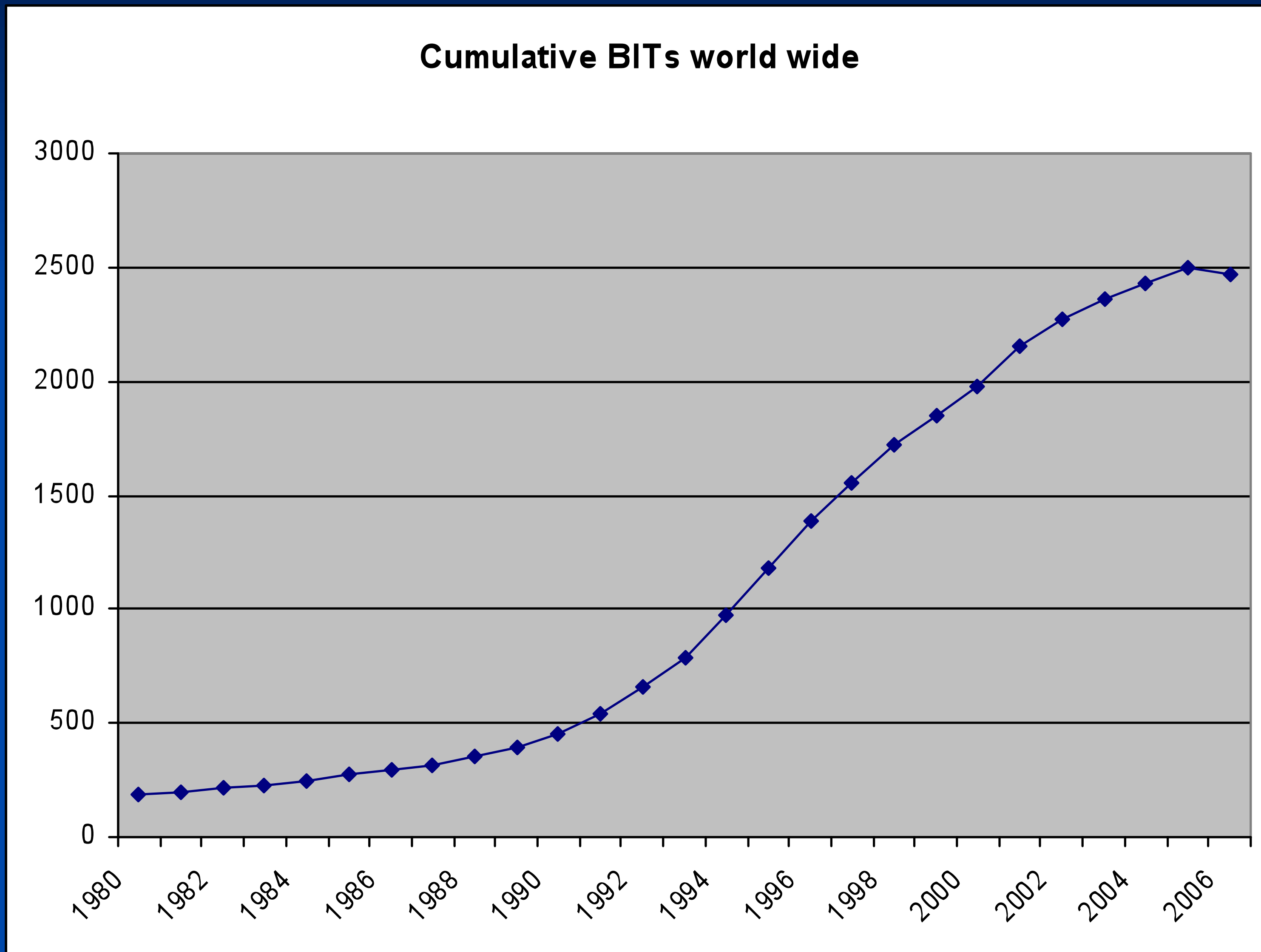


References to "ICSID, "UNCITRAL" and "International Arbitration" in world news sources, 1990-2009
ICSID hits
UNCITRAL hits
Int. Arbitration hits
Source: LexisNexis databas
ICSID and UNCITRAL hits
International Arbitration hits
0
20
40
60
80
100
120
140
160
180
200
200
400
600
800
1000
1200
1400
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009

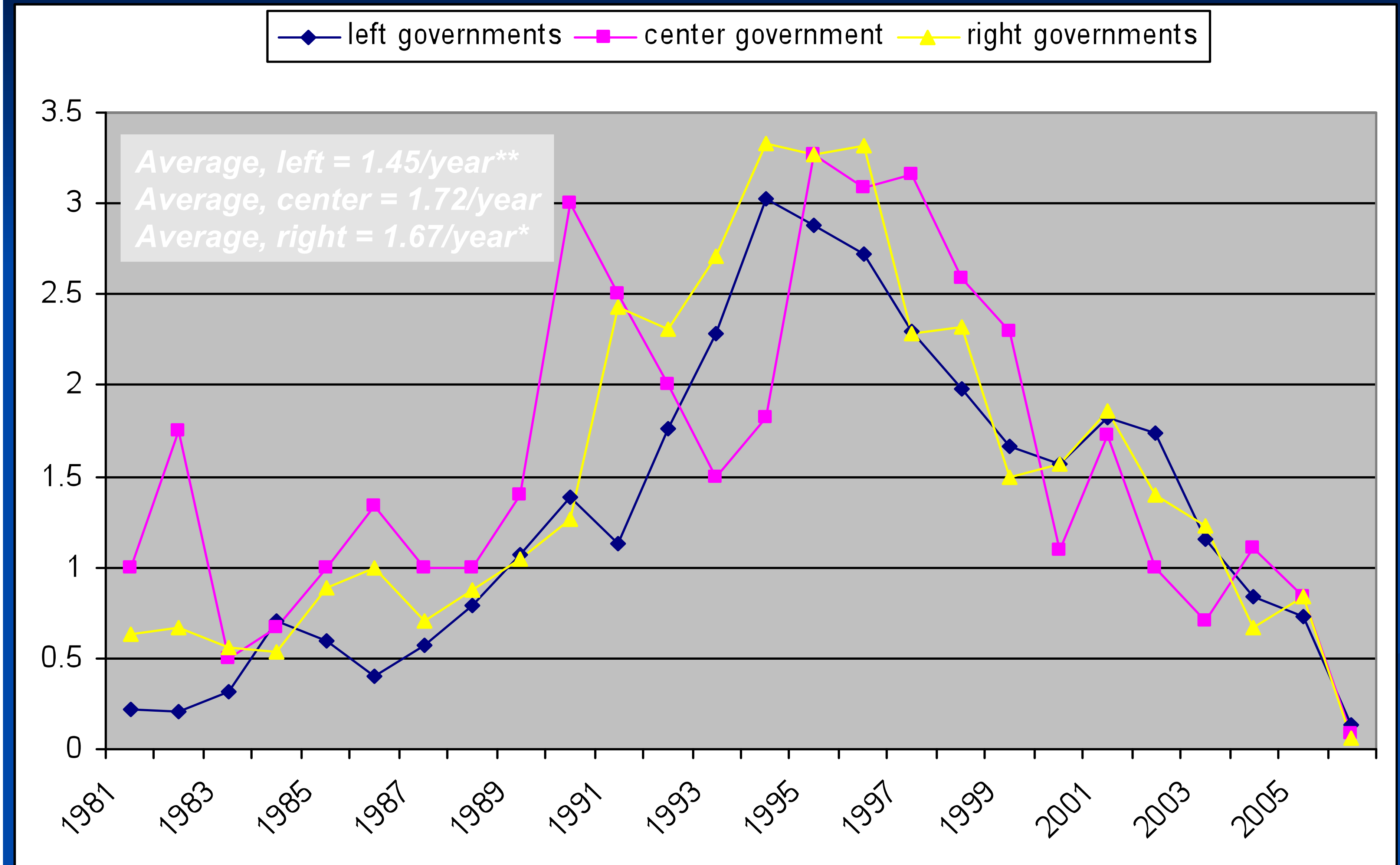
Outline of presentation

- The rise of BITs
- BITs as bargains – a look at contents
- The consequences of BITs
- Trends in arbitration
- Push-back: annulment proceedings
- Conclusions

The Rise of BITs



Average number of BITs negotiated each year by…



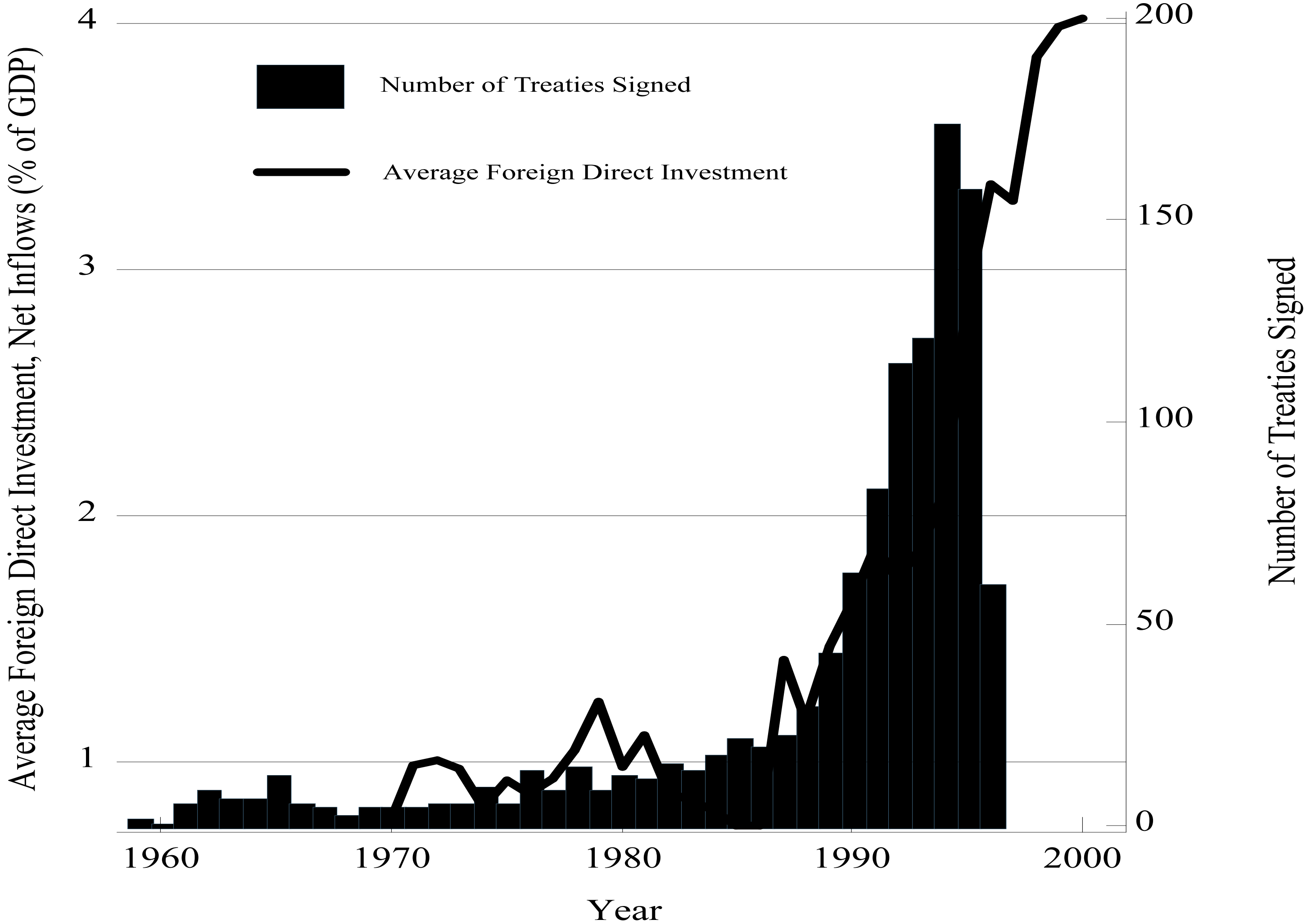
Why the BIT mania?

