



Legalization, diplomacy, and development: Do investment treaties de-politicize investment disputes?



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ARTICLE INFO

Article history:

Accepted 22 February 2018

Keywords:

Investment treaties
Investor-state disputes
Legalization
Diplomacy
Foreign investment
Multinational corporations

ABSTRACT

Empirical research on the impact of investment treaties has focused almost exclusively on their effect on foreign investment, with mixed results. Yet, another important promise of the treaties has been ignored altogether. Architects of the investment treaty regime, as well as many current proponents, have suggested that the treaties allow developing countries to de-politicize investor-state disputes; i.e. shield commercial disputes from broader political and diplomatic considerations with developed states. While this argument is widely accepted by legal scholars and practitioners and explicitly promoted by capital-exporting states, it has never been subjected to empirical investigation. We provide the first such test, using an original dataset of US diplomatic actions in 219 individual investment disputes across 73 countries as well as detailed case studies drawing on internal US State Department diplomatic cables. We find no evidence for the de-politicization hypothesis: diplomatic engagement remains important for investor-state dispute settlement, and the US government is just as likely to intervene in developing countries that have ratified investment treaties with the US as those that have not. Coercive American intervention in investment disputes is rare, but this is a general feature of American investment diplomacy after the Cold War, rather than one limited to investors with recourse to legalized dispute settlement procedures. These findings provide a critical corrective to our understanding of the investment treaty regime, and have important implications for understanding the effects of international legalization on developing countries.

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1. Introduction

Studies of the effectiveness of the investment treaty regime have focused overwhelmingly on whether, and to what extent, the treaties have succeeded in attracting foreign capital to developing countries. Results have been mixed (see, e.g., Aisbett, 2009; Poulsen, 2010; Yackee, 2010; Peinhardt & Allee, 2012; Kerner & Lawrence, 2014; Jandhyala & Weiner, 2014; Colen, Persyn, & Guariso, 2016). Yet another main justification for the treaties has thus far received little attention in empirical work, namely the potential for investment arbitration to “de-politicize” investment disputes. This is unfortunate. If this potential has been fulfilled, it provides a powerful political argument for developing countries to enter into the treaties irrespective of whether they promote foreign investment at the margin. Also, de-politicization was the

major justification for the establishment of the modern investment treaty regime, not investment promotion.

Prior to the rise of investment treaty arbitration, private foreign investors unable to resolve property rights disputes with host states depended on diplomatic protection. Although home governments often intervened on behalf of their investors, such interventions could impair diplomatic relations between states, and at times even devolved into questions of war and peace. For instance, developing countries would routinely be met with sanctions, or worse, if they failed to resolve serious investment disputes with American investors (Maurer, 2013). The modern investment treaty regime provided an alternate system of dispute resolution, whereby private investors could directly hold host countries accountable for property rights violations through international arbitration. Private access to international dispute settlement meant that disputes between foreign investors and host governments were relegated to technical legal procedures, rather than politicized quarrels debated by diplomats (Shihata, 1986: 267–272). Thus, home country diplomatic interventions – or the

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leveraging of state power and apparatus to advance the interests of private investors – would no longer be necessary. Conflicts over private investment disputes could be removed from the bilateral agenda between the home and host state.

The idea that access to investor-state arbitration de-politicizes investment disputes remains a key argument among scholars and practitioners advocating the expansion of the investment treaty regime. The US government argues that one of the main benefits of investment treaty arbitration is to “resolve investment conflicts without creating state-to-state conflict” (USTR, 2015). Some point to de-politicization as a justification even for North–North investment treaties (see, e.g., EFILA, 2015: 17; European Commission, 2015: 22; UNCTAD, 2015: 153), but the argument is primarily invoked as a core benefit for less powerful developing countries (Johnson & Gimblett, 2011: 692). Indeed, if the de-politicization promise is fulfilled, adopting investment treaties might be prudent for developing countries even if they do not substantially alter investment flows, since the treaties would act as an effective limitation on abuses of diplomatic protection by more powerful capital exporters. As noted by Echandi, “An important role ... that many developing countries have expected [investment treaties] to perform is to depoliticize international investment-related conflicts” (Echandi, 2016: 246).

Yet the hypothesis that access to investment treaty arbitration de-politicizes investor-state dispute settlement has never been subject to empirical testing. In this paper, we present the first such test. We analyze the investment diplomacy of the United States government in the investment treaty era, and ask: is the US government less likely to intervene diplomatically in disputes where investors have access to treaty-based investor-state arbitration than in disputes where investors lack such access? While the United States may not be representative of all capital exporting countries, it is a crucial case for the de-politicization hypothesis: as discussed below, de-politicization was a key goal of the early American bilateral investment treaty (BIT) program, and for developing countries the US is the hegemon whose power is most in need of restraint. If the de-politicization hypothesis is correct, the core benefit for a developing country entering into a BIT with the United States may not necessarily be a marginal increase in foreign investment, but rather reduced political pressure from the State Department (and, in the extreme, US security services) when disputes with American investors occur.

