Filling the Void: International Legal Structures and Political Risk in Investment

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Abstract

This Article is broken into five sections. Part I defines political risk. Part II provides a brief review of the academic literature showing the work that has been done in this area of law. Part III argues that there have indeed been oscillations in the degree of political investment risk in the world and explains that investment risks rise when changes in the world power structure cause temporary power vacuums. Once new institutions emerge for the protection of investments, the level of risk declines. Part IV discusses the current trend, in which the world is witnessing the emergence of a new institutional design for the protection of investments: A network of international legal institutions, and bilateral and multilateral treaties. Part V revisits the literature, showing that the results of previous scholarly studies support the theory of this Article.
FILLING THE VOID: INTERNATIONAL LEGAL STRUCTURES AND POLITICAL RISK IN INVESTMENT

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INTRODUCTION

In 1690, John Locke wrote that in the absence of government, personal property rights are not well secured. The "great and chief end, therefore, of men's uniting into commonwealths, and putting themselves under government, is the preservation of their property." However, while a government can offer protection for property rights as between its own subjects, its ability to guarantee that property will be free from governmental interference is far more limited.

One example of the risk to property posed by governments appeared in The Guardian on Dec. 12, 2006:

Shell is being forced by the Russian government to hand over its controlling stake in the world's biggest liquefied gas project . . . . The Russian authorities are also threatening BP over alleged environmental violations on a Siberian field in what is seen as a wider attempt to seize back assets handed over to foreign companies when energy prices were low.

Many in the international community were skeptical of the purported environmental concerns, and wondered if these incidents signaled a broader policy shift toward expropriation of foreign investments. Dmitry Peskov, Russian President Vladimir Putin's spokesman, also stated that Russia wanted to encourage western investment and closer links with countries in Western Europe. However, this desire to increase foreign investment

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2. Id. § 124.
4. See id.
5. See id.
may be impaired if investors see these actions as expropriatory. On the other hand, too much deference to foreign investors may hamper implementation of domestic policies, such as environmental protection.

The degree of scholarly effort devoted to discovering how governments make decisions regarding the expropriation of foreign investments has varied over time. While many works were published in the 1930s, the 1970s, and over the past decade, the periods of research have been interspersed with periods of silence. Logically, we would expect that interest would be driven by the level of risk, and, while we do not have data from before the 1970s, this seems to be true from the 1970s until the early 1990s. This Article seeks to answer two questions: (1) does the level of political risk in the world oscillate; and (2) if so, what causes the oscillations?

This Article is broken into five sections. Part I defines political risk. Part II provides a brief review of the academic literature showing the work that has been done in this area of law. Part III argues that there have indeed been oscillations in the degree of political investment risk in the world and explains that investment risks rise when changes in the world power structure cause temporary power vacuums. Once new institutions emerge for the protection of investments, the level of risk declines. Part IV discusses the current trend, in which the world is witnessing the emergence of a new institutional design for the protection of investments: A network of international legal institutions, and bilateral and multilateral treaties. Part V revisits the literature, showing that the results of previous scholarly studies support the theory of this Article.

I. WHAT IS POLITICAL RISK?

Before we can accurately assess political risk, we must define it. Scholars, analysts, courts, and government agencies have struggled to agree on an exact definition of political risk or to determine when a government is responsible for losses caused by political sources. Almost any definition may be problematic be-

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7. See Llewellyn D. Howell, Defining and Operationalizing Political Risk, in POLITICAL
cause government involvement or acquiescence could be blamed for nearly any investment loss.

In this piece, I define political risk as those acts that adversely affect investments and for which the government of the host country is considered legally responsible under international law. To characterize legal responsibility, I reference U.S. takings laws, bilateral investment treaties, and other sources of international law. Using these laws to describe political risk has two benefits: (1) these definitions are highly developed; and (2) they have real world significance. International laws may actually shape the behavior of governments because of consequences specified in those laws.

U.S. laws regarding takings are important because international law has already borrowed heavily from U.S. law and this practice may be expected to continue. The Fifth Amendment of the U.S. Constitution states that the government will not deprive citizens of "life, liberty, or property, without due process of law" and that private property shall not "be taken for public use, without just compensation." Identifying a taking is straightforward where a government assumes physical possession and ousts a private owner. However, in Penn Central Transportation Co. v. New York City, the U.S. Supreme Court stated that a taking need not include actual physical invasion of the property, but could also arise from economic regulation.\(^8\) The Court noted that compensation cannot be awarded for every taking, such as those done through taxes or routine regulation, since this would disrupt proper government functions.\(^9\) Important considerations include whether there has been a physical invasion of the property, the impact on the property owner, and the impact on investor expectations.\(^10\)

From this foundation, there has been substantial legal cross-fertilization. Often times, investors contractually specify that U.S. law will govern in the case of a dispute. In addition, tribunals may apply U.S. law because they are most familiar with it. For example, the Iran-United States Claims Tribunal (the "Tri-

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8. U.S. Const. amend. V.
10. See id.
11. See id.
bunal") has used definitions of expropriation substantially borrowed from U.S. Takings Clause jurisprudence.\textsuperscript{12}

A. Types of Takings Risks That Are Generally Protected Under International Law

In the international legal framework, the U.S. Model Bilateral Investment Treaty ("U.S. Model BIT") probably contains the most well developed rules regarding takings. It seeks to protect investors against expropriation, creeping expropriation, currency inconvertibility, and discriminatory property protection.\textsuperscript{13} The U.S. Model BIT allows expropriation only if it is: (1) for a public purpose; (2) done in a non-discriminatory manner; (3) promptly, adequately, and effectively compensated at the fair market price as of the date of expropriation, and the compensation includes the interest that would have been earned on the money since expropriation; and (4) done with due process of law.\textsuperscript{14}

Expropriations form a substantial portion of the takings that occur. There are several types of expropriations distinguished by subtle differences. Nationalization is the taking of all foreign investment or all foreign investment in certain industries, usually as part of a social or economic reform program.\textsuperscript{15} Confiscation is the taking of property without compensation.\textsuperscript{16} Creeping expropriation occurs when a government takes action with the intent to erode the investment's value, perhaps by imposing regulations that raise operating costs, increase tax burdens, require the slow transfer of ownership to a local counterpart, or require government appointment of managers.\textsuperscript{17} Eventually, these actions cause the investment to become unprofitable and the investor may sell the property, often at a heavy discount, to the government.\textsuperscript{18}  

\begin{itemize}
\item \textsuperscript{14} See id.
\item \textsuperscript{15} See PAUL E. COMEAUX & N. STEPHAN KINSELLA, PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW: LEGAL ASPECTS OF POLITICAL RISK 6 (1997).
\item \textsuperscript{16} See id. at 7.
\item \textsuperscript{17} See id. at 8-9.
\item \textsuperscript{18} See id.
\end{itemize}
Inability to access the cash proceeds generated by an investment is another common form of taking. The most common type of problem in this category is inconvertibility. The U.S. Model BIT states: "Each Party shall permit transfers relating to a covered investment to be made freely and without delay into and out of its territory." These transfers include contributions to capital, profits, dividends, proceeds from whole or partial sale of the investment, interest, royalty payments, management fees, technical assistance fees, payments made under contracts, payments on loans, payments made by the government as compensation for expropriation, and payments in compensation for disputes. Transfers must be allowed to occur in a freely exchangeable currency. However, the U.S. Model BIT allows countries to prevent transfers when done to assist law enforcement in civil awards and criminal penalties. A less typical example of interference with the cash proceeds of an investment occurred in Harza Engineering Co. v. Islamic Republic of Iran. There, the Iran-United States Claims Tribunal found that a taking occurred because of the government's unreasonable interference with the use of a bank account.

Takings also occur when governments fail to provide adequate property protection. The U.S. Model BIT states: "Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security." It defines full protection and security as the "level of police protection customary under international law." Variations in the level of police protection in different countries do not necessarily indicate variations in the level of political risk. However, if police systematically fail to protect foreign-owned facilities, such inaction

19. U.S. Model BIT, supra note 13, art. 7.
20. Id.
21. Id.
22. Id.
25. U.S. Model BIT, supra note 13, art. 5.
26. Id.
might indicate a policy of discrimination against foreign investors.

Property may also face inadequate protection in dispute resolution processes. The U.S. Model BIT requirement that investors receive "fair and equitable treatment" from host state governments includes access to judicial process.\textsuperscript{27} If we find that foreign investors are unable to access fair and enforceable dispute resolution, and especially if they face discrimination in the domestic courts, then these investors face a political risk.

Having set out the basic definition of a taking in international law, it is now important to explore the ambiguities. There are two potential sources of ambiguity in determining whether the government has taken property. First, is the government the relevant actor? Second, was there a true "taking" or merely permissible regulation?