- Technology for joint gains
- Spread of neo-liberal ideas of development

But also

- High stakes
- Tough competition
- Hard times

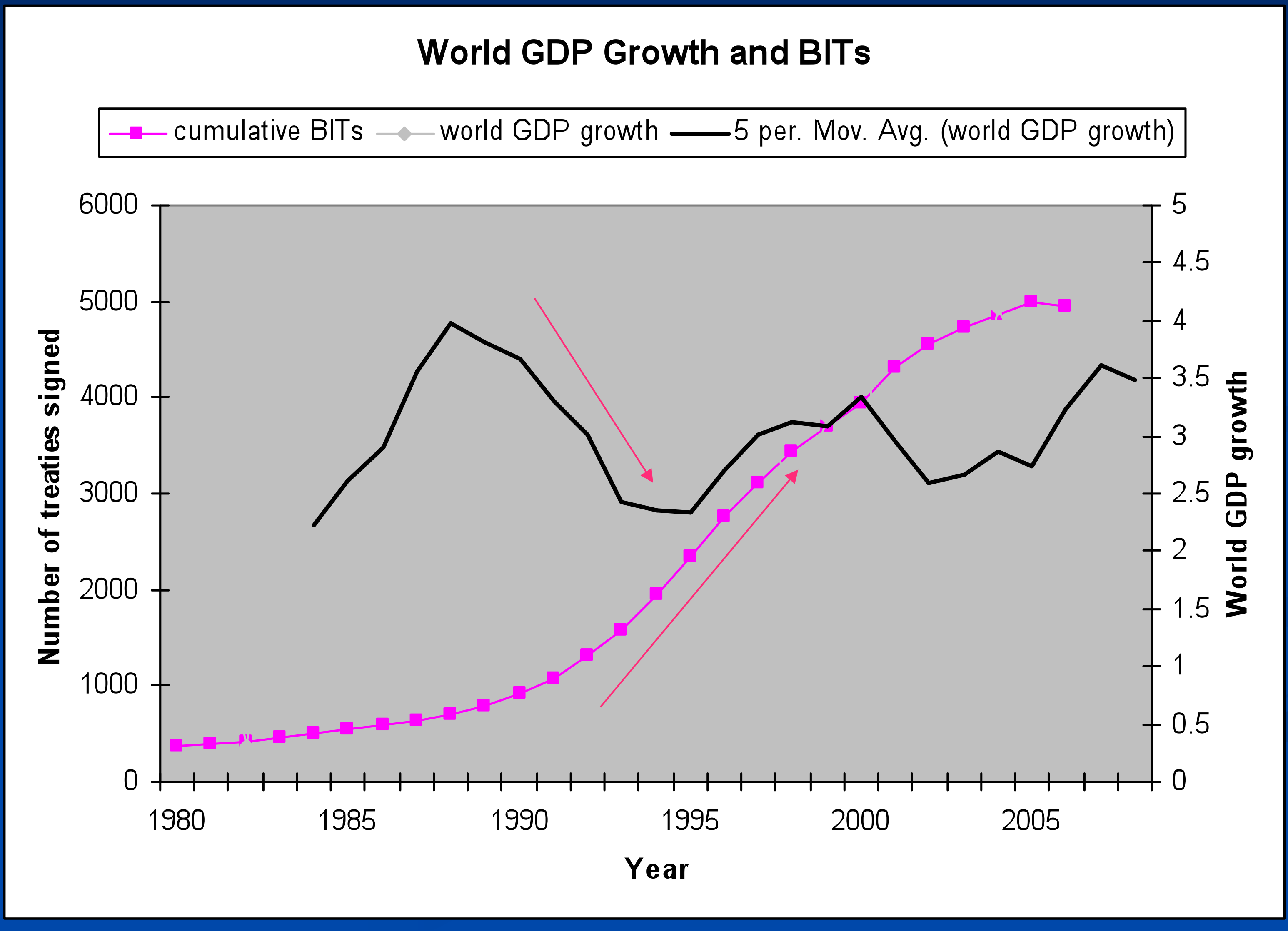
High stakes

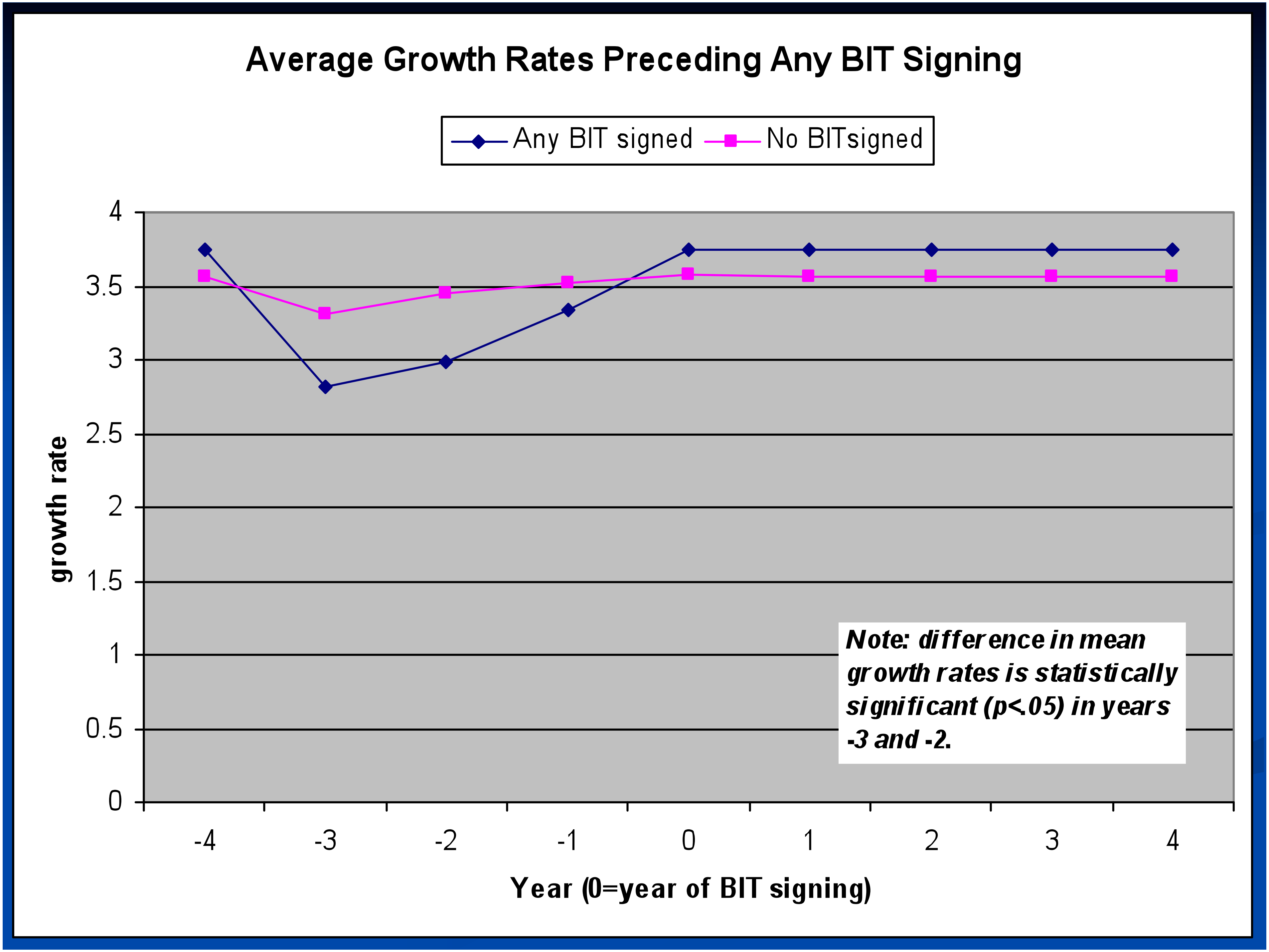

Number of Treaties Signed
Average Foreign Direct Investment
Average Foreign Direct Investment, Net Inflows (% of GDP)
4
3
2
1
Number of Treaties Signed
200
150
100
50
0
1960
1970
1980
1990
2000
Year

Tough Competition

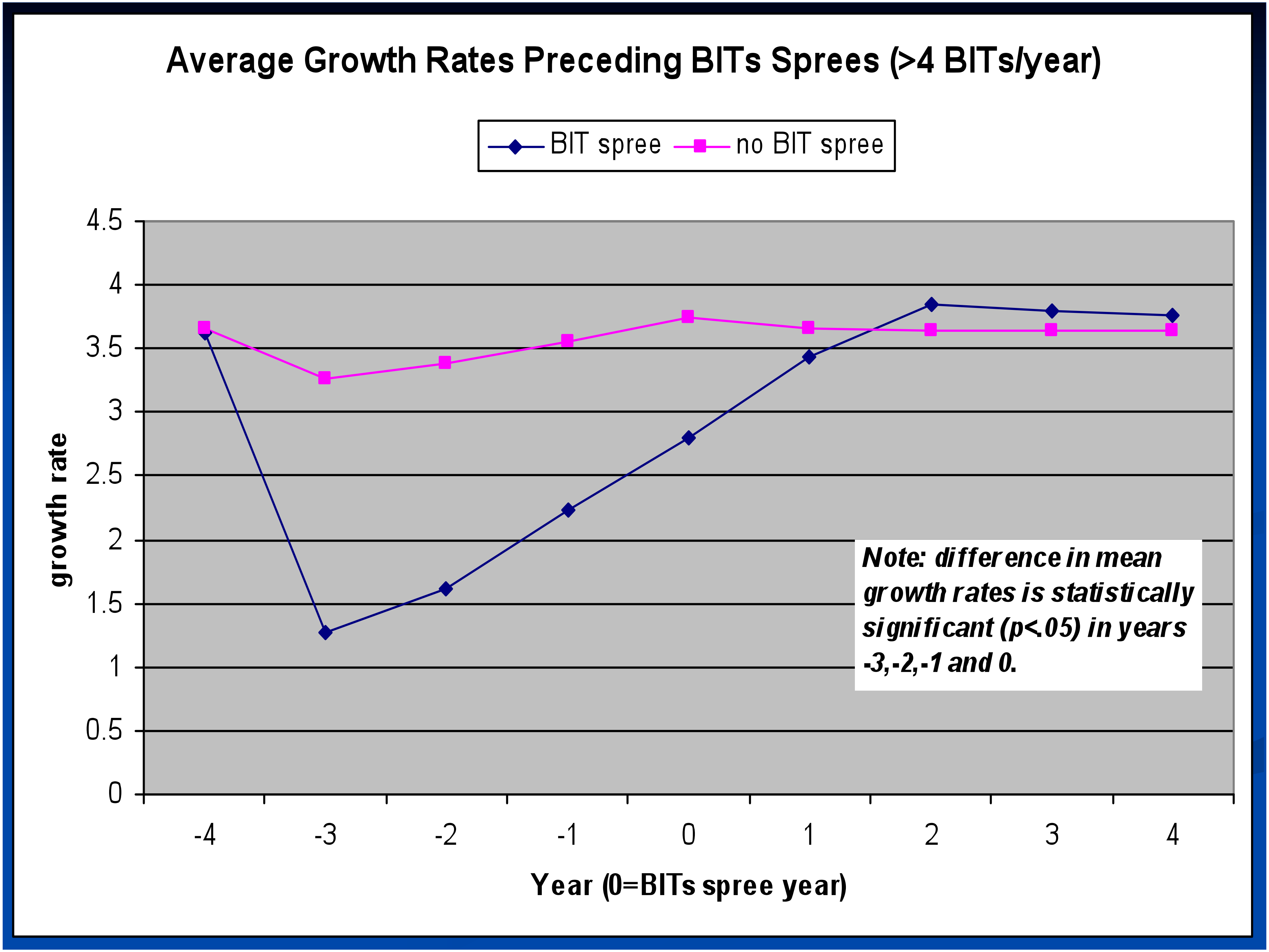
- Predictors that a developing will ratify a BIT with any other country:
  - Ratification in countries with similar infrastructure
  - Ratification in countries with similar work force
  - Ratification in countries with similar export profile
- *Developing countries do what their closest economic competitors for capital do.*

Hard Times


World GDP Growth and BITs
cumulative BITs
world GDP growth
5 per. Mov. Avg. (world GDP growth)
Number of treaties signed
6000
5000
4000
3000
2000
1000
0
5
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
World GDP growth
1980
1985
1990
1995
2000
2005
Year

