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Is investment arbitration biased against developing countries?

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Abstract

A major question in investment treaty arbitration is whether it is biased against developing countries. This paper replicates the results from a frequently cited paper on this question (Franck, 2009) that failed to find statistically significant results on the question. I find that a simpler research design (with coding corrections to the author's publicly available data) produces statistically significant support for developing countries being ordered to pay more than developed countries among those countries that are subjected to arbitration.

Introduction and background to IIA arbitration

Are "international investment agreements" (IIAs)[1] bad for development? The existing literature is divided. In this paper, I hone in on one particular aspect of this system: IIA arbitration, which has been studied empirically by legal scholar Susan Franck in a series of papers (Franck, 2007) (Franck, 2009) (Franck et al., 2011).

IIAs have been said to be a response of developed Western nations and their elites to a wave of nationalizations by newly independent developing nations in the 1950s (Simmons, 2010: 4-5). In 1958, a commission led by Deutsche Bank chairman Hermann Abs and former UK Attorney General Hartley Shawcross proposed a draft international convention that gave investors various substantive and procedural protections for their overseas investments, including the right to launch disputes against states at the International Court of Justice (ICJ). A year later, West Germany signed a treaty with Pakistan that captured the Abs-Shawcross substantive protections but did not explicitly contain investor-state dispute settlement.[2] Switzerland soon followed with its own similar investor protection treaties (Parra, 2012: 14-20).[3]

The procedural innovation of allowing direct investor suits against states under these treaties came together more gradually. In 1959, UN members finalized the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (also known as the New York Convention). While not explicitly addressing investor-state disputes, the New York Convention ensured that payments ordered in arbitrations that observed certain procedures would be enforceable in national courts. In 1961, Dutch diplomat and World Bank general counsel Aron Broches began developing what would become the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States. Also known as the Washington Convention, this treaty allowed states to agree to give their consent to settle disputes directly with investors through arbitration at the World Bank's new International Centre for the

[1] I use the term "international investment agreement" (IIAs) to refer to a treaty-like instrument between two or more nations that marries substantive investor protections with the procedural right of investors of one party to sue the government of one of the other parties. This definition comes from the United Nations Conference on Trade and Development, which first used the phrase in its 1996 World Investment Report (UNCTAD, 1996, at 181). By the 1998 report, "international investment agreement" (IIA) was used systematically to capture the incorporation of rights originally only in *bilateral* investment treaties into *regional and multilateral* agreements like the North American Free Trade Agreement (NAFTA) (UNCTAD, 1998, at xx).

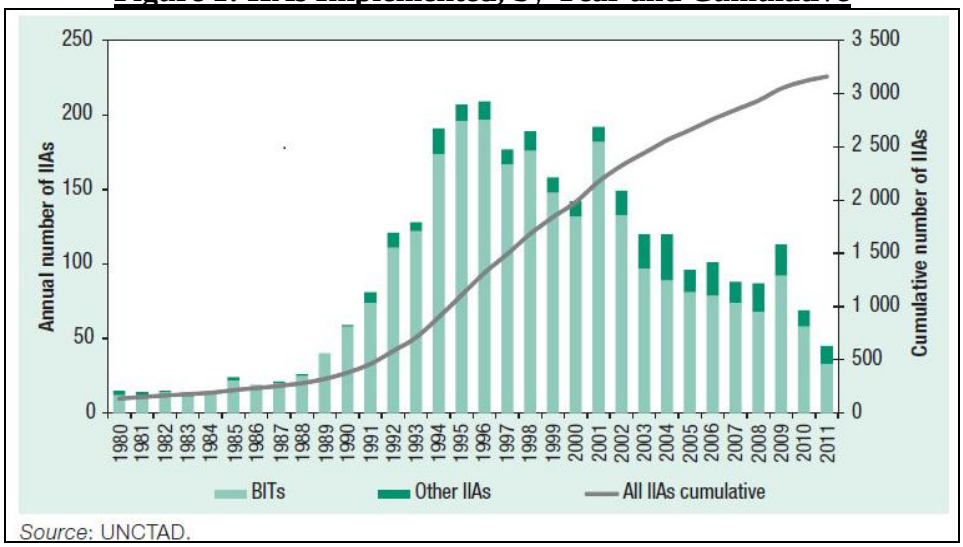
[2] Text available at: http://www.iisd.org/pdf/2006/investment_pakistan_germany.pdf

[3] German officials have attributed the two countries' early interest in investment treaties to their lack of colonial influence and to Germany's loss of property after the world wars (Büthe and Milner, 2009: 174).

Settlement of Investment Disputes (ICSID), which had its own procedural rules (Parra, 2012, at 13-26).