1. The Government as Relevant Actor

There can be no governmental taking where the government is not responsible for the taking.\textsuperscript{28} Therefore, the takers must be governmental authorities or agents of the government.\textsuperscript{29} The Tribunal in \textit{Sea-Land Service, Inc. v. Islamic Republic of Iran} found that the government was legally responsible for losses only if "there was deliberate governmental interference . . . the effect of which was to deprive Sea-Land of the use and benefit of the investment."\textsuperscript{30} In \textit{Schering Corp. v. Islamic Republic of Iran}, Schering alleged that a taking had occurred when the Islamic Worker's Council forced a local manager to sign an agreement giving the workers a veto power over all payments the subsidiary made.\textsuperscript{31} However, the Tribunal found that the Islamic Worker's Council was not acting pursuant to any governmental order; therefore, the government was not responsible.\textsuperscript{32}

Questions regarding government responsibility tend to arise most often in the context of inadequate or discriminatory prop-

\textsuperscript{27} \textit{Id.}
\textsuperscript{28} See Aldrich, \textit{supra} note 24, at 598-99.
\textsuperscript{29} \textit{Id.}
\textsuperscript{30} \textit{Sea Land Serv. Inc. v. Islamic Republic of Iran}, 6 Iran-U.S. Cl. Trib. Rep. 149, 166 (1984); see also \textit{COMEAX & KINSELLA, supra} note 15, at 16.
\textsuperscript{31} \textit{See Schering Corp. v. Islamic Republic of Iran}, 5 Iran-U.S. Cl. Trib. Rep. 361, 362-63 (1984); \textit{see also} Aldrich, \textit{supra} note 24, at 602.
\textsuperscript{32} \textit{Schering}, 5 Iran-U.S. Cl. Trib. Rep. at 368.
erty protection. For example, in Autopista Concesionada de Venezuela v. Bolivarian Republic of Venezuela, Autopista built a highway and had an agreement with the government that it would recoup the costs through tolls.\(^3\) However, after the highway was built, motorists refused to pay and drove through the tolls.\(^3\) Because the National Guard stood back and refused to intervene, the International Centre for Settlement of Investment Disputes ("IC-\(\text{SID}\)") arbitral tribunal found that the government of Venezuela was liable for the losses because of discriminatory property protection.\(^\text{35}\)

With respect to political violence, some losses are considered to be government caused and others not. In addition, there can be confusion because political insurance corporations, such as the Overseas Private Investment Corporation ("OPIC"), routinely include civil war, rebellion, rioting, terrorism, and any other politically motivated violence that causes damage to facilities, injures employees, or causes interruption in the production and sale of goods.\(^\text{36}\) However, when losses from politically motivated violence are not caused by the government, there is generally no right to compensation under international law.\(^\text{37}\) For example, a U.S. company owned and operated a rubber plantation in Liberia. A civil war ensued in Liberia and rebels took control of the plantation and destroyed it.\(^\text{38}\) Since the investor was OPIC-insured, it was compensated even though the loss was not caused by the government.\(^\text{39}\)

However, there are other circumstances in which a government might be legally responsible for the political violence of non-governmental actors. In American Manufacturing and Trading, Inc. v. Republic of Zaire, the company alleged that its facilities in Kinshasa had been looted on two occasions and that the government had failed to provide the protection required under


\(^34\) Id.

\(^35\) Id.


\(^39\) See id.
the bilateral investment treaty ("BIT"). The tribunal found that the government had violated the minimum standard of treatment because of its inadequate protection.

2. Expropriation vs. Permissible Regulation

As in U.S. law, the line between permissible regulation and expropriation is difficult to draw. Courts and tribunals are very reluctant to find that regulations constitute expropriations because this would severely limit the rights of a sovereign to exercise its ordinary police powers. Any inquiry is also likely to cease if it appears that the regulation is non-discriminatory. However, even this inquiry is very cursory since it could require the tribunal to analyze the motives of the state in enacting the legislation, which can be difficult to discern and may also be seen as a lack of respect for a state's sovereignty.

Tribunals tend to have no difficulty finding expropriations in those cases where the government passed a law explicitly transferring ownership from foreign owned enterprises. For example, the Iranian government passed a law in 1979 that nationalized all insurance companies. Another clear example of a direct expropriation is the Cuban government's legal action in 1960 to take the property of U.S. nationals. The law read:

In pursuance of the powers vested in us, in accordance with the provisions of Law No. 851, of July 6, 1960, we hereby, RESOLVE:

FIRST: To order the nationalization, through compulsory expropriation, and, therefore, the adjudication in fee simple to the Cuban State, of all the property and enterprises located in the national territory, and the rights and interests resulting from the exploitation of such property and enterprises, owned by the juridical persons who are nationals of the United States of North America, or operators of enterprises
in which nationals of said country have a predominating interest, as listed below.47

Creeping expropriations can be more difficult to identify, but heavy interference with the management of a business tends to be construed as expropriatory. For example, in Starrett Housing Corp. v. Islamic Republic of Iran, the Claims Tribunal decided that the temporary appointment of Iranian managers had interfered with the claimant's ownership rights to such an extent that the rights had lost substantially all value.48 In addition, in Tippetts v. TAMS-AFFA Consulting Engineers of Iran, the Tribunal found that a taking had occurred primarily due to the actions of the government-appointed manager, rather than the appointment itself.49 There, the manager refused to respond to communications from the Tippets headquarters.50 The Tribunal stated:

While the assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation was not merely ephemeral. The intent of the government is less important than the effects of the measure on the owner, and the form of the measures of control or interference is less important than the reality of their impact.51

Where creeping expropriation is done through regulations, the regulations may appear to be ordinary exercises of a state's police power to promote the health, safety, and well-being of its citizens.52 The U.S. Model BIT recognizes that regulations may sometimes be improperly regarded as expropriations when they are actually legitimate exercises of a state's police powers. To encourage the protection of certain interests that might be considered especially sensitive, it designates areas of law in which

49. See Tipetts v. TAMS-AFFA Consulting Eng'rs of Iran, 6 Iran-U.S. Cl. Trib. Rep. 219, 226 (1986); Aldrich, supra note 24, at 589.
50. See Tipetts, 6 Iran-U.S. Cl. Trib. Rep. at 226.
51. Id. at 225-26.
52. See Parisi, supra note 42, at 388-90.
sovereign regulation should receive special deference. These include environmental laws, labor laws, national security, and regulation of the financial services industry.\textsuperscript{53}

However, even exercises of police powers in these areas may not be upheld if they appear to be post-hoc justification for expropriation. For example, in \textit{Metalclad Corp. v. United Mexican States}, Metalclad began construction of a waste disposal facility after receiving assurances from the governor and other state officials that all of the permits were in order and the site was suitable for hazardous waste disposal.\textsuperscript{54} Metalclad completed construction in 1995; however, demonstrators protested the opening of the facility and Mexican troops blocked access to it, preventing it from opening.\textsuperscript{55} The government then sought several additional concessions to which Metalclad agreed, including designation of thirty-four hectares of Metalclad’s site for protection of certain species, Metalclad’s contribution of two new pesos per ton of waste toward local social works, a ten percent discount for waste disposal from that state, and provision of free medical care for local inhabitants for one day per week.\textsuperscript{56} After operating for thirteen months, the local municipal authority told Metalclad it needed a permit from the municipality to continue operations, and the municipality refused to grant such a permit.\textsuperscript{57} The state governor also issued an Ecological Decree, designating the area of the landfill as an ecological preserve for rare cacti.\textsuperscript{58}

The tribunal found that the state’s actions were clearly not based on environmental concerns, but were motivated by political factors.\textsuperscript{59} Furthermore, the Mexican authorities had not followed Mexican law and procedures when refusing to allow continued operations. The tribunal determined that refusing a per-

\textsuperscript{53} U.S. Model BIT, \textit{supra} note 13, arts. 12, 13, 18, 20.
\textsuperscript{54} \textit{See} Metalclad Corp. \textit{v. United Mexican States}, Award, ICSID Case No. ARB(AF)/97/1 (Aug. 30, 2000), 16 \textsc{ICSID Rev.-Foreign Invest. L.J.} 168, 179-81 (2001).
\textsuperscript{55} \textit{See id.} at 182.
\textsuperscript{56} \textit{See id.}
\textsuperscript{57} \textit{See id.} at 183.
\textsuperscript{58} \textit{See id.} at 189. When Metalclad initiated proceedings pursuant to NAFTA, Mexico agreed that it was responsible for any illegal actions of the state and local governments under the state responsibility rule of the International Law Commission of the United Nations in 1975. \textit{Id.} at 189.
\textsuperscript{59} \textit{See Metalclad Corp.}, 16 \textsc{ICSID Rev. Foreign Invest. L.J.} at 190.
mit for environmental reasons was a subject matter beyond the jurisdiction of the municipality. Furthermore, the denial of the permit was done at a Municipal Town Council meeting of which Metalclad had not been given notice or an opportunity to appear. Because of these circumstances, the tribunal did not defer to the state's right to regulate, even though the regulations pertained to the environment, which is widely regarded as a sensitive area.

B. Other Definitions

While I use the legal takings definitions, the reader should be aware that there is no consensus on the definition and that other scholars and entities have defined political risk differently. The government agency, OPIC, defines political risk as loss resulting from political violence, expropriation, or currency inconvertibility. The Political Risk Services and International Country Risk Guide ("ICRG"), defines political risk as the risk of property loss from government acts, and provides a list of political risk components that it believes may contribute to inconvertibility, expropriation, civil strife, and negative government actions.

Political risk is also defined in many ways in the scholarly literature. Fitzpatrick divides the literature into four categories. The first category defines political risk as the risk of government interference. The second category defines it in terms of occurrences of political events and acts, including political violence, even if not caused by the government. The third category analyzes risk in terms of the overall political environment. The fourth category considers political risk to be a generalized country risk. Some scholars define political risk as risk from political sources exclusive of commercial risks. Other scholars divide risk into macroeconomic risk, which affects all economic

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60. See id. at 192.
61. See id. at 193.
63. Howell, supra note 7, at 14.
65. See id.
66. See id. at 250.
67. See id.
68. See, e.g., D.A. Jodice, Trends in Political Risk Assessment: Prospects for the Future, in
actors in the economy, and microeconomic risk, which affects only particular actors or industries.69

Although others have defined political risk differently, I believe that there are important advantages in using legal definitions from U.S. and international law. These include: (1) governments are held accountable only for the choices they make and not the independent actions of third parties; and (2) international law itself may deter governments from engaging in the proscribed acts.

II. QUESTIONS DISCUSSED IN THE EXISTING LITERATURE

This Section summarizes the research that has been done on political risk thus far, demonstrating that there is a gap in the literature regarding how forces external to host countries affect risk. Some scholars have focused on the effects of political risk. Some have analyzed host country incentives. Finally, some have studied policy instability at levels short of a taking. Authors in business schools have been fascinated by political risk. They have shown that political risk increases interest rates,70 that bad political news affects exchange rates more than good news,71 that risk increases currency fluctuations,72 depresses stock premiums,73 often increases necessary project returns,74 and stimulates capital flight,75 even from the home country.76

Authors have also discussed methods of mitigating political risk. Boyacigiller discusses the "right" proportion of expatriate

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70. See Michael P. Dooley & Peter Isard, Capital Controls, Political Risk, and Interest Rate Parity, 88 J. Pol. Econ. 370, 370 (1980).
75. See Robert Lensink et. al., Capital Flight and Political Risk, 19 J. Int'l Money and Fin. 73, 73 (2000).
managers in a host country based on cultural distances and personal risk to managers.77 Burgman,78 Cosset & Suret,79 and Butler & Joaquin80 suggest using cross-national diversification to smooth political risks, reduce overall portfolio risk, reduce earnings volatility, and reduce bankruptcy risk because cross-national investment risks show greater orthogonality than domestic investment risks.