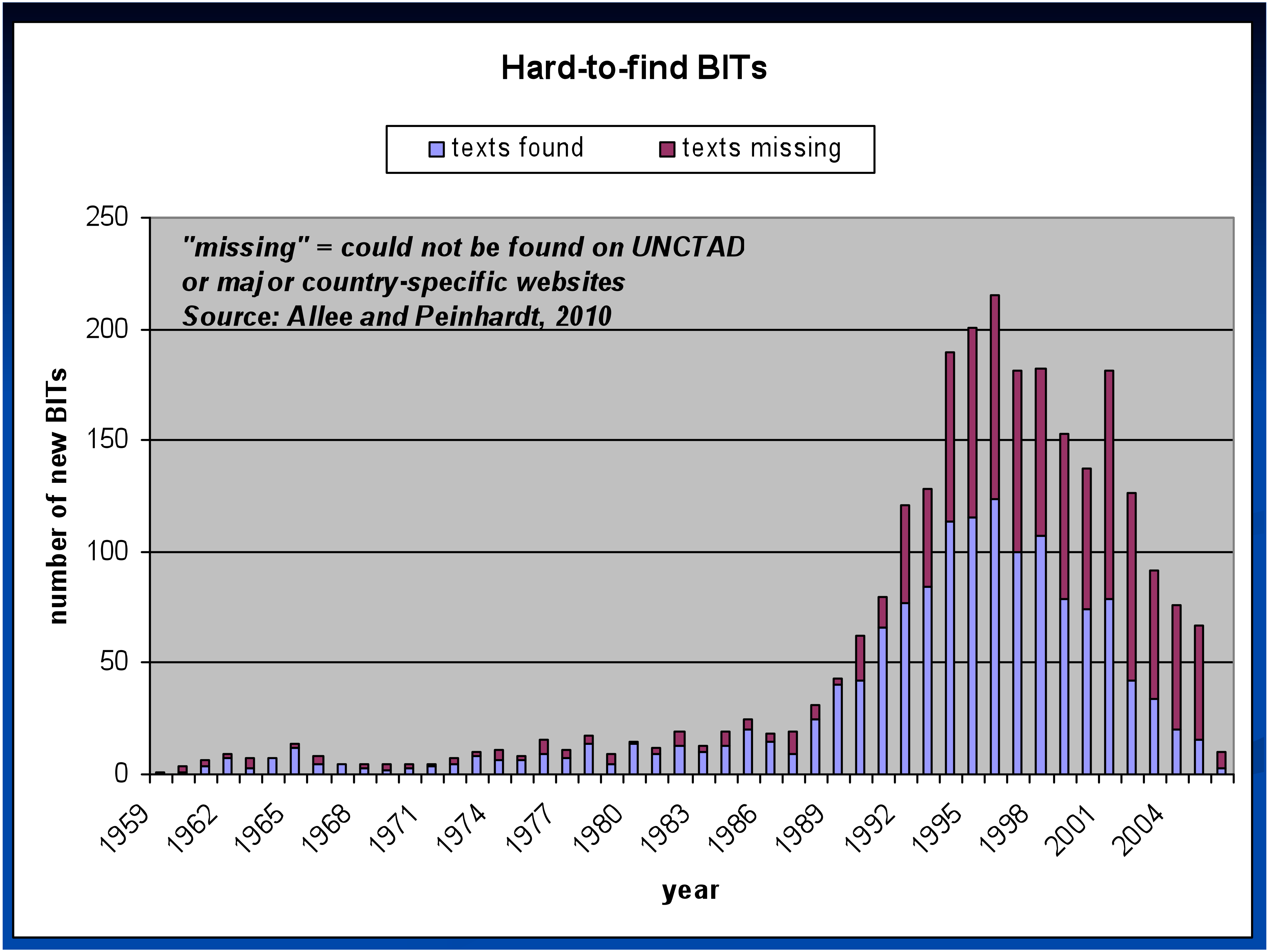


Average Growth Rates Preceding Any BIT Signing
Any BIT signed
No BITsigned
growth rate
4
3.5
3
2.5
2
1.5
1
0.5
0
-4
-3
-2
-1
0
1
2
3
4
Year (0=year of BIT signing)
Note: difference in mean growth rates is statistically significant (p<.05) in years -3 and -2.

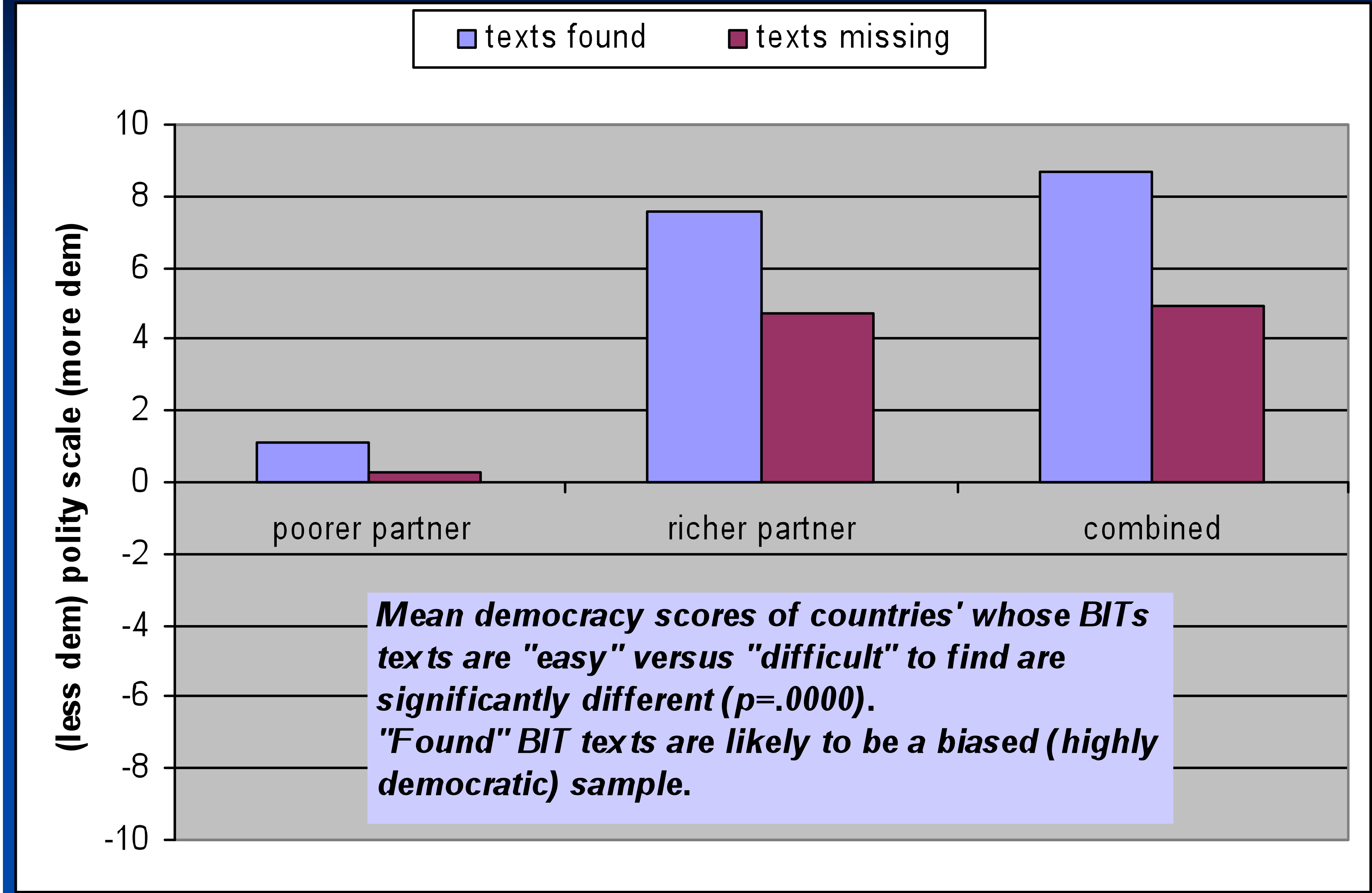

Average Growth Rates Preceding BITs Sprees (>4 BITs/year)
BIT spree
no BIT spree
growth rate
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
-4
-3
-2
-1
0
1
2
3
4
Year (0=BITs spree year)
Note: difference in mean growth rates is statistically significant (p<.05) in years -3,-2,-1 and 0.

BITs as bargains: a look at contents

- Getting the text – not as easy as it sounds.
- Deciding what to code – not as obvious as it may seem.
- Starting point: dispute settlement clauses.
- Simple assumptions:
  - Capital importing countries want as much local control as they can get away with
  - Investors want a dispute as removed from local host country institutions as possible
- Hypothesis: host countries in weak bargaining positions lose more sovereign control in the event of disputes


Hard-to-find BITs
texts found
texts missing
"missing" = could not be found on UNCTAD
or major country-specific websites
Source: Allee and Peinhardt, 2010
number of new BITs
250
200
150
100
50
0
1959
1962
1965
1968
1971
1974
1977
1980
1983
1986
1989
1992
1995
1998
2001
2004
year

How random are the "hard-to-find" BITs?



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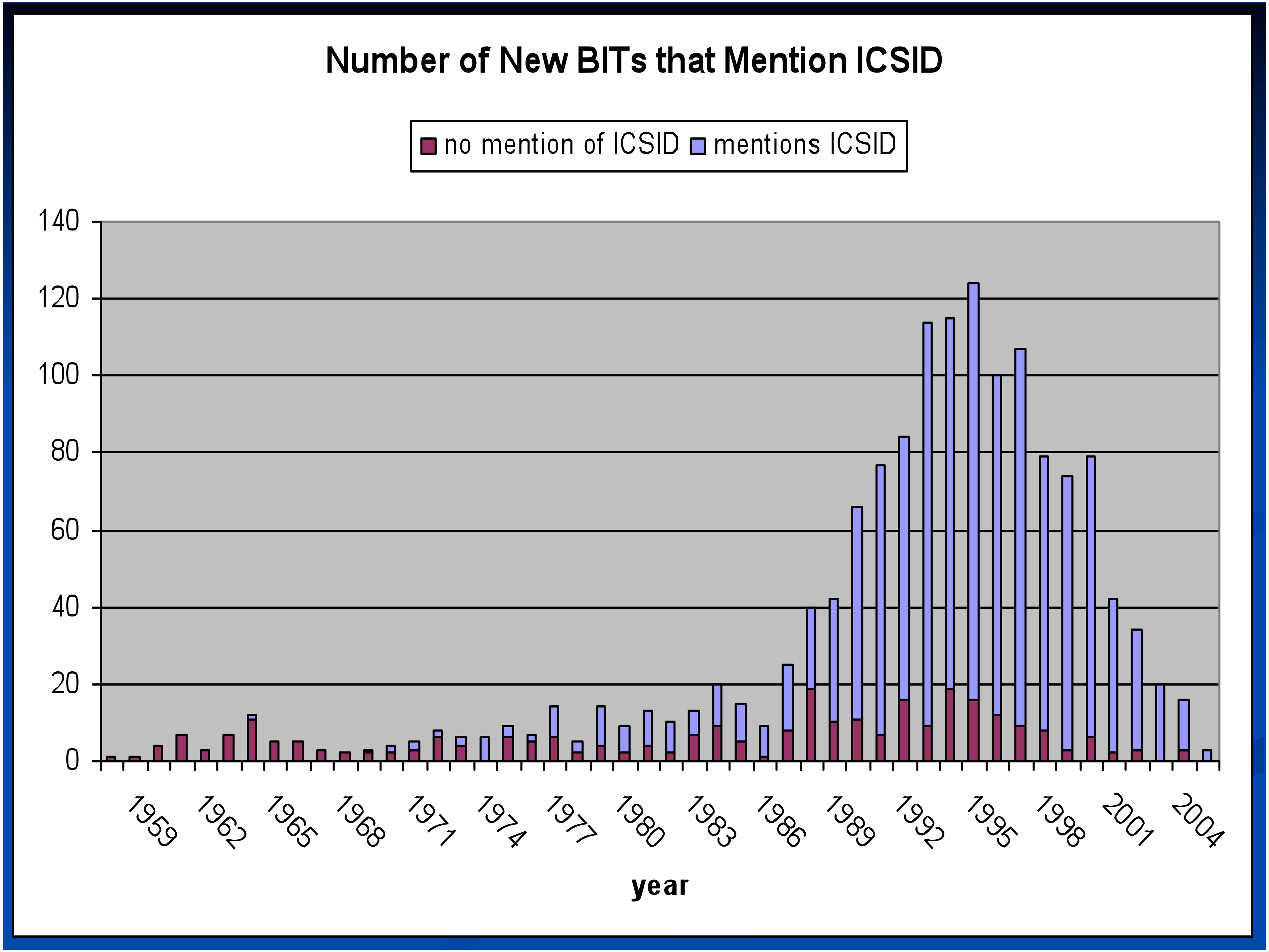
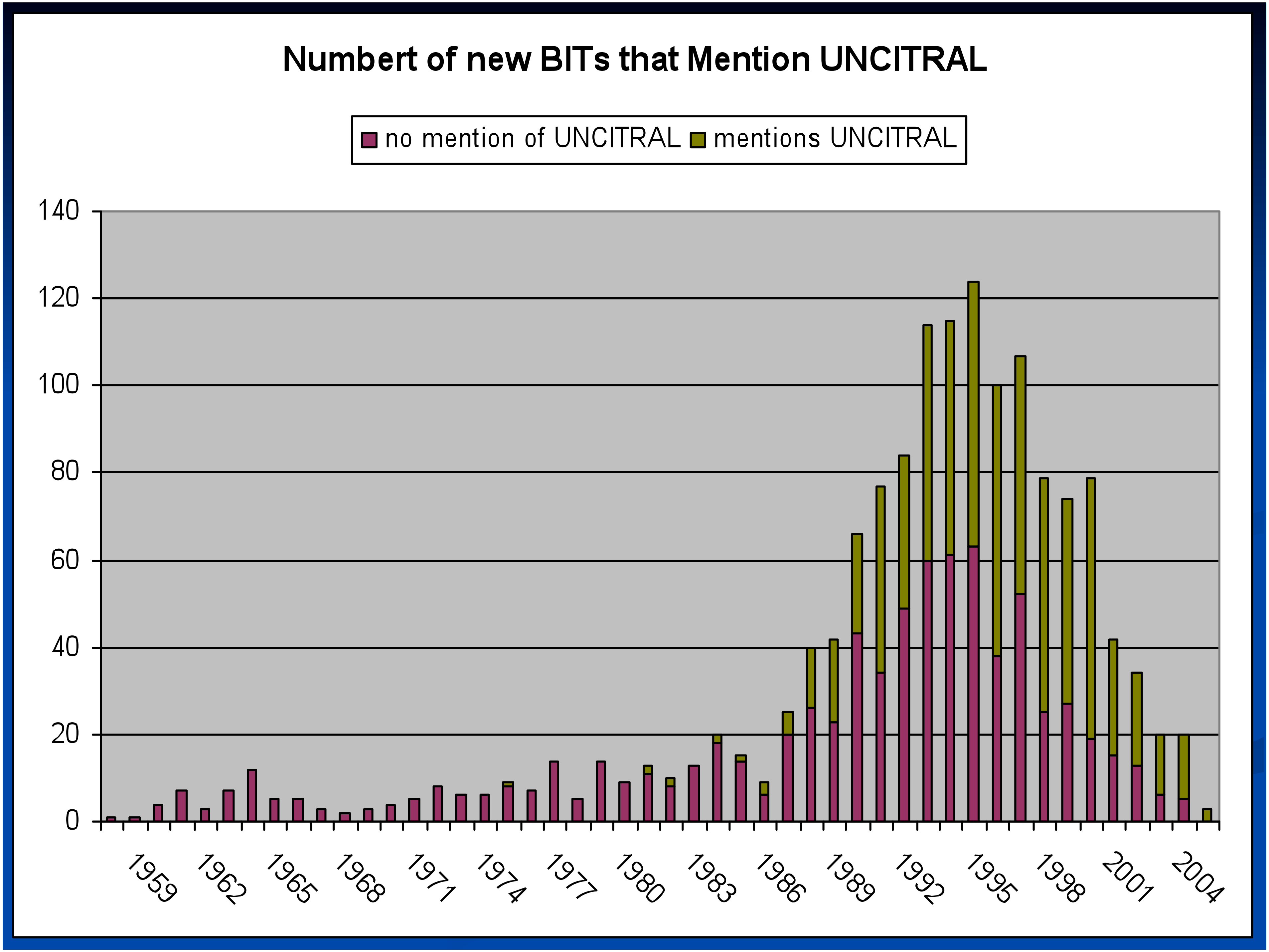