To assess whether this expectation is correct, we rely on a novel data source: internal US State Department diplomatic cables, which were subsequently publicly leaked. Using these cables we identify 219 investment disputes from 1996 to 2010 with information about the extent of US diplomatic interventions. The cables provide a unique window into behind-the-scenes American investment diplomacy, and allow us to study the otherwise hidden world of non-legalized dispute settlement with developing countries. This is a core innovation compared to other studies of investment disputes. Lacking alternatives, many studies of political risk and investor-state disputes rely on datasets of publicly-known arbitration claims as the universe of investment disputes, blind to the much larger category of disputes that never make it to arbitration (Peinhardt & Allee, 2016: 205–206). Our research design avoids this source of selection bias.

Two important findings emerge from our analyses. First, US diplomatic intervention in disputes between developing country governments and American investors is widespread. In nearly a third of the disputes in our dataset, the US government strongly intervened, placing disputes on the states’ bilateral agenda. While explicit threats of coercive sanctions were rare – a notable shift from the Cold War era – high-level US officials, legislators, ambassadors and other representatives regularly pushed top developing country officials to resolve disputes. Second, and crucially, we find

no evidence that diplomatic intervention is less likely in disputes where American investors have access to investment treaty arbitration than in those disputes where investors lack such access. Moreover, looking in-depth at three case studies of individual disputes, we find no evidence that actors’ decision-making follows the logic suggested by the de-politicization hypothesis.

These results provide a corrective to our understanding of the investment treaty regime. Granting investors treaty-based rights to sue sovereign states in front of international tribunals has resulted in significant litigation in recent years, where investors have often walked away with hefty compensation. Moreover, investment treaty claims have touched on highly sensitive policy areas, including governments’ responses to financial crises, environmental and public health regulation, sovereign debt, and court decisions. Not surprisingly, the often-heated debates about the treaties’ impact on government regulation has begun to find its way into development literature (see, for example, Manger, 2008; Shadlen, 2008; Cotula, 2013; Bos & Gupta, 2018). And given the economic and political costs to states of opening themselves to such claims, it is notable that one of the promises of the regime appears unfulfilled. Provided our results are supported by future research, they could hold important policy relevance in an era where many developing countries are rethinking their investment treaty practice.

More broadly, our findings have implications for the legalization literature. One expected benefit of the legalization of international economic disputes is that it offers states the ability to compartmentalize ‘lowly’ disputes over exports and money from broader political and diplomatic relations (Jackson, 1979: 3–4; Fischer, 1982: 273; Abbott & Snidal, 2000: 433; Davis, 2012: 14–15; Puig, 2013: 550–552). Legalized, third-party settlement of disputes can prevent individual disagreements from spilling over into other aspects of the bilateral agenda, allowing states to continue reaping benefits from cooperation and interdependence despite the occasional dispute (Davis & Morse, 2016). Such de-politicization effects are of particular relevance for weaker states and are expected to be particularly strong when legalized regimes allow private actors direct access to file claims against sovereign states. When considering filing an international claim governments must weigh the foreign policy costs of pursuing an unfriendly diplomatic act, meaning that political considerations continue to shape inter-state disputes (Alter, 2003: 799–800; Alvarez, 2002: 156–157; Davis & Shirato, 2007: 284; Davis, 2012: 11–15). Private actors are not burdened with such diplomatic considerations, and thus legalized dispute settlement with private access should be further insulated from political relations (Levy & Srinivasan, 1996: 95–96; Sykes, 2005: 15). This is intuitively plausible, yet our results imply at a minimum that the relationship between private access to international dispute settlement and inter-state relations requires more scrutiny. In the investment treaty regime, at least, the benefits of de-politicization appear to have been oversold to developing countries.

2. Assessing the De-politicization hypothesis

All international legal disputes are ‘political’ in one form or another (Lauterpacht, 1933: 153–160). It is therefore important to clarify what is meant by ‘politicized’ dispute settlement. For instance, even when disputes don’t go to international arbitration, public threats to sue a host government can lead to highly politicized and confrontational bargaining between foreign investors and host states (Post, 2014: 6). When disputes do go to arbitration, politicization could refer to the political costs suffered by either claimants or respondents in settling an investment dispute. In addition, legal literature on the investment treaty regime has

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