Authors have proposed various means for measuring political risks. Bunn & Mustafaoglu propose constructing a measure to track political events by looking back through newspapers to see what circumstances preceded them, and predicting future events based on the frequency of the precursors.81 Amariuta, Rutenberg, & Staelin surveyed international Vice Presidents of firms randomly chosen from Standard and Poor's index regarding Eastern European political risks.82 Similarly, Chevalier & Hirsch sent surveys to the 750 largest firms on the Fortune 500.83 Stephen Kobrin discusses methods of surveying experts, such as the Delphi method, in which experts voice opinions, read the opinions of other anonymous respondents, and modify their opinions until a consensus is reached.84

With respect to the causes of political risk, the early scholarly research on expropriation consisted of case studies on expropriations in Mexico, Cuba, and Eastern Europe.85 Kobrin86 and Minor87 performed more extensive analysis using cross-na-

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80. See Butler & Joaquin, supra note 74, at 599.
86. See Stephen J. Kobrin, Foreign Enterprise and Forced Divestment in LDCs, 34 INT'L ORG. 65, 69 (1980).
87. See Minor, supra note 6, at 184.
tional data, and concluded that before about 1960, most forced divestments were associated with massive upheaval and governmental changes. Gordon\textsuperscript{88} and Kobrin\textsuperscript{89} explain that during this early period, governments were motivated by considerations of national sovereignty.

However, after 1960, expropriations became more targeted, and, on average, mass expropriations accounted for only a small minority of cases.\textsuperscript{90} To explain the expropriations in the later period, Kobrin, Jodice, and Eaton & Gersovitz argue that a government, in an effort to gain control over major economic activity within its borders, will weigh the relative benefits of expropriation versus regulation.\textsuperscript{91} Over time, the value of a given investment will decline because of factors such as the age of the technology used.\textsuperscript{92} Simultaneously, the government may realize that it cannot effectively control the enterprise through regulation.\textsuperscript{93} In some cases, no amount of regulation will achieve the government’s objective because the industry has strategic significance and must be totally controlled, not merely regulated. National control may also be essential in industries that are essential to the economy. For example, if extractive industries dominate an economy, foreign control could pose a security risk.\textsuperscript{94}

Jodice and Ramamurti discuss the effect of colonial history on expropriation. Contrary to his expectations regarding the effect of national sovereignty, Jodice found that expropriations were less common where the home country was a country that had previously controlled the host country, such as through colonization.\textsuperscript{95} Ramamurti writes that as least developed countries (“LDCs”) became more confident in their independence, multinational corporations (“MNCs”) may have seemed to pose less of a threat to sovereignty.\textsuperscript{96} This was particularly true as LDCs

\textsuperscript{88} See Gordon, supra note 85, at 4.
\textsuperscript{89} See Kobrin, supra note 86, at 69.
\textsuperscript{90} See id.
\textsuperscript{91} See Jonathan Eaton & Mark Gersovitz, A Theory of Expropriation and Deviations From Perfect Capital Mobility, 94 ECON. J. 16, 39 (1984); David A. Jodice, Sources of Change in Third World Regimes for Foreign Direct Investment, 1968-1976, 34 INT’L ORG. 177, 185 (1980); Kobrin, supra note 86, at 69-70.
\textsuperscript{92} See Kobrin, supra note 86, at 70.
\textsuperscript{93} See id.
\textsuperscript{94} See, e.g., id.
\textsuperscript{95} See Jodice, supra note 91, at 185 (1980).
diversified their investments from home countries and developed their own local private sectors.\textsuperscript{97}

Jodice writes about the short term payoffs governments would receive by either expropriating or not expropriating in both economic and political terms. From the economic perspective, he found that a decline in the growth rate of the economy makes expropriation more likely because of the increased need for cash infusion.\textsuperscript{98} In addition, in industries with high profits there is more temptation to expropriate.\textsuperscript{99} From a political perspective, Jodice found that increases in the amount of internal protest, political unrest, and resentment of foreign corporations are positively correlated with expropriation.\textsuperscript{100}

Ramamurti argues that countries are less likely to expropriate when they are heavily dependent on foreign aid.\textsuperscript{101} LDCs may also have become more needful of foreign direct investment ("FDI") because of the fall in aid from the United States. Aid as a share of capital flows from developed to developing countries fell during the 1980 to 1990 period by over twenty percent.\textsuperscript{102} This led to an overall fall in capital flows.\textsuperscript{103} Commercial bank lending fell during the 1980s because of the banking crisis.\textsuperscript{104}

Ramamurti and Wells & Wint focus on the effects of overall economic policy on expropriation, suggesting that changes in LDC policy away from import-substitution to a more open-market strategy explain the decline in mass expropriations.\textsuperscript{105} During the 1988-1993 period, 43.4\% of the FDI that flowed to transition economies was linked to privatization efforts.\textsuperscript{106} With FDI comprising a much larger share of capital inflows, developing countries entered into a large number of bilateral investment treaties, which they hoped would raise the amount of FDI flowing to them. At the multilateral level, increased FDI access was

\textsuperscript{97} See id.
\textsuperscript{98} See Jodice, supra note 91, at 199.
\textsuperscript{99} See id. at 201.
\textsuperscript{100} See id. at 203.
\textsuperscript{101} See Ramamurti, supra note 96, at 30.
\textsuperscript{102} See id.
\textsuperscript{103} See id.
\textsuperscript{104} See id.
\textsuperscript{105} See id. at 27; see also LOUIS T. WELLS, JR. & ALVIN G. WINT, FOREIGN INV. ADVISORY SERV., MARKETING A COUNTRY: PROMOTION AS A TOOL FOR ATTRACTING FOREIGN DIRECT INVESTMENT I (Occasional Paper No. 20357) (2000).
\textsuperscript{106} See Ramamurti, supra note 96, at 32.
exchanged by developing countries for bail-out money following banking and currency crises.\textsuperscript{107}

Kobrin,\textsuperscript{108} Jodice,\textsuperscript{109} and Minor\textsuperscript{110} noted a marked decline in expropriations after about 1980. In addition, Minor noted that the trend appeared to be reversing as governments privatized industries in the early 1990s that had previously been government run.\textsuperscript{111}

A different branch of literature has focused on explaining policy changes of a more minor nature. This literature is important because of the well recognized ambiguity between permissible regulation and creeping expropriation. Since it can be difficult to distinguish the two, much of the literature regarding regulatory stability is likely to be relevant to the political risk discussion.

One of the most important arguments explaining minor policy changes is that governments manipulate the economy prior to elections in order to increase the chances of winning for the incumbents. This theory was developed by Nordhaus,\textsuperscript{112} Cukierman & Meltzer,\textsuperscript{113} Rogoff & Silbert,\textsuperscript{114} and Rogoff,\textsuperscript{115} with mixed results. Alesina, Cohen, & Roubini find evidence of looser economic and monetary policies before elections but their results do not show corresponding actual economic effects.\textsuperscript{116} Shultz argues that the political business cycle is affected by the current needs of the party in power.\textsuperscript{117} Where that party is relatively certain to remain in power, it is less likely to attempt

\textsuperscript{107} See id. at 31.
\textsuperscript{108} See Kobrin, supra note 86, at 65.
\textsuperscript{109} See Jodice, supra note 91, at 177.
\textsuperscript{110} See Minor, supra note 6, at 184.
\textsuperscript{111} See id.
\textsuperscript{114} See Kenneth Rogoff & Anne Silbert, Elections and Macroeconomic Policy Cycles, 55 REV. OF ECON. STUD. 1, 1 (1988).
\textsuperscript{115} See Kenneth Rogoff, Equilibrium Political Budget Cycles, 80 AM. ECON. REV. 21, 21 (1990).
economic manipulations that it may have to pay for later.\textsuperscript{118} Regardless of whether the attempted economic manipulations actually result in economic benefit, the important result for the purposes of this study is that governments make these attempts. It is not relevant to investors whether their investments are beneficial to the economy once taken, only that the investments are taken. However, the effect on investments before elections is unclear since two effects may occur in opposite directions. It is possible that a government would increase adverse actions against foreign investors in order to give itself more wealth to disperse before an election. However, it is also possible that governments would be especially conservative because massive takings before an election could cause capital flight from the country.

Other scholars focus on the ability of governments to change policies due to their institutional structures. Mulas-Granados writes about the ideological composition of a government in determining fiscal policy adjustments.\textsuperscript{119} Perotti & Kontopoulos argue that a higher number of parties in government causes higher budget deficits.\textsuperscript{120} Sundquist and Fiorina argue that divided government produces less significant legislation.\textsuperscript{121} Tsebelis proposes the veto players theory which hypothesizes that policy stability is positively related to the number of players whose approval is necessary to effect change, the magnitude of policy preference differences among these players, and the internal cohesion of each player.\textsuperscript{122}

While governments could attempt to increase policy stability by changing their institutional structures, they are often reluctant to do so. Clark & Hallerberg argue that incumbents are reluctant to tie their own hands with tools such as central bank independence and will structure changes in institutions that are

\begin{itemize}
\item \textsuperscript{118} See id.
\item \textsuperscript{120} See Roberto Perotti & Yianos Kontopoulos, \textit{Fragmented Fiscal Policy}, 86 J. PUB. ECON. 191, 192 (2002).
\end{itemize}
merely illusory.\textsuperscript{123} Keefer and Stasavage note the reluctance of countries to change their institutional structures to make the bureaucracy and courts more independent since that imposes a future constraint on the government.\textsuperscript{124}

While not focusing specifically on expropriation or other political risks for which governments are legally considered liable, scholars have discussed how policy changes affect international investment. North & Thomas argue that institutions were crucial in post-war Europe for encouraging investment by making it more difficult for governments to take actions adverse to international investors.\textsuperscript{125} MacIntyre applies veto player theory to qualitatively study four East Asian economies, arguing that while there is a risk of policy volatility when there are few veto players, investors may also suffer a risk of policy rigidity when governments are unable to respond to crises.\textsuperscript{126}

III. \textit{POLITICAL RISK LEVELS VARY WITH WORLD POWER STRUCTURES}

While the literature regarding country-specific political risks is fairly well developed, the literature regarding world system risks is not. This Section argues that the history of political risk in investment indicates that risk levels tend to change in several countries at once because of shifts in world power. For example, when a foreign state has been exerting influence on several countries at once, and then withdraws from all of them, the investment environment will become unstable. In the power vacuum, investment losses will rise.