Number of New BITs that Mention ICSID
no mention of ICSID
mentions ICSID
140
120
100
80
60
40
20
0
1959
1962
1965
1968
1971
1974
1977
1980
1983
1986
1989
1992
1995
1998
2001
2004
year


Numbert of new BITs that Mention UNCITRAL
no mention of UNCITRAL
mentions UNCITRAL
140
120
100
80
60
40
20
0
1959
1962
1965
1968
1971
1974
1977
1980
1983
1986
1989
1992
1995
1998
2001
2004

BITs as bargains: a look at contents

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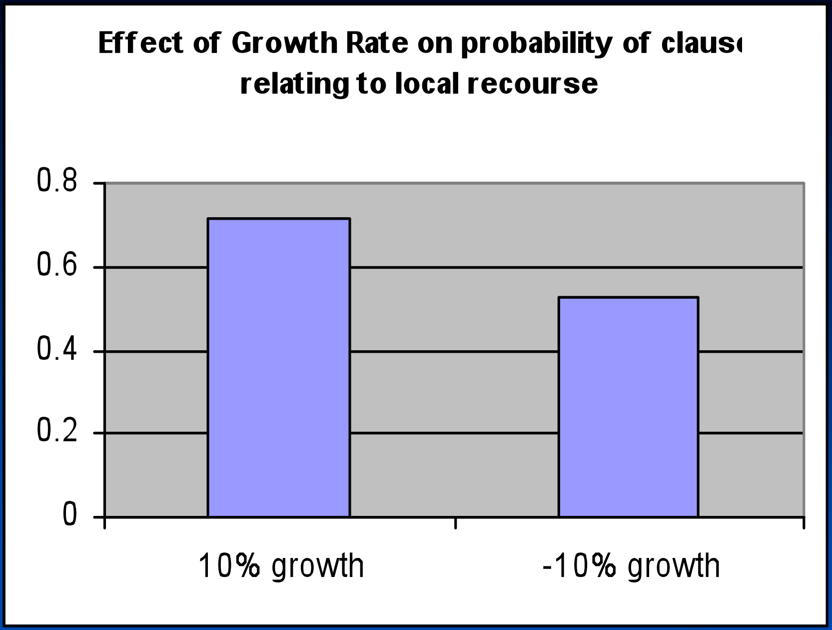
What explains the choice of dispute settlement provisions?

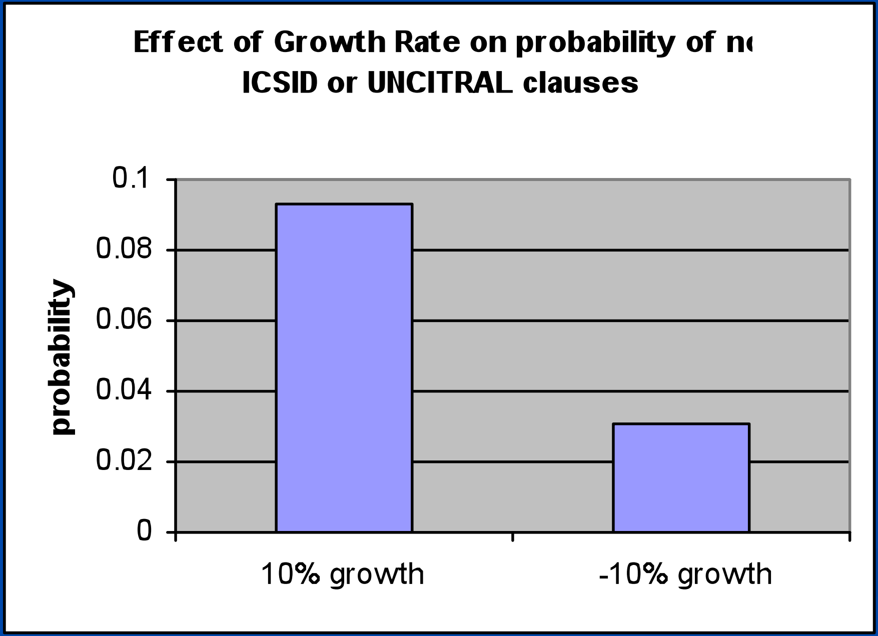
Results of a series of probit models;
dependent variable: presence or absence of particular kind of clause

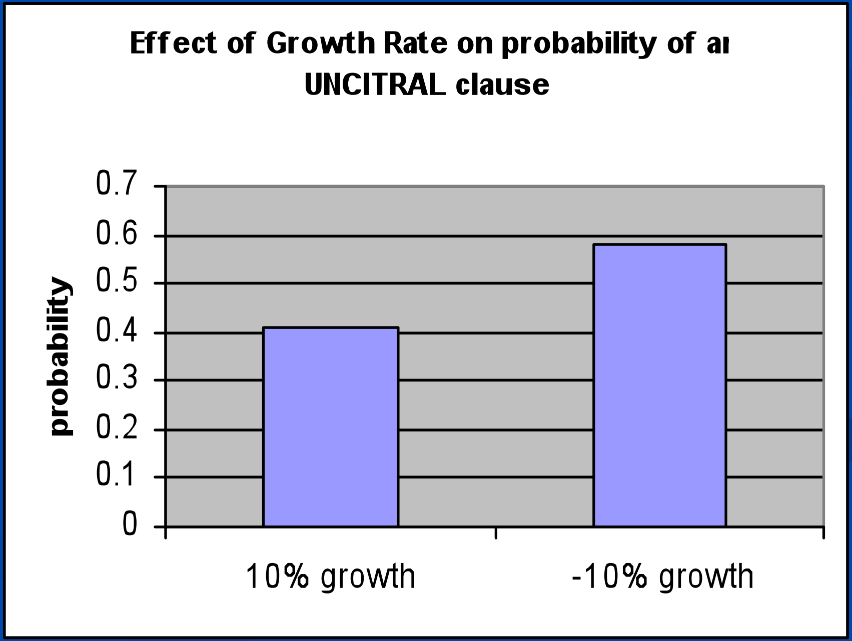
	ICSID provision	UNCITRAL provision	*Neither* ICSID *nor* UNCITRAL	Local body provision	Exhaust Local remedies
Growth past 3-yrs (host)	-.005 (p=.422)	-.021*** (p=.003)	.027** (p=.012)	.024*** (p=.000)	.028** (p=.028)
Joint democracy	.038*** (p=.000)	.011 (p=.112)	-.034*** (p=.000)	-.005 (p=.315)	-.007 (p=.477)
Difference in development	.096 (p=.102)	-.054 (p=.427)	-.078 (p=.261)	-.283*** (p=.000)	-.203** (p=.015)
Year	.061*** (p=.000)	.093*** (p=.000)	-.061*** (p=.000)	.050*** (p=.001)	-.037* (p=.098)
# obs.	1213	1213	1213	1204	1205
Pseudo R^2	.120	.091	.135	.082	.053

Data on provisions: Allee and Peinhardt 2010.

The consequences of the host business cycle for BITs dispute settlement clauses…







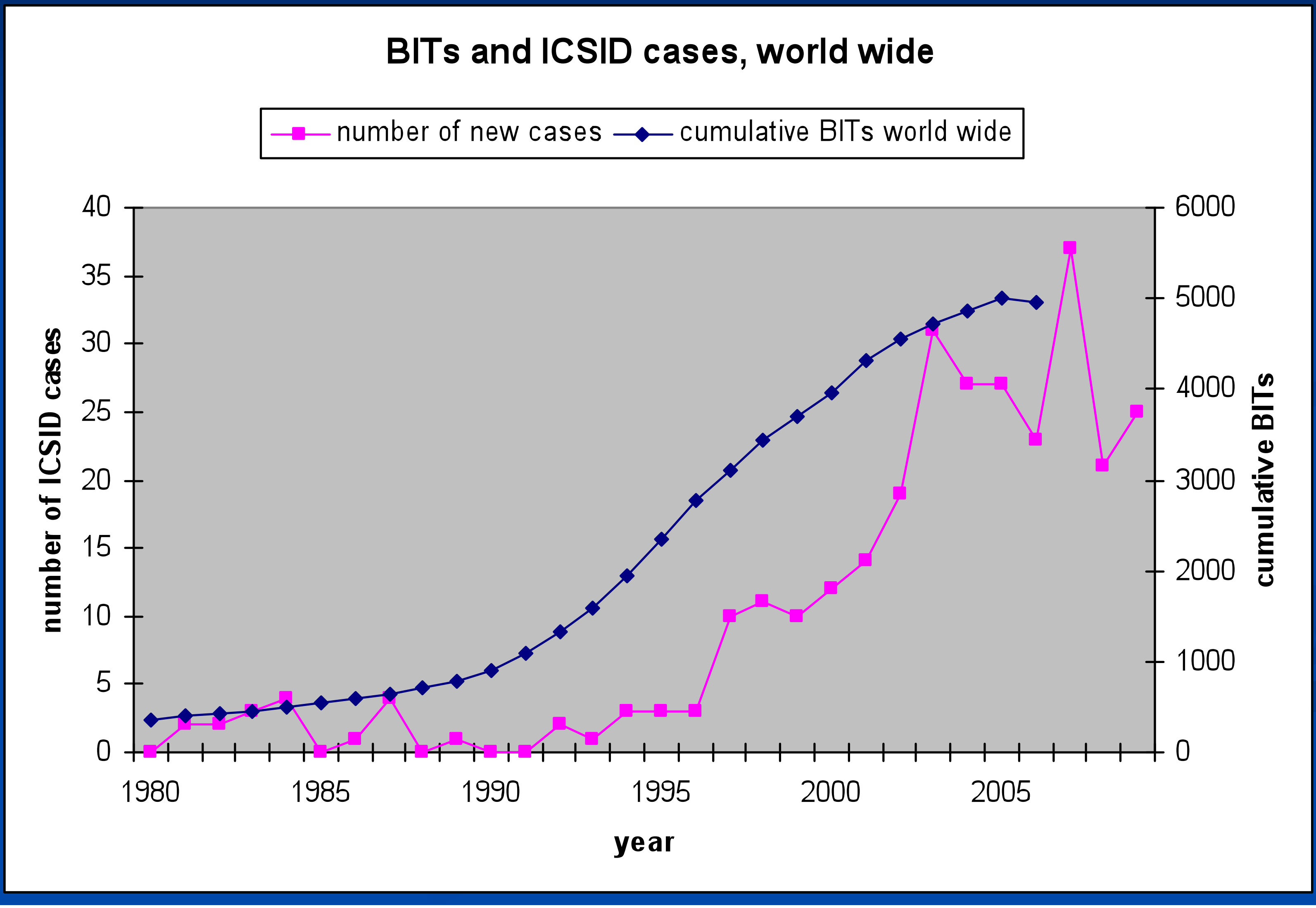
What are the consequences of signing BITs?

- Great source of collected articles:
  - Sauvant, Karl P., and Lisa E. Sachs. 2009. *The Effect of Treaties on Foreign Direct Investment*. Oxford: OUP

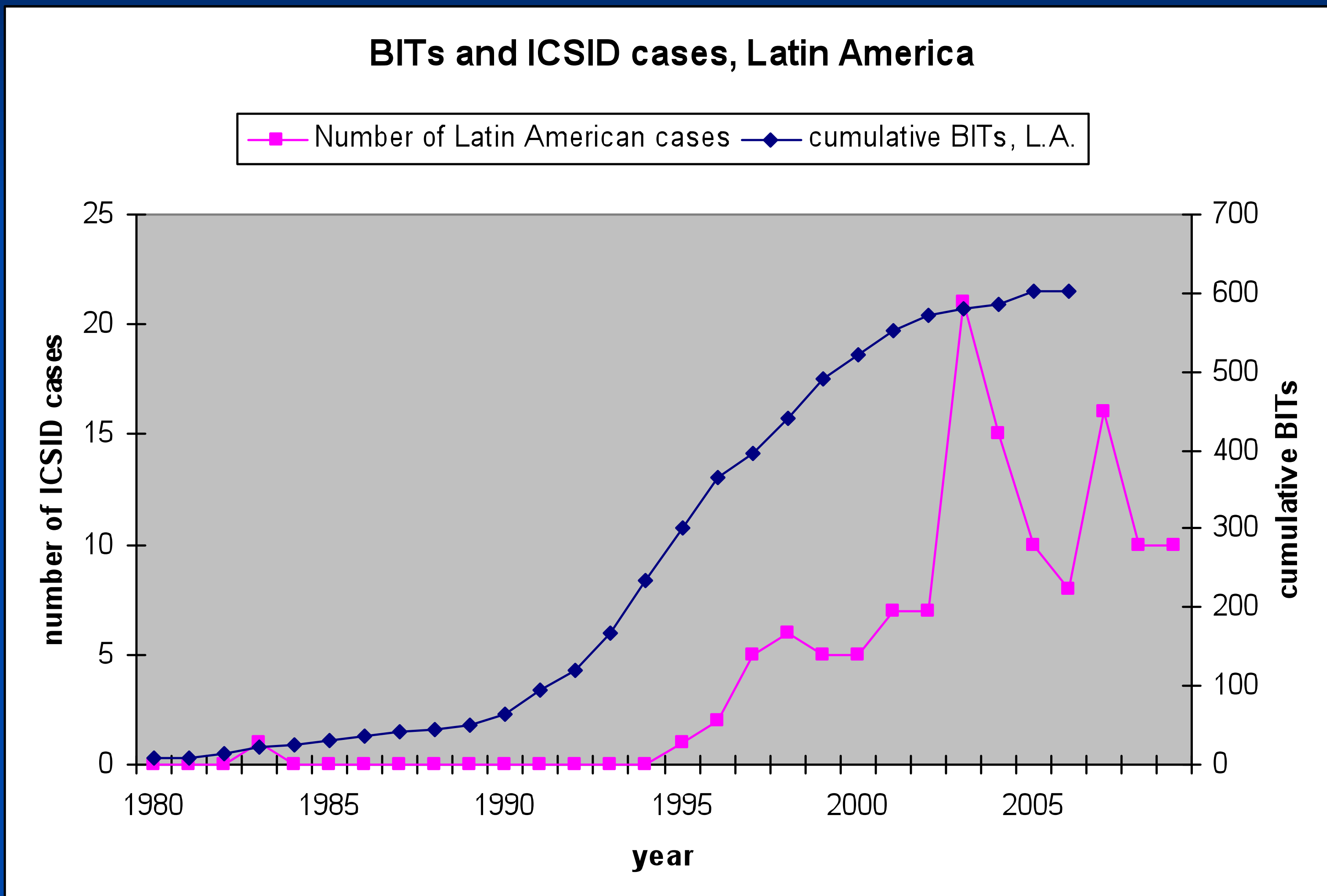
- Effect of BITs signings/ratifications on FDI flows:
  - very little if any, conditional on:
    - good domestic institutions (Hallward-Driemeier 2003; Rose-Ackerman and Tobin 2005) and
    - the capital source (Gallagher and Birch 2006).
  - Some positive benefits Eggera and Pfaffermayr 2004; Neumayer and Spess 2004; Kerner 2009).

- The *most predictable* outcome of ratifying BITs…

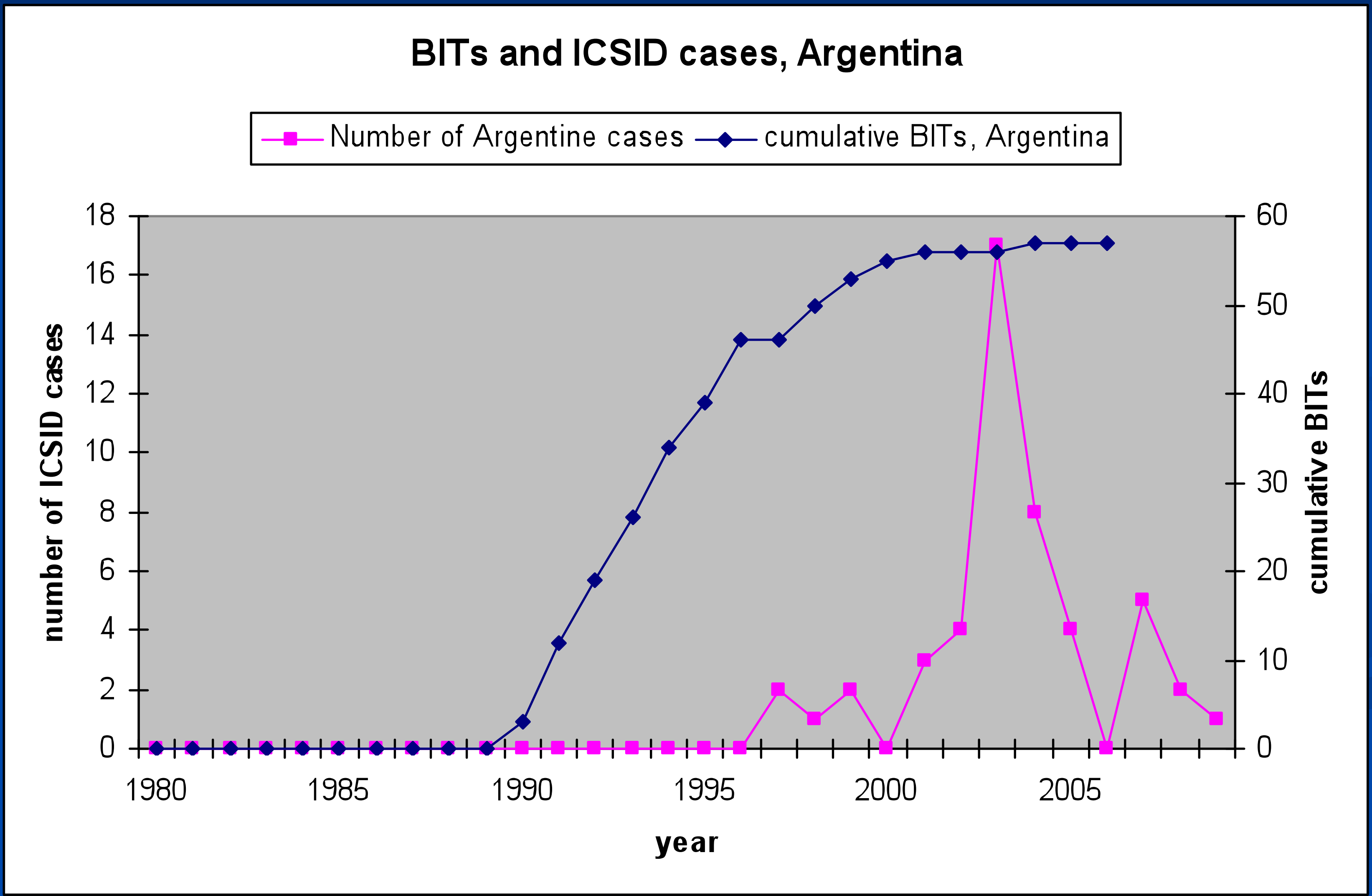
BITs: If you Ratify, They Will Litigate…



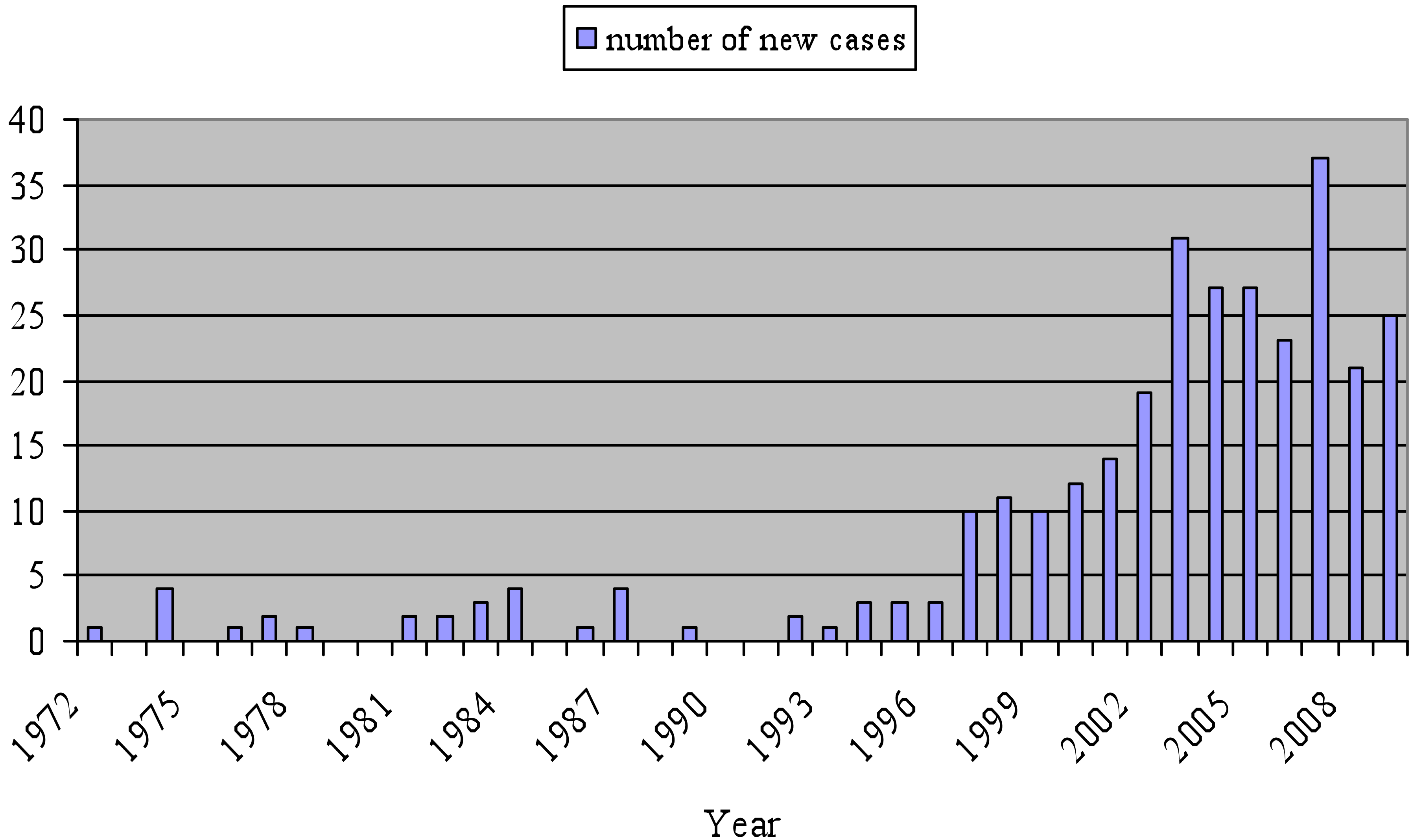
BITs: If you Ratify, They Will Litigate…