In a Hobbesian world, people form and submit to governments to provide and enforce law that will protect their lives and property. Hobbes writes that men need “a common power to keep them all in awe” or else they will remain in a condition of war.\textsuperscript{127} To avoid war, he writes that men must keep their cove-

\begin{itemize}
  \item \textsuperscript{125} See Douglass C. North & Robert Paul Thomas, \textit{The Rise of the Western World: A New Economic History} 155 (1973).
  \item \textsuperscript{126} See Andrew MacIntyre, \textit{Institutions and Investors: The Politics of the Economic Crisis in Southeast Asia}, 55 \textit{Int'l Org.}, 81, 81 (2001).
  \item \textsuperscript{127} Thomas Hobbes, \textit{Leviathan} 76 (George Rutledge & Sons 1886) (1651).
\end{itemize}
nants. However, he recognizes that this is not feasible without a common power to ensure that the punishment for breaking a covenant exceeds the benefit of breaking that covenant.\textsuperscript{128}

In international investment, there is no common power to preserve a general state of peace and provide ultimate assurance that agreements will be honored. However, the situation in which there is no force with which to enforce agreements is not sustainable. Kant wrote, “It is the spirit of commerce which cannot co-exist with a state of war, and which sooner or later masters each nation.”\textsuperscript{129} It is this unsustainability that causes people in the Hobbesian world to form governments.

This Section shows that investors have sometimes overcome the absence of a common power by developing systems of law and, at times, administering that system without the benefit of sovereign enforcement. However, because of the additional enforcement abilities that sovereigns possess, investors often seek sovereign recourse. This Section traces the history of investment protection, showing how international forces have exerted influence on host countries and, at times, controlled them in order to protect foreign investors.

The discussion begins with the law merchant system that first arose during the medieval period, lasting from the eleventh to the sixteenth centuries.\textsuperscript{130} The system then waned from the seventeenth to the nineteenth centuries because home countries engaged in colonial protection of investments.\textsuperscript{131} However, when world wars crippled Europe, European countries could no longer control their colonies. In the post-colonial world, investors again faced political risks for which their home state sovereigns were not able or not willing to intervene. Investors began developing new methods of filling these gaps by developing international arbitral institutions. After the Soviet Union lost its grip on much of Eastern Europe, political risk increased yet again, and efforts to create international institutions to aid in

\textsuperscript{128} See id. at 82.


\textsuperscript{131} See id. at 104.
the protection of investments accelerated. During the period of
the 1990s, there was rapid proliferation of bilateral investment
treaties, treaties to foster international arbitration, and domestic
laws to encourage foreign direct investment. Therefore, the cur-
rent force exerting external control on host countries is a net-
work of legal rules and home country mechanisms for enforcing
those rules.

A. The Medieval Law Merchant

The first power vacuum examined herein occurred with the
decline of the Roman empire in the period before the creation
of the modern nation-state with the Peace of Westphalia. The
medieval law merchant arose during the period of Roman impe-
rial decline. The modern era of nation-states created by the
Peace of Westphalia in 1648 was yet to commence. Shipping had
developed significantly and merchants were coming together
from different places, forming business relationships with re-
peated transactions. Through these repeated transactions with
merchants from all over Europe, common understandings of
business formed and became custom. Although the primary threats to merchant property at this
time stemmed from other merchants instead of governments,
the complete lack of property protection and access to justice
would probably violate the U.S. Model BIT Article 5 require-
ments of “full protection and security” and “fair and equitable
treatment.” From a theoretical perspective, Frieden has ar-

133. See Kerr, supra note 130, at 350.
134. U.S. Model BIT, supra note 13, art. 5.
135. See Jeffry A. Frieden, International Investment and Colonial Control: A New Inter-
pretation, 48 Int'l Org. 559, 564 (1994).
136. See Kerr, supra note 130, at 356.
merchants trading within the merchant guilds and fairs that were not otherwise available.\(^{137}\) Even in England, where common law courts were available, merchants were allowed to pursue remedies through the law merchant because these additional remedies encouraged trade.\(^{138}\) In fact, merchants often preferred the law merchant because the provision of justice was much faster, enabling them to make their trades and be on their way to the next port.\(^{139}\)

The law merchant's ruling would ordinarily instruct one party to pay damages to another. In a few jurisdictions, governments gave the law merchant authority to impose penalties such as fines.\(^{140}\) However, in most jurisdictions, the law merchant had no way to compel the parties to comply with the ruling. Instead, if a party failed to comply, the penalty was a loss of reputation.\(^{141}\) Other merchants would not trade with that merchant, resulting in market exclusion, and potentially, bankruptcy.\(^{142}\)

The law merchant did not have unlimited authority, but could often impose a sufficient penalty to gain compliance. By providing a supervised forum, the law merchant turned individual transactions into long term business relationships.\(^{143}\) This is quite analogous to the single transaction versus repeated prisoner's dilemma game. For example, in a single transaction, a grain seller and purchaser get no benefit if they do not choose to trade with one another. They both benefit if they both perform as agreed. However, if the purchaser pays in counterfeit money, the seller is worse off than if they had never made a deal. In addition, if the seller's goods are spoiled, the purchaser is worse off than if they had never made a deal. If they know that they will never see one another again, and if neither will know whether the other has transacted honestly until it is too late, they are each better off cheating one another. Since each dealer un-

\(^{137}\) See Cutler, supra note 130, at 138.

\(^{138}\) See Francis M. Burdick, What is the Law Merchant?, 2 Colum. L. Rev. 470, 472 (1902).

\(^{139}\) See id.

\(^{140}\) See Keit, supra note 130, at 364.


\(^{142}\) See Cutler, supra note 130, at 104.

derstands these incentives, they will decide not to make a deal in the first place. If they could find a way to enforce the deal, then they could transact, making them each better off.

In most cases, the repeated prisoner’s dilemma solves this problem by allowing the dealers to engage in a series of transactions. By bargaining and performing under the shadow of the future, the traders are often, but not always, better off performing honestly.\textsuperscript{144} If they do not perform honestly, the other trader may refuse to make future deals, which is a consequence of cheating that is costly for both parties.

The law merchant gave merchants a place to trade in which everyone knew the reputation of everyone else. Ostracism by other merchants meant that a merchant could no longer get the benefits of trade if he cheated others. If the merchant dealt honestly with others, he would expect to receive a benefit in subsequent transactions. However, if he cheated, his expected return would be high in the current round and very low in subsequent rounds.\textsuperscript{145}

In this way, the law merchant system fostered the development of laws with international application where no sovereign was necessary and, oftentimes, no sovereign was available. However, with the creation of the system of sovereign states in the Peace of Westphalia, the enforceability of contracts was no longer totally dependent on repeated transactions, and merchants came to prefer sovereign justice, discontinuing the law merchant fairs.

B. The Rise of the Nation-State as Enforcer of International Contracts

The Peace of Westphalia of 1648 created the modern system of nation-states as the highest political authorities in the world.\textsuperscript{146} From the seventeenth to the nineteenth centuries, the nation-states of Europe adopted the merchant laws into codes and common law decisions, which came to be regarded as the only definitive sources of law.\textsuperscript{147} The nation-state also became an accepted, if not preferred, method of ensuring justice in commerce. Investors increasingly expected host country govern-

\begin{thebibliography}{100}
\bibitem{144} See id.
\bibitem{145} See id.
\bibitem{146} See generally Gross, \textit{supra} note 132, at 20.
\bibitem{147} See \textit{Cutler}, \textit{supra} note 130, at 147-48.
\end{thebibliography}
ments to provide a measure of protection. If host country governments would not do so, then investors might turn to their home country governments.

Samuel Pufendorf, writing in the year 1673, stated that it would be just for people to go to war to preserve their property. The European nation-states turned to colonialism to protect citizens who invested abroad. By taking control of the host country, the colonizers eliminated the inter-jurisdictional nature of the investment contracts. The benefit to investors is shown by the fact that investors tended to receive higher returns on investments made in colonies belonging to their home countries. Consequently, they tended to invest more in colonies controlled by their home countries. Where they did invest in colonies of other powers, the investments tended to be in industries such as manufacturing which were more difficult to expropriate than primary production industries.

European control of colonies in the Western Hemisphere ended as colonies declared independence and culminated in 1823 when the United States announced the Monroe Doctrine, whose purpose was to permanently end colonization in the Western Hemisphere. The United States, a relatively small and weak state, was opposed to European powers reestablishing themselves on its doorstep. This placed the European and Latin American states in a Hobbesian state of war that was not sustainable. With no alternative to the use of military force, the Monroe Doctrine was only a guarantee of Latin American sovereignty while the United States was willing and able to provide such a guarantee. However, the United States was not able to provide this guarantee during its civil war. During this time, with no one to stop them, the French used military control to enforce...


150. See id. at 564.

151. See id. at 575.

152. See id.

153. See id.


155. See id.
the claims of French citizens against the Mexican government.156

After Mexico reestablished its independence, Mexico and other Latin American states sought to deter such military actions by adopting the Calvo Doctrine, which sought to prohibit foreign investors from seeking diplomatic aid from their home countries.157 Instead, investors would be confined to using remedies available to domestic investors.158 However, the European powers were not always deterred by such policy pronouncements, using military pressure to secure payments on public debt in Venezuela in 1902,159 and threatening intervention in Haiti and the Dominican Republic in 1915.160

Recognizing that this Hobbesian state of war was not sustainable, the United States decided that the Monroe Doctrine was not tenable as it stood. European investors demanded some enforcement of their property rights, and, if the United States did not want European militaries to enforce them, the United States would have to provide enforcement.161 This prompted the announcement by the United States of the Roosevelt Corollary to the Monroe Doctrine. It stated that the United States would intervene in Latin American affairs when Latin American governments failed to keep order and pay their obligations, particularly if such deficiencies were chronic.162 As a consequence, in 1916, the United States intervened in the Dominican Republic, setting up a pro-American dictatorship to maintain stability and protect foreign investment interests.163

However, as the fighting of World War I consumed Europe, the Roosevelt Corollary became unnecessary as a deterrent to European aggression. With Europe significantly weakened, the United States no longer needed the Roosevelt Corollary to keep

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158. See id.
161. See id.
162. See generally Samuel Flagg Bemis, Latin American Policy of the U.S. 157-166 (1943); Molineu, supra note 160, at 40.
163. See Molineu, supra note 160, at 45.
Europe out of the Western Hemisphere and the policy was formally abandoned in 1936 when the United States agreed not to intervene in the domestic affairs of Latin American states in the Convention on Rights and Duties of States.\textsuperscript{164} This saw the beginning of an era of mass expropriations as countries sought to regain control over investments operated by nationals of their former conquerors.