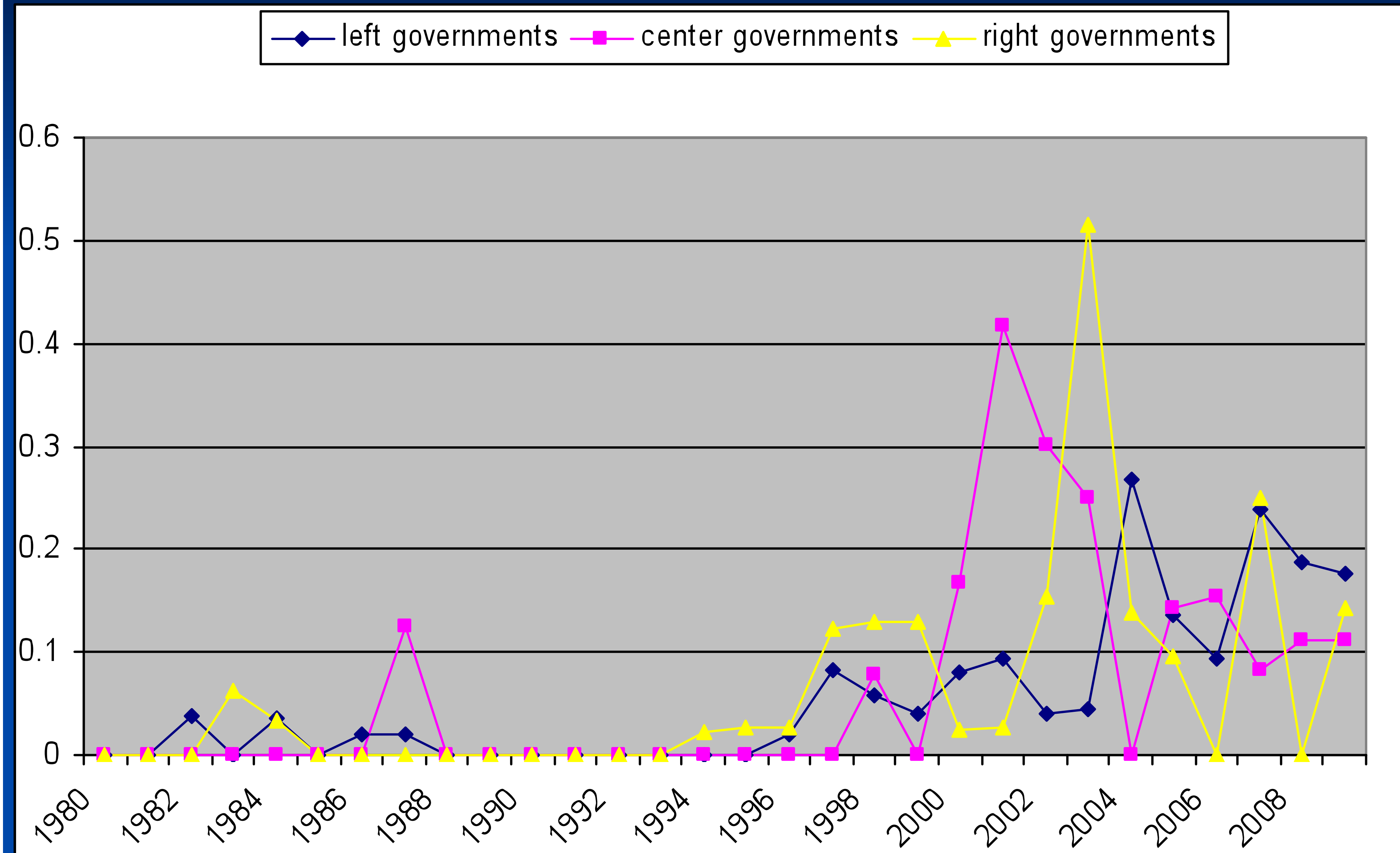
BITs: If you Ratify, They Will Litigate…



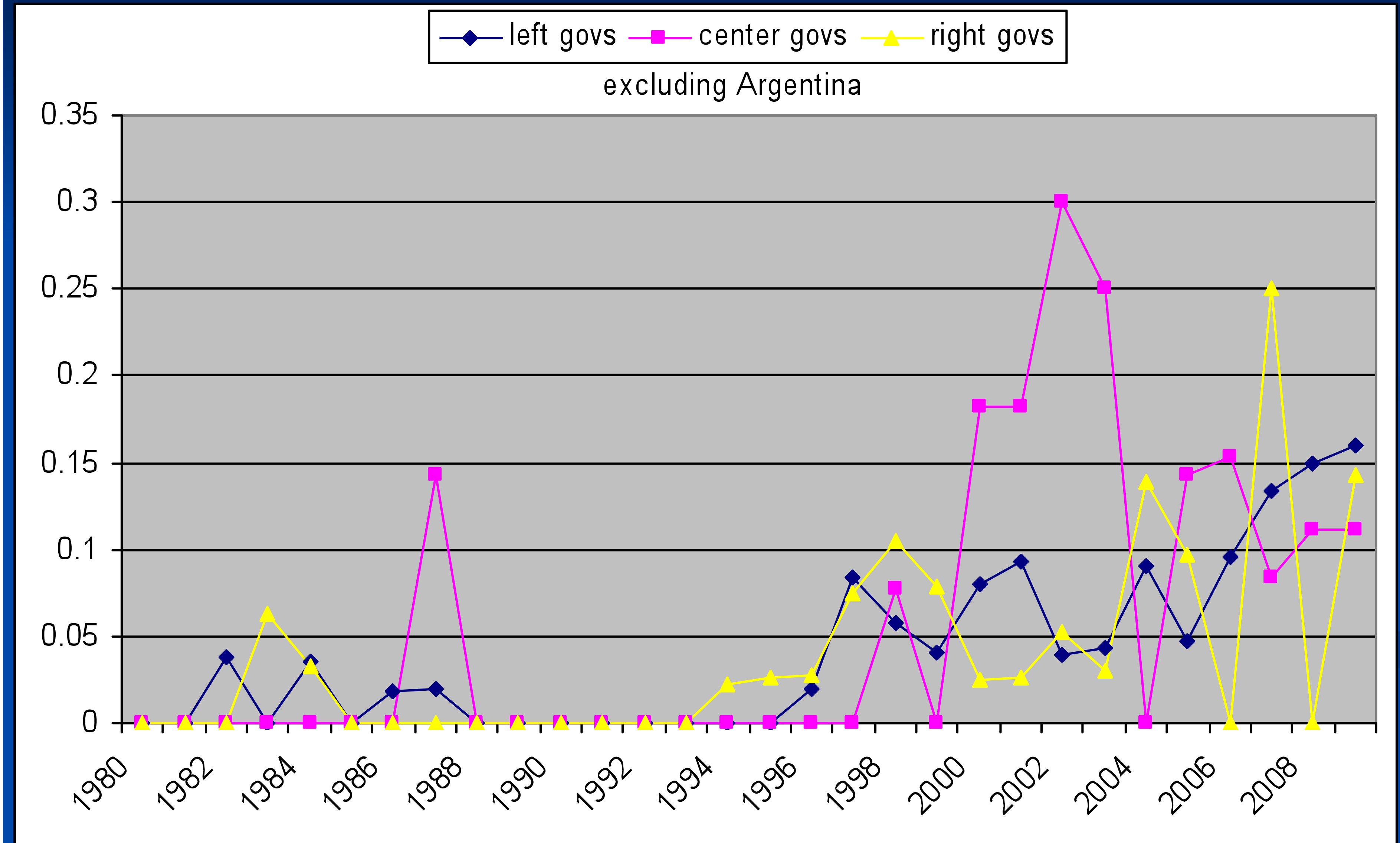
Growth in Investor-State Arbitration, ICSID Cases



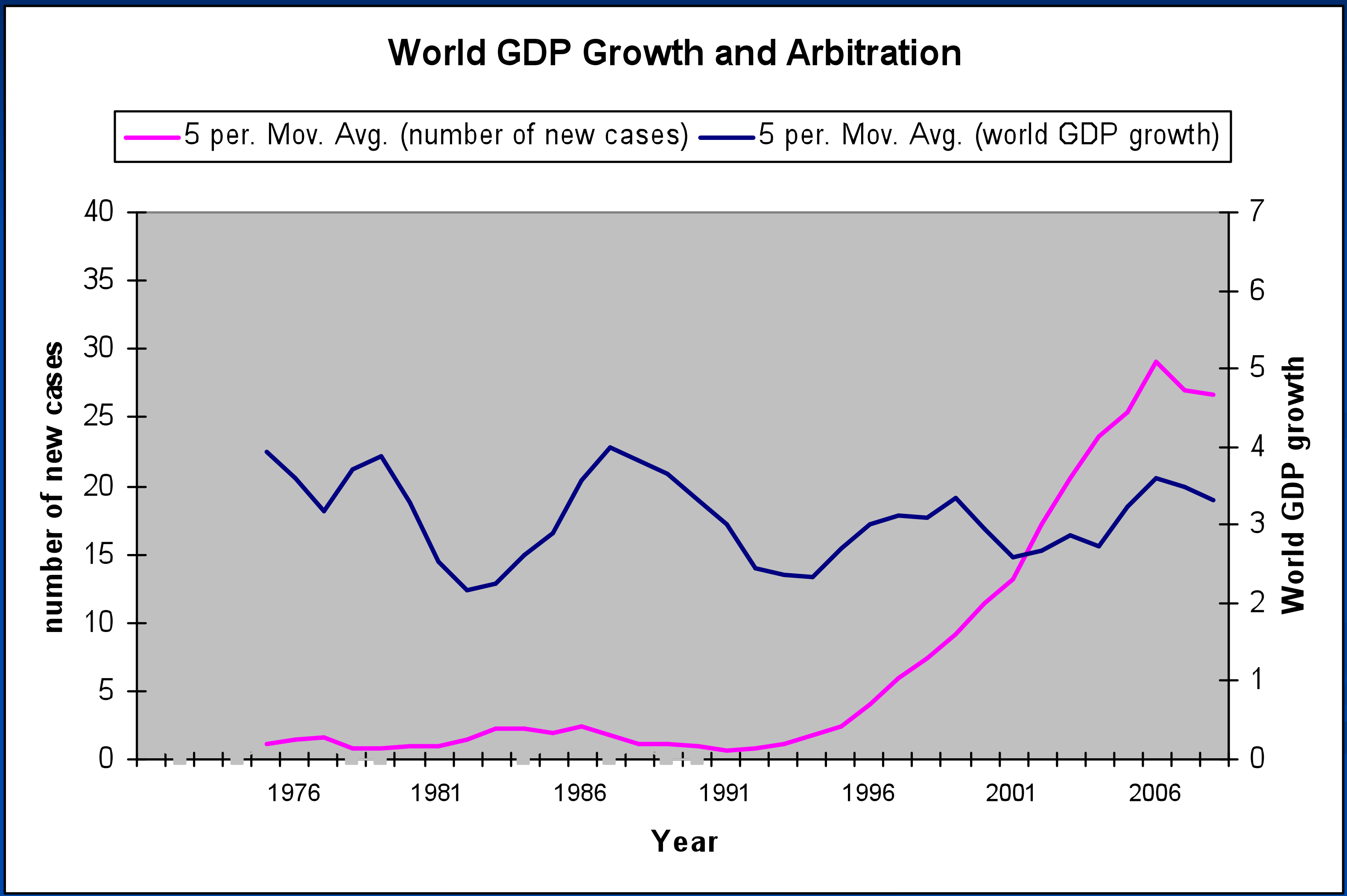
Average number of arbitrations by…



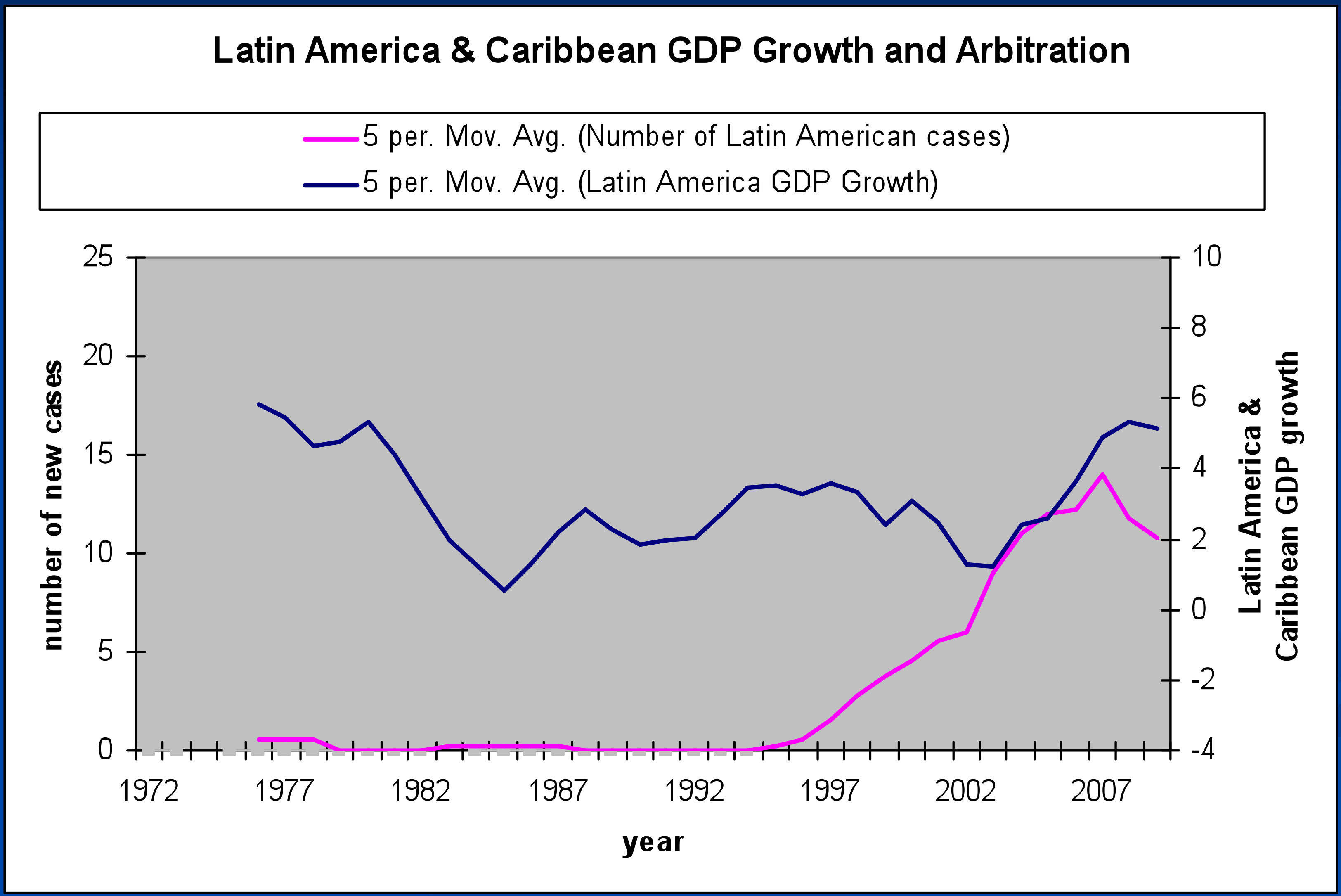
Average number of arbitrations by…



Economic Conditions prior to Arbitrations



Economic Conditions prior to Arbitrations



Economic Conditions prior to Arbitrations

Conditions associated with arbitration

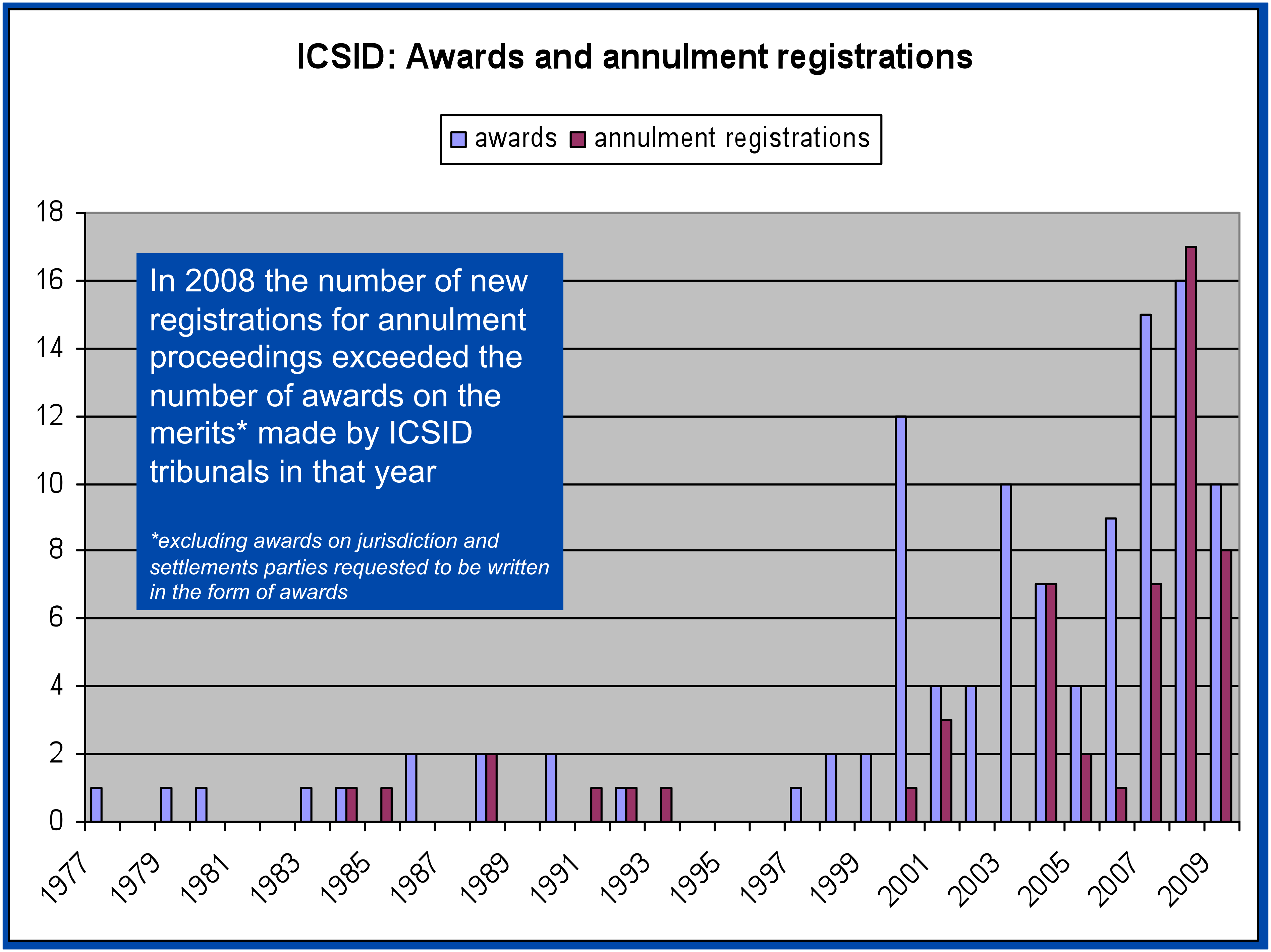
Dependent variable: arbitration in a given year (probit coefficients, p-values)

Explanatory Variables:	Model 2	Model 3	Model 4	Model 5
Log of arbitration, (t-1)	.202*** (p=.000)	.215*** (p=.001)	.224*** (p=.001)	.220*** (p=.000)
log of cumulative # of BITs	.133*** (p=.000)	.255*** (p=.000)	.119** (p=.011)	.224*** (p=.000)
Year	.029*** (p=.000)	.024*** (p=.001)	.030*** (p=.000)	.025*** (p=.000)
Log inflation (t-2)	.067* (p=.055)	--	--	--
Log change in reserves (t-2)	--	-.088*** (p=.002)	--	--
FDI outflows (t-2)	--	--	-.004** (p=.027)	--
Change in foreign debt service/ GDP(t-3)	--	--	--	-.009** (p=.047)
Overall R2	.074	.096	.079	.092
# of countries	162	118	155	130
Total # observations	2739	2065	2094	2037

It's the economy, stupid!

Annulments

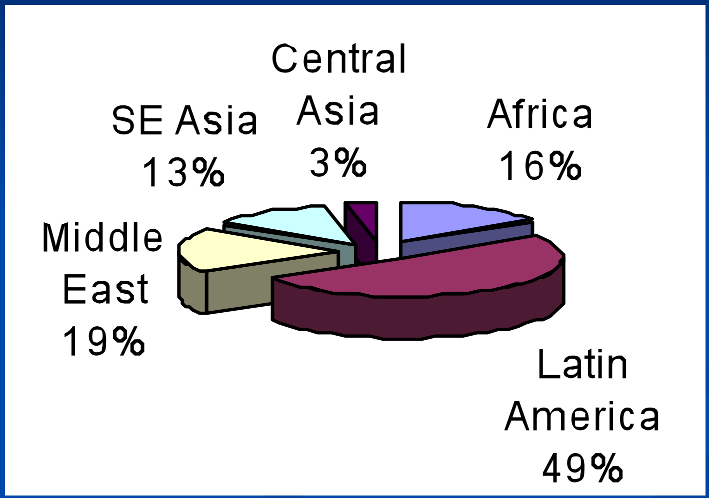
- No appeals of ICSID tribunal decisions (compare WTO DSM).
- Annulments on only very narrow grounds
  - absence of proper reasoning
  - manifest "excess of powers"
- And yet…

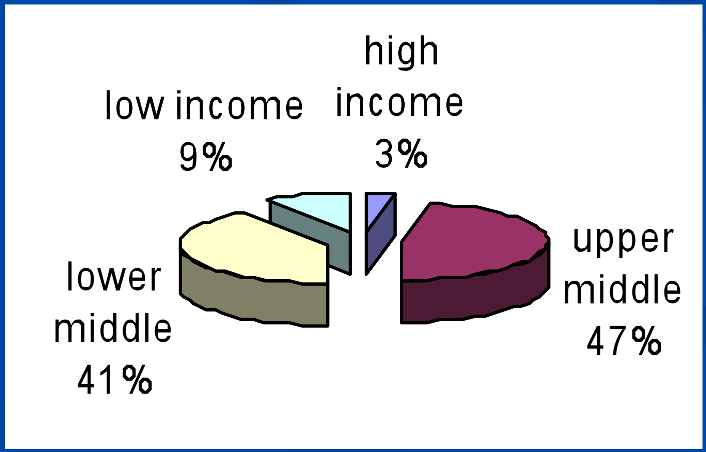


ICSID: Awards and annulment registrations
awards
annulment registrations
18
16
14
12
10
8
6
4
2
0
In 2008 the number of new registrations for annulment proceedings exceeded the number of awards on the merits* made by ICSID tribunals in that year
*excluding awards on jurisdiction and settlements parties requested to be written in the form of awards
1977
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
2007
2009