In essence, with Europe at war, the power formerly exerted to protect foreign investments was absent, creating a power vacuum. While much scholarly effort has been devoted to diagnosing host country risk factors, this change in risk was not generated internally in any particular host country. Instead, it was a result of external shifts in the world power structure.

C. The Modern Era: Revival of the Law Merchant

As European power waned with continental warfare, investors sought other methods by which to protect investments. First, a new law merchant began to fill the void left by the departure of sovereign military power as investors acted through private organizations to develop investment laws and monitor sovereigns. The development and harmonization of international commercial law began with the private organization of merchants and continued with the involvement of nation-states.

For example, a private French association called the International Chamber of Commerce ("ICC"), formed in the 1920s, produced its first set of rules in 1936, and has continued developing international commercial rules and arbitrating disputes under them.\textsuperscript{165} The ICC, like the law merchant of medieval Europe, values merchant self-regulation.\textsuperscript{166} The ICC members are corporations, business associations, law firms, chambers of commerce, and individuals.\textsuperscript{167}

Merchants also formed courts of arbitration to administer the rules they made. The London Court of Arbitration was founded in the late nineteenth century.\textsuperscript{168} The ICC Court of

\begin{footnotesize}
\begin{enumerate}
\item[164.] See Fenwick, \textit{supra} note 159, at 637.
\item[165.] See generally Cutler, \textit{supra} note 130, at 208.
\item[168.] See Cutler, \textit{supra} note 130, at 228.
\end{enumerate}
\end{footnotesize}
Arbitration formed in the 1920s, and the American Arbitration Association formed in 1926.169 The ICC Court of Arbitration is the most popular, and many regard it as the best equipped to deal with different legal systems and levels of development.170 Even though there is no stare decisis in arbitral decisions, arbitrators often cite previous arbitral cases. Cross-fertilization also occurs when the same arbitrators are chosen for different panels in different disputes, conducted under different treaties.171

Governments joined in the process of harmonizing international commercial law in the 1950s and 1960s. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"), the most widely adopted convention on arbitration, was created in 1958, and invited nations to agree to enforce arbitral awards under certain conditions.172 Thirteen major regional conventions have been adopted since 1950.173 The Hague Conference on Private International Law attained status as an international organization in 1955, although it began as an almost exclusively European regional organization.174 The United Nations Commission on International Trade Law ("UNCITRAL") was created in 1966 to promote global, rather than simply regional, harmonization of law.175 The challenge at this time, according to Clive Schmitthoff, one of the leaders in establishing UNCITRAL, was to design a system that would function well in a world of both free market and planned economies, and countries in different stages of development.176 Also instrumental to the success of UNCITRAL was the participation of the United States, which controlled a substantial amount of world investment but had not actively participated in previous efforts.177 Capital exporting nations also often write model bilat-

169. See id.
170. See id.
174. See Cutler, supra note 130, at 209-10.
175. See id. at 212.
176. See id. at 212.
177. See id. at 214.
eral investment treaties to aid their foreign investors.\textsuperscript{178} The widespread use of these model BITs has led to great uniformity among international investment treaties.\textsuperscript{179}

During the Cold War, the world settled into a bipolar power structure with the United States and the Soviet Union largely dominating world affairs. Scholars noted that after about 1960, the era of mass expropriations seemed at an end. Kobrin,\textsuperscript{180} Jodice,\textsuperscript{181} and Minor\textsuperscript{182} noted a marked decline even in targeted expropriations after about 1980.

D. Collapse of the Soviet Union

A new shift in the world power structure occurred in the 1990s and led to a surge in political risk. This shift was caused by the fall of the Soviet Union, which resulted in the formation of several new governments and increased investment opportunities in the Newly Independent States. However, these new opportunities were not immediately accompanied by any new and stabilizing force. Unlike changes in risk in earlier periods, numerical data are available to demonstrate that this shift occurred.

I use two types of data to analyze the rise in political risk during the 1990s. First, I use measures of actual risk, developed from ICSID arbitral claims and OPIC claims. Second, I use measures of perceived political risk such as from expert surveys and news coverage. These measures capture different things because actual risk may not be perfectly perceived. Investors are more likely to be affected by actual risk. However, host states are more likely to be affected by how investors perceive risk levels. Where perceived risk does not reflect actual risk, countries may be unfairly punished or rewarded.

In order to capture takings for which international law recognizes a right to compensation, it is necessary to look at awards rendered under international law. ICSID provides arbitral facilities for disputes between states and nationals of other states for investment disputes. Therefore, the cases tend to be ones in

\begin{footnotesize}
\begin{enumerate}
\item[178.] See Garcia, \textit{supra} note 171, at 309.
\item[179.] See \textit{id}.
\item[180.] See Kobrin, \textit{supra} note 86, at 65.
\item[181.] See Jodice, \textit{supra} note 91, at 177.
\item[182.] See Minor, \textit{supra} note 6, at 184.
\end{enumerate}
\end{footnotesize}
which the investor is claiming that the state has inflicted an injury with respect to his property. Clearly, awards are not always rendered in favor of the investor. However, the investor does prevail a substantial amount of the time. By analyzing the pattern of claims, we can assess the attributes of modern political risk.

In contrast to decisions of many courts, arbitral decisions are not always made public, causing problems in collecting data from the decisions. While investor-State arbitration is sometimes performed through methods other than ICSID arbitration, the ICSID decisions are more publicly available. Importantly, even where ICSID does not publish an opinion at the request of the parties, it still lists the decision on its list of pending and completed cases, allowing us to know of missing data. In addition, many of the opinions are published online or in different volumes and journals. I started with the official opinions published by ICSID and the sources that ICSID cites. However, there were still many missing cases. Therefore, I searched for news articles that referred to these cases to supplement the data. While the articles might not give details of the award or proceedings, they frequently would give a brief description of the dispute, the industry, and the investor.

In addition, I obtained data from OPIC, which offers political risk insurance to U.S. corporations for expropriations, currency inconvertibility, and political violence. Claims against OPIC would tend to occur where the remedy through the international arbitral system is inadequate. For example, the remedy could be inadequate where the country refuses to pay and has insufficient assets outside its borders to satisfy the award. For example, in the expropriation claim of MidAmerican Energy Holdings Company, several of the claims submitted to OPIC were based on the fact that the Indonesian government would not pay the arbitral award. The OPIC claim decision states that an investor has a valid claim for compensation where the investor obtains a valid, final arbitral award against the country,

and that the country fails to pay the award within ninety days.\textsuperscript{184} The tribunal cited the Restatement (Third) of Foreign Relations Law, which states that "a state may be responsible . . . if, having committed itself to a special forum for dispute settlement, such as arbitration, it fails to honor such commitment; or if it fails to carry out a judgment or award rendered by such domestic or special forum."\textsuperscript{185} The tribunal also stated that Article II of the New York Convention recognizes the importance of these provisions and that each signatory, including Indonesia, was obligated to support and enforce agreements to arbitrate, and that economic crisis was no excuse for nonperformance under the Treaty.\textsuperscript{186}

I obtained data from the sources described in Table 1.

\textbf{\textit{TABLE 1: SOURCES OF DATA}}

<table>
<thead>
<tr>
<th>Variable</th>
<th>Unit</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>OPIC Industry</td>
<td>Number</td>
<td>Developed by Author From OPIC Claims obtained under FOIA</td>
</tr>
<tr>
<td>OPIC Taking Type</td>
<td>Number</td>
<td>Developed by Author From OPIC Claims obtained under FOIA</td>
</tr>
<tr>
<td>OPIC Taking Value</td>
<td>Current $US</td>
<td>Developed by Author From OPIC Claims obtained under FOIA</td>
</tr>
<tr>
<td>ICSID Industry Claims</td>
<td>Number</td>
<td>Developed by Author From ICSID official sources and new reports of claims in ICSID arbitration</td>
</tr>
<tr>
<td>ICSID Taking Type</td>
<td>Number</td>
<td>Developed by Author From ICSID official sources and new reports of claims in ICSID arbitration</td>
</tr>
<tr>
<td>Perceived Political Safety</td>
<td>(0-25) with 25 the safest</td>
<td>Euromoney Magazine</td>
</tr>
</tbody>
</table>

\textsuperscript{184} \textit{Id.} at 4-5.
\textsuperscript{185} \textit{Id.} at 5 (citing \textit{RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW} § 712 cmt. h (1999)).
\textsuperscript{186} \textit{Id.}
1. Risk Trends Apparent in the ICSID Data

Figures 1, 2, 3, 4, and 5 show the evolution in ICSID claims over time and the jump in claims during the 1990s. Figure 1 shows a plot of all ICSID claims between 1970 and 2004. The number of claims escalates in the 1990s through 2004. Figure 2 shows a plot of ICSID claims falling short of expropriation.
These claims tended to be for things such as discriminatory treatment and contract disputes and appear to be fairly constant over time. Figure 3 shows the number of non-creeping (abrupt) expropriations. This figure shows that levels of abrupt expropriations were high during the late 1970s and early 1980s, which is a result that agrees with the Kobrin line of studies. After about 1980, the number drops off before rising dramatically after 1995. Figure 4 shows the number of creeping expropriation claims over time. While there were some claims in the 1970s, these claims completely ceased during the 1980s before surging in the 1990s, and falling off somewhat in the new millennium. While the rise in abrupt and creeping expropriation claims in the 1990s suggests that the risk of expropriation increased, it probably did not increase as dramatically as these figures would suggest. With the increasing number of bilateral investment treaties signed by countries, ICSID jurisdiction to hear these claims would also increase. Therefore, the rise is not as dramatic as these graphs would indicate. Figure 5 shows the total number of claims divided by the number of bilateral investment treaties and confirms that the claims fell during the 1980s and rose during the 1990s, peaking in about 1996.

These results indicate that there was not only an increased interest in political risk in the mid-1990s, but there was actually an increase in political risk. This means that scholars who thought that the late 1970s and early 1980s signaled the end of political risk were only witnessing the end of one phase of it.
FIGURE 2: ICSID CLAIMS FOR LOSSES SHORT OF EXPROPRIATION

FIGURE 3: ICSID NON-CREEPING EXPROPRIATIONS

FIGURE 4: ICSID CREEPING EXPROPRIATIONS
2. Risk Trends Apparent in the OPIC Data

Figures 6, 7, 8, and 9 show the incidence of all claims, expropriation claims, inconvertibility claims, and political violence claims, respectively, over time. Figure 7 confirms the Kobrin conclusion that expropriations became very uncommon after about 1985. However, between 1995 and 2000, there is a jump in the number of expropriations. While there were not a huge number of expropriations in any year, the return of expropriations concentrated in a short period of time following a long absence is still at least suggestive of an actual shift in the risk trend.

Figure 8 shows that before 1990, governments often prevented investors from repatriating their profits or otherwise converting currencies. In contrast to expropriation, inconvertibility problems appear to have ceased and not returned. In stark contrast to both expropriation and inconvertibility claims, political violence claims sharply increased during the early 1990s before
dipping and then rising slightly again in 1996, before falling off in the late 1990s.

Political violence was relatively rare in the 1980s. However, it rose sharply in the early 1990s. After 1995, the level of violence appeared to subside.

3. Trends in Perceived Risk

Because the Euromoney political risk perception data is largely based on how countries rank relative to one another, it cannot show trends in the level of overall perceived risk. Therefore, in order to ascertain the levels of perceived risk in the 1990s, I examined the amount of media coverage regarding risk.
The frequency of reporting shows how important political risk is relative to other general business issues. Articles on political risk automatically displace news on other topics.

As shown in Figure 10, reporting in the *Economist* about political risk was essentially non-existent before 1992. There were no articles between 1980 and 1988. The almost complete lack of reporting prior to 1992 followed by a somewhat regular presence suggests that something changed around 1992, or perhaps a little earlier, which made political risk much more of a business concern.

![FIGURE 10: POLITICAL RISK ARTICLES IN THE ECONOMIST](image)

The results from *Risk Management Magazine* also suggest that a significant change occurred in the early 1990's. Prior to 1990, most years did not include a single article on political risk. Interest rose over the next few years until, in 1996, Risk Management devoted an entire issue to political risk. With the exception of 1996, reporting seems to have stabilized at about three or four articles per year.

![FIGURE 11: POLITICAL RISK ARTICLES IN RISK MANAGEMENT](image)

E. *Explaining the Surge*

1. Regime Durability and Democracy

I believe that this surge can be explained by the dissolution
of the Soviet Union in 1991, which radically altered the world power structure. In this period, democracy greatly expanded and the governments of the Newly Independent States were fragile. Fortunately, for the 1990s period, we have numerical data that we can use to test and support this hypothesis. Before conducting the analysis, I expected that low regime durability in the Newly Independent States would increase expropriations because host governments would not expect to be in power long enough to endure the consequences of the expropriations. However, I was unsure whether democracy would increase or decrease risk. On the one hand, it might increase risk because people might pressure the government to take property in times of economic hardship. On the other hand, democracy might diminish risk because it might cause the government to move more slowly.

In order to test the hypothesis that these sea changes in power caused the massive increase in risk, I examined the relationships between democracy, regime durability, and political risk (actual and perceived). Then, upon finding that regime durability affects political risk, I analyzed trends in regime durability. The results indicate that immediately after the dissolution of the Soviet Union, regimes became much less durable and this contributed to the sharp increase in risk. Democracy had no net effect on risk.

Table 2 shows two fixed-effects panel analyses. The first dependent variable is the Euromoney political risk perception index. The second dependent variable is ICSID Claims/BITs. The independent variables are: regime durability, level of democracy, and GDP per capita. GDP per capita is a useful control variable because wealthy countries may be more able to withstand periods of slow economic growth without expropriation. Regime durability is measured by the number of years since the most recent regime change. Level of democracy represents a scale of -10 to 10, where 10 is the most democratic and -10 is the most autocratic. The regime durability and democracy variables are borrowed from the Polity IV dataset. I controlled for GDP per capita (constant year US$2000), and expected that political risk would diminish as country wealth increased.

The data indicate that regime durability is positively and significantly related to perceived political safety and negatively correlated with the number of ICSID Claims/BITs. These results
indicate that a one year increase in the age of the regime raises investor confidence by about .103 on the zero to twenty-five Euromoney political risk scale. A one year increase in the age of the regime corresponds to a decrease in Claims/BITs of -.00026, which is substantively significant given that the values of this variable only range from zero to about .25. These coefficients are also significant in light of the range of regime durability values, from 0 to 194.

**TABLE 2: DURABILITY AND DEMOCRACY**

<table>
<thead>
<tr>
<th>Independent Variables$^{187}$</th>
<th>Regime Durability</th>
<th>Level of Democracy</th>
<th>GDP Per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Euromoney Perceived Safety</td>
<td>0.1026092***</td>
<td>0.0527805***</td>
<td>0.0555548***</td>
</tr>
<tr>
<td>ICSID Claims/Number of BITs</td>
<td>-0.0002645*</td>
<td>0.000194</td>
<td>6.41E-07</td>
</tr>
</tbody>
</table>

Increased democracy levels were also positively correlated with perceived political safety at highly statistically significant levels. However, democracy levels were not significantly correlated with ICSID Claims/BITs. The effect of democracy on perceived political risk, while statistically significant is not substantively significant in light of the range of democracy values. A one unit increase in the democracy score corresponds to a .053 unit increase in perceived safety. Since the democracy variable ranges only from -10 to 10, even a radical change in democracy level will not affect perceived risk substantially. Table 2 shows that the previously discussed positive and negative effects of democracy on political risk balance out, yielding no net effect.

Wealthier countries were perceived as less risky. However, GDP per capita had no significant effect on ICSID Claims/BITs, indicating that once regime durability is controlled, level of economic development does not increase safety. The effect of GDP per capita on perceived political risk is substantively significant.

$^{187}$ In the tables that follow, significance of the results are indicated as follows: * indicates that the result is significant to the .90 level; ** indicates that the result is significant to the .95 level. *** indicates that the result is significant to the .99 level.
A one unit increase in GDP per capita corresponded to an increase of .056 on the perceived political risk scale. GDP per capita consists of GDP in constant US$2000 divided by population. Therefore, an increase in GDP per capita of only US$20 would positively affect perceptions of political risk by one point on the 25 point scale. This is a huge affect, and since it does not appear in the Claims/BITs analysis, it is possible that investors are misperceiving wealthier countries as being safer than they are.

Now that we have identified that regime durability plays an important role in affecting risk, and that democracy and regime durability are important factors affecting perceived political risk, we must ask whether regime durability and democracy underwent radical changes in the 1990s period. If so, it is likely that the dissolution of the Soviet Union caused a power vacuum in the 1990s.

**FIGURE 12: MEAN OF REGIME DURABILITY**

Figure 12 shows average regime durability for all countries in the world from 1960-2004. Notably, regime stability appears to be on a constant increasing trend until about 1990. This means that regime stability may not be a good predictor of the political risk of the 1970s, but became an important predictor of expropriations and other political risks during the 1990s.

Figure 13 shows average world democracy levels over time. The average level of democracy was falling during the 1960s,
fluctuated in the 1970s, and then rose steadily during the 1980s. In the early 1990s, it rose dramatically, dipping slightly in the mid-1990s before rising steadily once again. Predictably, the high levels of growth in democracy correspond in time with increased ICSID Claims/BITs and increased media coverage. Therefore, looking only at the graph might lead one to believe that democracy increased risk. However, the periods of rapid growth in democracy also correspond to periods of low regime stability and the regression equation has diagnosed the true cause of political risk as being regime instability.

FIGURE 13: MEAN OF WORLD DEMOCRACY LEVELS (1960-2004)

2. Evaluating Industry Affects

The beginning of this Article referenced a newspaper article regarding expropriation of oil interests in Russia. The article hypothesized that the government’s actions were driven by its belief that it had sold the oil interests at unacceptably low prices. In the privatization period following Soviet dissolution, countries may have sold facilities on terms that they later came to regret, prompting us to ask whether certain industries subsequently became more vulnerable. In addition, this inquiry is necessary because previous literature noted that risks were higher in natural resource industries.

Surprisingly, Table 3 shows that economies focused on in-
dustry were perceived as being less safe, while fuel and agriculture had no affect on perceptions. However, the correspondence between Industry as a percentage of GDP and perceived risk was slight. In order to accomplish even a one unit change in Euromoney risk rating would require a change in industry percentage of about 20%.

**TABLE 3: SHORT TERM INDUSTRY TEMPTATION**

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Fuel Exports % GDP</th>
<th>Industry % GDP</th>
<th>Agriculture Exports % GDP</th>
<th>GDP Per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Euromoney Perceived Safety</td>
<td>-0.0157115</td>
<td>-0.0498639**</td>
<td>-0.0073323</td>
<td>0.000823***</td>
</tr>
<tr>
<td>ICSID Claims/Number of BITs</td>
<td>0.0004421***</td>
<td>0.0002868</td>
<td>0.0001588</td>
<td>5.75E-07</td>
</tr>
<tr>
<td>Corporate Tax Change from Previous Year</td>
<td>-0.0445666**</td>
<td>-0.0862528*</td>
<td>-0.0336998</td>
<td>-1.03E-05</td>
</tr>
</tbody>
</table>

As expected, economies focused on fuel had higher levels of ICSID claims than those that were focused on industry and agriculture. This effect is not very significant since obtaining change in the Claims/BIT ratio of .1 would require an increase of over 200% in the “Fuel Exports % GDP” variable.