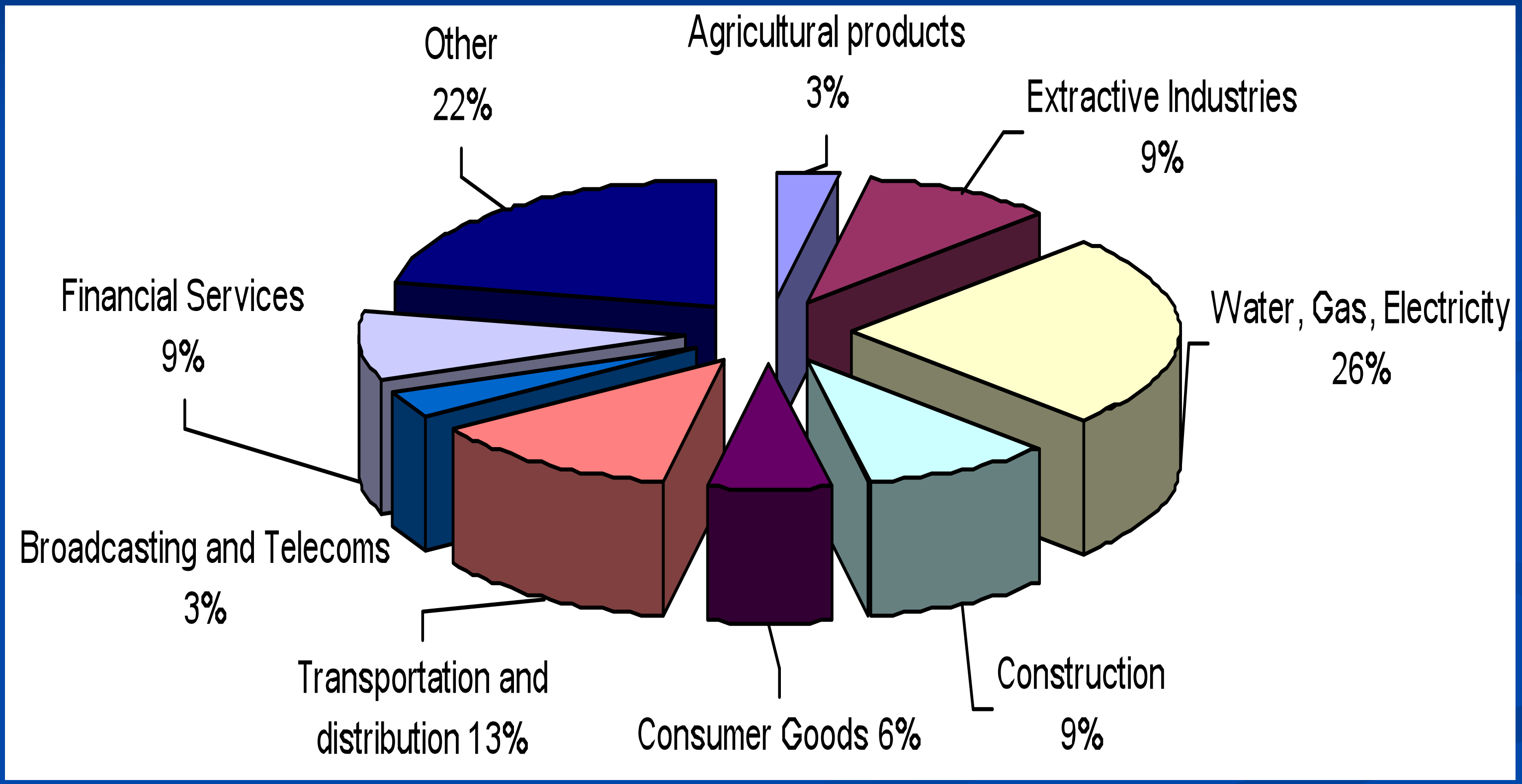
A Closer Look at Annulment Attempts…

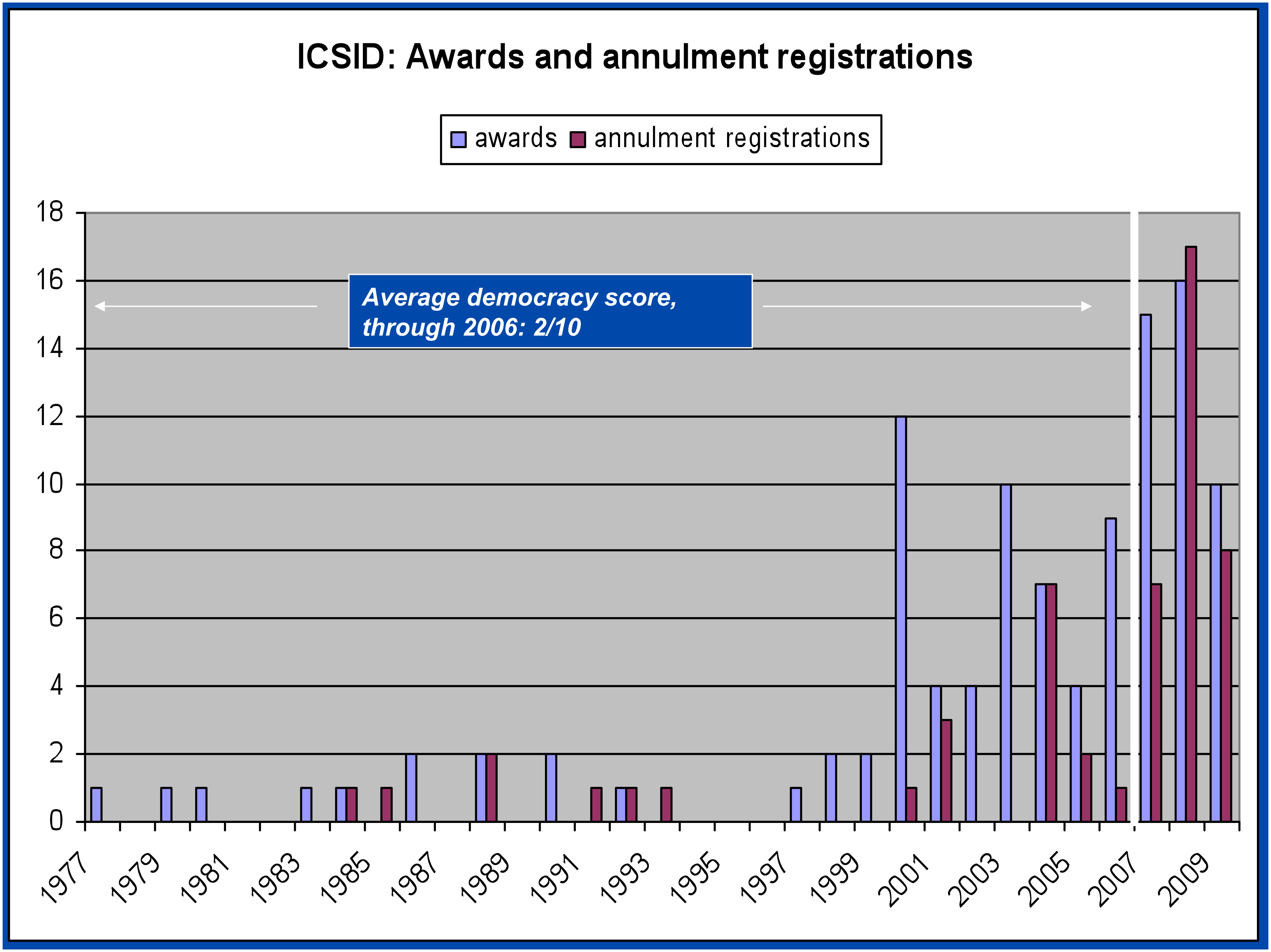
Argentina	8
Egypt	4
Chile	3
Ecuador	2
Malaysia	2
Peru	2
Cameroon	1
DRC	1
Gabon	1
Guinea	1
Guyana	1
Indonesia	1
Kazakhstan	1
Morocco	1
Philippines	1
Seychelles	1
United Arab Emirates	1





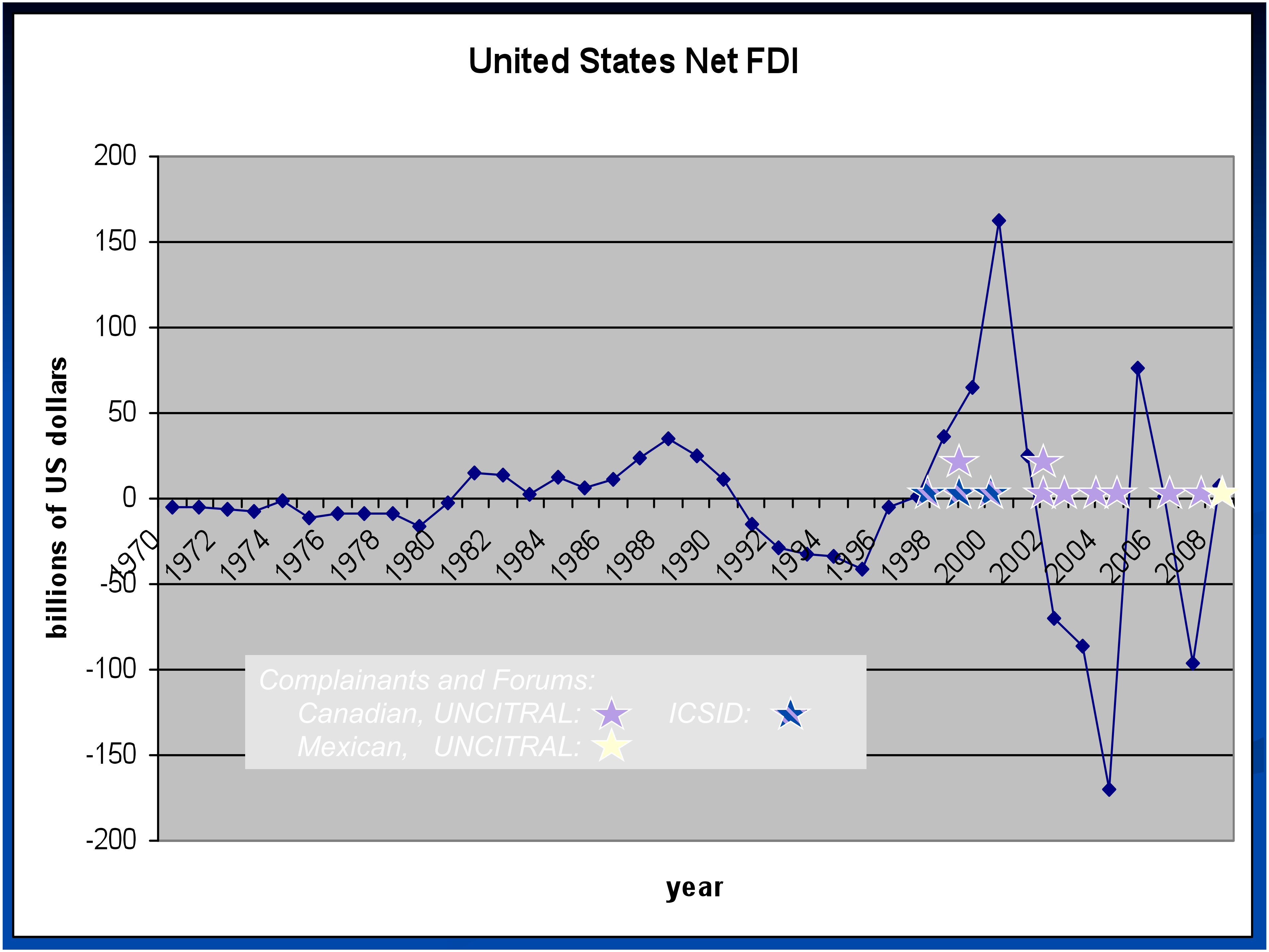
Sectors in which annulments have been sought…




ICSID: Awards and annulment registrations
awards
annulment registrations
Average democracy score, through 2006: 2/10
18
16
14
12
10
8
6
4
2
0
1977
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
2007
2009

Things to think about

- The model that BITs are freely accepted fully-informed contracts should be re-examined.
- Though not coerced, many developing countries entered these agreements under "stressful" conditions.
- Bargaining asymmetries have consequences:
  - Rapid BIT spread
  - Poor terms
  - Insufficient consideration of the risks
  - Systemically – result is an asymmetrical regime that gives investors much more than was "customary" and puts most of the risk of economic vulnerability on states.
- Many are questioning the payoffs (attracting more litigation than investment?)
- Fortunately, there are pressures for change…



United States Net FDI
200
150
100
50
0
-50
-100
-150
-200
billions of US dollars
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
year
Complainants and Forums:
Canadian, UNCITRAL:
ICSID:
Mexican, UNCITRAL:

Reasonable responses

- Reduce the asymmetries.
- Interpret contracts flexibly
- Allow for appeals.
- Rely more on an insurance regime than a litigation regime.