However, investors in countries with substantial fuel exports face diminished risk of changes in tax laws. A one unit increase in fuel exports as a percent of GDP only corresponds to a decrease of .0446 in the change in the highest marginal corporate tax rate.

This may be because many governments that contracted to privatize formerly government run facilities agreed to restraints on changes in taxes. Those that violated the agreements sometimes instituted arbitral proceedings before ICSID. The increased risk in this industry is not surprising given the policies of many countries in the early 1990s to privatize state run facilities. In some ICSID claims, opposition to privatization formed and the government took adverse measures amounting to expropriation.

Figure 14 shows that trade in fuel declined after about 1980,
presumably because of the oil cartels. This trend leveled off since the late 1990s with a brief increase in 2000. However, this trend does not seem to correspond with the increased political risk periods.

Table 4 shows a simple cross-tabulation of the types of OPIC claims by industry. There was only one claim for compensation in the financial industry and that was for inconvertibility. The two construction claims were for contractually related disputes. About half of the extraction and farming industry claims were for expropriation, and the other half for political violence. There was only one claim for inconvertibility in the extraction industry and only one claim in farming. Manufacturing interests were much less likely to make claims for expropriation than for inconvertibility and political violence. These results support the Kobrin hypothesis that governments are less likely to expropriate manufacturing interests. However, the manufacturing interests are more likely to either be the target of political violence or simply happen to be damaged in episodes of unrest. Manufacturing interests were also more likely to encounter difficulties in repatriating profits, possibly because governments wanted to keep profits local to appease local interests.
Table 4 shows the corresponding results for the ICSID claims data. Because there were more observations in the ICSID dataset, this table separates out the expropriations that were creeping from those that were not. In addition, it is important to note that the definition for political violence is very different in the ICSID data. Here, it refers to instances of political violence for which the government is considered legally responsible because it directly caused the loss or because it deliberately failed to afford protection to the facilities. There were very few instances of this type of political violence. There were also very few instances of currency inconvertibility. Creeping expropriation was the biggest threat for the construction and extraction industries. Outright expropriation was the biggest threat in the financial industries, followed by inconvertibility. The manufacturing sector suffered about equally from creeping and outright expropriation, but also was fairly likely to have disputes with the government and episodes of political violence. The telecommunications sectors and utilities were most likely to be affected by

**Table 5: ICSID Tabulation of Claim Type by Industry**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>3</td>
<td>2</td>
<td>4</td>
<td>0</td>
<td>0</td>
<td>9</td>
</tr>
<tr>
<td>Extraction</td>
<td>4</td>
<td>3</td>
<td>11</td>
<td>0</td>
<td>0</td>
<td>18</td>
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<tr>
<td>Farming</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>2</td>
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<tr>
<td>Finance</td>
<td>1</td>
<td>4</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>6</td>
</tr>
<tr>
<td>Manufacture</td>
<td>4</td>
<td>9</td>
<td>10</td>
<td>0</td>
<td>2</td>
<td>25</td>
</tr>
<tr>
<td>Services</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>6</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Tourism</td>
<td>0</td>
<td>3</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Utility</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>14</td>
<td>26</td>
<td>30</td>
<td>2</td>
<td>2</td>
<td>74</td>
</tr>
</tbody>
</table>
creeping expropriation. Services and tourism industries such as hotels and resorts were most affected by outright expropriation.

This Section has shown that the data support the framework of analysis described in Part I of this Article. Following the dissolution of the Soviet Union, regime durability in the world declined. The data strongly support the hypothesis that reductions in regime durability cause increased risk to investments.

The data also suggest that while countries are strategic in taking adverse action, they are also constrained by their own political structures. Therefore, while democracy may increase political pressure on the government to take adverse action, it might also constrain the government in taking any action because of coordination issues and the number of veto players.

**IV. INTERNATIONAL LAW: THE CURRENT WORLD POWER STRUCTURE PROTECTING INVESTMENTS**

Before the 1990s, investors had already begun developing their own legal rules and systems for administering those rules. The 1990s saw a rapid acceleration of these efforts. Governments became even more involved with the development, dissemination, and enforcement of these laws through the use of BITs. Instead of military intervention, governments have brokered international agreements that allow for satisfaction of awards and judgments through host country property located outside the host country. The following is a brief discussion of how sovereigns are now able to provide enforcement without military intervention.

**A. Satisfaction of Awards With Property Outside the Host Country**

The effectiveness of investment treaties depends on the maintenance of assets of a host state outside of that host state. This condition is generally easily satisfied because states frequently maintain assets outside of their borders. These assets are subject to the laws of the jurisdictions wherein they are situated, and courts will take possession of those assets and award them to those with valid claims against a host state government.

For example, in *People's Revolutionary Republic of Guinea v. Atlantic Triton Company*, while the arbitral proceedings were ongoing and before any award was granted, Atlantic petitioned the Commercial Court of Quimper for the attachment of three fish-
ing vessels registered under the Minister of Fisheries of the People's Revolutionary Republic of Guinea that were being repaired in a French shipyard. Attachment of the vessels would prevent the government of Guinea from disposing of the vessels during the course of the proceedings and ensure that there would be funds with which to satisfy an award. The issue of whether the assets could be attached even before the issuance of an award went up to the Cour de Cassation. The Cour de Cassation ruled that Atlantic could seek attachment to protect its interests even though the case was proceeding in arbitration instead of in the French court system.

Investors are best able to use this system by shopping for the best laws and legal systems. This involves inserting forum selection clauses in their contracts and clauses that select the substantive law to be applied to the contract. The key with respect to forum selection is to choose a country that will uphold the forum selection clause and to make sure that the country where the assets are located will recognize the validity of the award. This power allows the forum sovereign to be able to give the investor a remedy, without the involvement of the host state.

International law increasingly respects these contractual choices of the investors, and gives less deference to host state objections. For example, in Compagnie d'Enterprises CFE, SA v. Republic of Yemen, the Yemen Port Authority had entered into a contract with Compagnie d'Enterprises. A dispute arose after local authorities froze Compagnie's assets for a period of time following civil unrest. Compagnie sought to recover damages from having its assets frozen. Pursuant to the contract, it submitted the dispute for arbitration in the International Chamber of Commerce, and the forum was Cyprus. After the panel determined that it had jurisdiction, the Port Authority obtained an anti-suit injunction from a court in Yemen. However, the arbitrator did not recognize this injunction as valid because only a

189. See id.
190. See id.
192. See id. at 13.
193. See id. at 13-14.
194. See id. at 14.
court in Cyprus had the authority to issue such an order. The panel continued with the proceedings, and the government of Yemen sought to have a court in Cyprus issue a similar order, which it refused to do.\textsuperscript{195}

When Compagnie brought suit in the United States to enforce the judgment using assets located in the United States, the District Court of the District of Columbia entered judgment for Compagnie in accordance with the arbitral ruling.\textsuperscript{196} First, it stated that Compagnie had a right to seek enforcement of the award in the United States pursuant to the New York Convention. It then acknowledged that under the Sovereign Immunities Act, "no federal district court shall enter default judgment against a foreign state unless the claimant establishes its right to relief by evidence satisfactory to the court."\textsuperscript{197} In entering judgment for Compagnie, the court found that Compagnie had met its burden because: "(1) it filed certified copies of the parties' arbitration agreement and the underlying arbitral award, which is final, conclusive, and binding under the laws of Cyprus, the jurisdiction in which the award was rendered; and (2) it followed the procedures for recognition and confirmation of the award set forth in the New York Convention and the [Foreign Sovereign Immunities Act ("FSIA")]."\textsuperscript{198} This was all Compagnie needed to do to invoke the power of the U.S. court system in aiding its recovery. Accordingly, since Yemen had assets in the United States, the United States had jurisdiction over those assets and could enforce the award for Compagnie.

Another example of this is the case of Westland Helicopters Ltd. \textit{v.} Arab Organization for Industrialization. The Arab Organization for Industrialization ("AOI") was formed by Egypt, the United Arab Emirates, and Qatar. The AOI entered into a contract with Westland for the purchase of helicopters, but refused to continue with the contract following the Camp David Accords.\textsuperscript{199} The dispute was submitted for arbitration in the International Chamber of Commerce, which, in 1993, entered an award against AOI for US$385 million, and against Westland for


\textsuperscript{196} See Compagnie d'Enterprises, 180 F. Supp. at 14.

\textsuperscript{197} Id.

\textsuperscript{198} Id.

\textsuperscript{199} See Cheng, supra note 195, at 513.
US$30 million. U.S., French, and English courts then agreed to enforce the award against the foreign assets of AOI and its Member States.200

Tribunals may even punish host states for attempting to enjoin the arbitral proceedings. In Amco Asia Corp. v. Republic of Indonesia, and Himpurna California Energy Ltd. v. Republic of Indonesia, tribunals found that Indonesian courts had denied justice to Amco, and ordered the Republic to compensate Amco for the Indonesian court injunction that had sought to suspend the arbitral proceedings.201

In this manner, investors are able to obtain the best of both worlds. They are frequently able to create their own rules for solving disputes, select the arbitrators that they believe are the most competent, and get the benefit of enforcement from potentially any country in which the host state has assets. However, since international relations might suffer by the taking of the property of host states to satisfy awards, it is not done without the host state’s agreement. The following Section discusses the process by which the host state’s agreement is obtained.

B. Countries Use Bilateral Investment Treaties to Compete For Investment

While Kant wrote that effective and controlled governance can be obtained by pitting forces within a government against one another, the new law merchant allows investors, recipients of investment, and governments to choose the institutions that will govern them. Where governments choose institutions that are less effective, the cost of investment in that country will go up, and investment will decline.

BITs serve as a signaling mechanism to investors regarding which countries are safer than others. Ten percent of the manufacturing companies and sixteen percent of the companies in the services sector surveyed in the World Bank Group/Multilateral Investment Guarantee Agency (“MIGA”) Foreign Direct Investment Survey reported that the existence of a bilateral investment treaty greatly influenced them in deciding where to in-
Several home countries have drafted model BITs, which serve as a starting point in negotiations with other countries. The U.S. Model BIT is a particularly important example of these increasingly popular instruments because of the amount of FDI inflow and outflow of the United States, and the number of BITs of which the United States is a party.

Host countries often have mixed opinions about the benefits of BITs. On the one hand, BITs may attract increased investment. However, some find it offensive that BITs and multilateral investment treaties may confer more extensive protections to foreign investors than the nationals of a host country enjoy. In the past, many countries have declined to grant these increased protections for foreigners. For example, for several decades, Latin American states followed the Calvo Doctrine, whereby foreign investors were entitled to no greater protection than nationals. The Calvo Doctrine was adopted at a time when Latin American countries still feared European military intervention. However, since this threat has subsided, many Latin American countries have decided that the benefits of BITs do now exceed the costs.

When host countries have been reluctant to sign BITs, home countries sometimes provide additional incentives. For example, some home countries, such as Germany and France, only provide investment insurance for investments in countries with whom they have BITs. Notably, this mechanism provides a benefit to home country investors that may actually be at the expense of other home country interests.

LDCs may also have become more needful of FDI because of the fall in aid from the United States. Aid as a share of capital flows from developed to developing countries fell during the 1980s and 1990s by over 20%. This led to an overall fall in capital flows. Commercial bank lending also fell during the 1980s because of the banking crisis. The combination of these fac-

203. See Garcia, supra note 171, at 310.
204. See id. at 319.
205. See Coe, supra note 157, at 350.
207. See Ramamurti, supra note 96, at 30.
208. See id.
tors has provided an incentive for LDCs to sign BITs in order to compete for investment, and the number of BITs they sign may indicate a "bidding contest." The figures and discussion below indicate competition to sign not only BITs, but to enact new foreign direct investment laws, new arbitration laws, and to become parties to international conventions.

Figure 15 shows the number of bilateral investment treaties that states entered between 1959 and 2004. This data was collected from ICSID and UNCTAD, which maintains a list of bilateral investment treaties and the dates on which they were entered.209 Prior to the mid-1980s, countries did not tend to enter into bilateral investment treaties. However, during the mid-1980s through the mid-1990s, countries rushed to create international law to govern investment, and promised to enforce it. The number of BITs signed in the 1990s through 2004 has leveled off, but remains high.

Additional evidence of the competition for investment through international commitments has been in the signing of the New York Convention. While the New York Convention was created in 1958, more countries signed it in the 1990s than at any other time. From 1958 to 1969, the average number of new

yearly signatories was 3.09. In the next decade, the average was 2. In the 1980s, the average was 2.5, and in the 1990 to 2002 period, the average was 4.08.\textsuperscript{210} Similarly, the number of contracting states in the ICSID Convention grew dramatically during the 1990s. In the initial period from the inception of the ICSID Convention in 1966 to 1969, an average of thirteen states signed the convention each year. The average then fell between 1970 and 1979 to 2.3 states per year and fell between 1980 and 1989 to 1.6 states per year. However, this trend reversed during the 1990s, when the average rose to four states per year, before declining again to 2.2 states per year in the 2000 to 2004 period.\textsuperscript{211}

Competition for investment also required the adoption of national arbitration laws. Figure 16 displays the number of national arbitration laws passed by countries around the world from the late 1800s to 2003. The data were collected from Kluwer Law, which tracks arbitral law passage in countries worldwide. In some cases, a country passed more than one law in a given year and each law was separately counted. However, in most instances, individual countries did not pass more than two laws in any given year.

Figure 16 shows that national arbitral laws were almost non-existent until about 1920, which is when Europe started to lose its grip on the world. In most years until about 1980, no countries passed any arbitral laws. After 1980, the number of laws per year dramatically increased. The number peaked in the mid-1990s before declining somewhat.\textsuperscript{212}


\textsuperscript{211} Data was obtained from The International Centre for the Settlement of Investment Disputes, List of Contracting States and other Signatories of the Convention, http://www.worldbank.org/icsid/constate/c-states-en.htm (last visited Sept. 15 2007).

Figure 16 shows the number of arbitration laws passed from 1860 to 2000. The data indicate a steady increase in the number of laws, with a significant spike in the mid-1960s.

Figure 17 shows the number of key FDI laws listed by UNCTAD in its World Investment Report. These data also indicate a spike in activity in the mid-1990s. While the UNCTAD list is not exhaustive of the total number of laws and does not indicate the level of favorability to investors of those laws, the race for FDI in the 1990s indicates that much of this activity has been meant to foster FDI.

What all of these figures show is that countries engaged in a flurry of activity to formalize protections for international investors in an effort to compete for international investment. Home countries were also very active in promoting the formalization of protection and encouraging host countries to pre-commit to protecting foreign investments.

If host countries enact BITs and other laws to protect investors, they could be said to want to give increased assurances to investors. However, they may also simply be formalizing protection that they have already afforded investors. To determine what causes real and perceived change in protection through changes in laws and legal structures, I collected data on the
number of BITs in force in each year, the number of domestic arbitration laws, and the number of key laws regulating FDI listed by UNCTAD.

Table 6 shows that regime durability positively affects the number of BITs, the number of domestic arbitration laws, and the number of FDI laws listed by UNCTAD. This is expected because regimes with more durability value the future more and are more interested in cultivating future investment. In addition, they are more capable of enacting laws because there is less disruption to the law making process. This result is not surprising in light of the earlier results indicating that political risk is inversely related to regime stability. Therefore, while BITs could increase protections in regimes that are less stable, it is also likely that they merely formalize the protections already inherent in stable regimes.

**TABLE 6: CAUSES OF INCREASED FORMAL PROTECTIONS**

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Number of BITs (Beta)</th>
<th>Number of Domestic Arbitration Laws (Beta)</th>
<th>Number of FDI Laws Listed by UNCTAD (Beta)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regime Durability</td>
<td>1.466734***</td>
<td>0.0501683***</td>
<td>0.119405***</td>
</tr>
<tr>
<td>Democracy Level</td>
<td>1.428689***</td>
<td>0.0764183***</td>
<td>0.198153***</td>
</tr>
<tr>
<td>Fuel Exports % GDP</td>
<td>-0.0208003</td>
<td>-0.0140683***</td>
<td>-0.02449*</td>
</tr>
<tr>
<td>FDI % GDP</td>
<td>0.6047966***</td>
<td>0.0288318**</td>
<td>0.180645***</td>
</tr>
<tr>
<td>GDP Per Capita</td>
<td>0.0015329***</td>
<td>0.000281***</td>
<td>0.000453***</td>
</tr>
</tbody>
</table>

A more interesting result is that democracies seek to impose more legal constraints on themselves and thereby foster investment. Previous results showed that the level of democracy had no affect on political risk, which could have been due to a balancing of political pressures and veto players. The results in Table 6 show that democracies are seeking to further constrain themselves with respect to investments. This makes sense because the benefit of the constraint is immediate, in that investors will invest more. However, the cost is deferred and discounted.
since the desire to expropriate a particular investment may not have yet materialized.

In all three equations, the coefficient for fuel exports is negative, and it is significant in two of the equations. This indicates that countries are reluctant to increase protections where the temptation to take adverse action against investments is high, supporting the argument that these countries are reluctant to confer protections through legal structures that do not already exist.

Lastly, the result for FDI as a percent of GDP is not surprising. Those countries with great dependence on FDI are more inclined to give additional assurances to investors, although these assurances may or may not reflect actual increased protections.

V. DISCUSSION OF LITERATURE IN LIGHT OF RESULTS

The results discussed above largely comport with the results of previous studies. This is true because previous results have substantially focused on the efforts of newly independent countries to take control of their economies. For example, Kobrin and Minor noted that most expropriations before 1960 were associated with massive governmental upheaval, and Gordon and Kobrin link these episodes with the establishment of national sovereignty. Eaton & Gersovitz argue that even later, more targeted episodes represented consolidations of national power. These results support my hypothesis because these are all directly related to declarations of independence from former controlling powers.

Jodice and Ramamurti note with surprise that former colonizers were the least at risk in their former colonies. This result is not surprising when viewed in the context of my hypothesis regarding repeated transactions because, after independence, without external governmental force to protect investments, investors had to rely on repeated dealing. Former colo-

213. See Kobrin, supra note 86, at 69 (1980).
214. See Minor, supra note 6, at 184.
216. See Kobrin, supra note 86, at 69.
217. See Eaton & Gersovitz, supra note 91, at 39.
218. See Jodice, supra note 91, at 185.
219. See Ramamurti, supra note 96, at 27.
nizers are likely to have had the best investment infrastructure and business contacts to foster these repeated deals. In addition, certain businesses may not have been able to survive without foreign management. Therefore, these substantial and repeated transactions provided incentives for host country cooperation.

Previous research also supports my theory that home countries became involved in the provision of incentives. For example, Ramamurti notes that countries were less likely to expropriate when they were recipients of foreign aid. In addition, home countries became increasingly involved with investor protection and access, linking a substantial amount of FDI and capital bailout money to privatization efforts.

While scholars have tended to attribute these results merely to host country characteristics and circumstances, I believe that a look behind these results supports the conclusion that one of the main underlying causes of political risk is change in external pressure.

**CONCLUSION**

This Article has gathered evidence that supports the hypothesis that factors external to host countries greatly affect political risk within host countries. In many situations, host countries refrain from taking property because of external pressure. The world becomes a riskier place when there are changes in the degree or character of the external pressure exerted. Usually, the change begins with the decline of one source of pressure, which is followed by an increase in risk, and ends with the rise of a new mechanism for exerting pressure. This research represents an advance over prior research, which focused on host country factors without noting external political situations.

Because a decline in external pressure can increase risk, investors have substantial incentives to foster new methods of host country control, with previous forms ranging from reputational pressure to colonialism. While governmental and perhaps military force is often the preferred method of exerting this pressure, investors have managed their own institutions, often working in concert with home governments.

Finally, this Article discussed the current method of exert-

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220. See id. at 30.
221. See id. at 32.
ing external pressure. Since the early 1990s, there has been a proliferation of legal structures such as ICSID, investment treaties, and domestic laws to foster foreign direct investment. Investment treaties ask that countries consent to having their property abroad used to satisfy judgments and awards issued against them. Because these agreements foster investment, governments enter them and, when a taking occurs, the property abroad can be used if necessary. While in previous periods, investment has involved the use of force by home states, in the current period, home state force can be used without military intervention in the host state.