By 1969, the substance of investment protection and procedural rights for investor-state dispute settlement at ICSID were explicitly married in Italy's bilateral investment treaty with Chad. Over the next two decades, some Western European countries and the U.S. began designing and negotiating treaties with Asian and African nations that followed this new template (Vandevelde, 2005, at 166-171). However, it was not until 1993 that a majority of developing countries had even one IIAs with strong investor-state procedural protections, and Germany didn't begin transitioning its treaties until 1988 (Yackee, 2007b: 31-35). According to UNCTAD's tally (which appears to include investment agreements both with and without investor-state dispute settlement), there are now more than 3,164 IIAs (UNCTAD, 2012).[4]

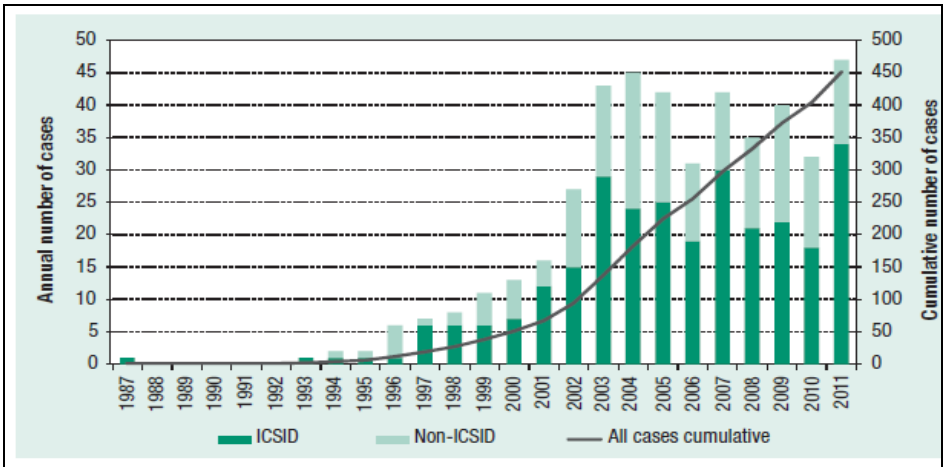
Figure 1: IIAs Implemented, by Year and Cumulative



The expansion of IIA arbitral cases brought by investors against governments has lagged the creation of the treaties. While investors had used ICSID for private contract disputes with governments since 1972,[5] the first award rendered under an IIA came only in 1990, in a challenge by a UK investor against Sri Lanka (Parra, 2012: 183).[6] Over the course of the 1990s, only five additional IIA awards were made.[7] This changed abruptly in 2000, when seven awards were made. The upward trend continued in the years since, culminating in over 450 known cases today, as shown in Figure 2.

[4] Using this number seems justifiable, as an estimated 76 percent of IIAs now include investor-state dispute settlement (Blake, 2010: 156).
[5] The Iran-U.S. Claims Tribunal (1981-present) appears to be the first time that private citizens could argue their own cases against a foreign government outside of contract disputes (Caron, 1990: 135).
[6] The Hong Kong-based investor claimed that an anti-rebel military action destroyed its farm, and the arbitral panel awarded it $460,000 (*Asian Agricultural Products Ltd. v. Republic of Sri Lanka (Final Award)*, 1990: paras. 3, 116). The claim was straightforward and the award small by the standards of later IIAs.
[7] Some early confidential IIA awards are only recently being made public, so these counts are subject to upwards revision (Poulsen, 2011: 192-194).

Figure 2: IIA Arbitration Cases, by Year and Cumulative



Source: UNCTAD.

Early IIAs were between a developed country and a developing country.[8] They were formally reciprocal, meaning developing country investors could have sued developed countries and vice versa. Despite this, almost all arbitrations (95 percent) are by developed country investors against developing countries.[9]

Theory and overview of this paper

Scholars have described IIAs as "colonialism reconstructed … through new techniques" (Anghie, 2007: 243). Yet empirical work has argued that there is no real bias in the system. Some have argued that the nationality (development status) of arbitrators or respondent countries has no influence on arbitral outcomes (Franck, 2009), while others have stated that frequent re-appointment does not influence arbitral decisions (Kapeliuk, 2012). Both utilize bivariate association techniques, like chi-square and ANOVA, and neither produced statistically significant results.

Franck's work has been considerably influential in policy debates (Department Of State, 2009), but has been criticized for poorly instrumenting the sources of arbitrator bias (Waibel and Wu, 2011), for using descriptive statistics that obscure aggregate bias (Gallagher and Shrestra, 2011), and for allegedly failing to disclose the tentative nature of its conclusions (Van Harten, 2011). However, social scientists have used regression techniques to shed more light on the possible

[8] In recent years, there has been a surge in "South-South" IIAs, which now account for as much as 40 percent of the total stock of IIAs (Poulsen, 2010a: 101). Elkins and colleagues document that the mean GDP difference between dyads in IIA has dropped substantially in recent decades (Elkins et al., 2008: 272).

[9] Here I use numbers only for ICSID, which is the only arbitral institution to publish the information in this level of detail. Out of 252 concluded cases at ICSID, only six (2.4 percent) were against IMF Advanced Economies. Three were against the U.S. (Loewen, 1998; Mondev, 1999; and ADF, 2000), and one each was against Iceland (Swiss Aluminum, 1983), New Zealand (Mobil, 1987), and Germany (Vattenfall, 2009). Of 168 pending cases, six (3.6 percent) were against a developed country (Canada, Mobil, 2007), (US, Apotex, 2012), (Canada, Mercer, 2012), (Germany, Vattenfall, 2012), (Spain, Inversión, 2012), and (Belgium, Ping An, 2012). Thus, out of 420 total ICSID registered cases, only 12 or 2.9 percent were against developed countries.

causes (poor institutional quality) (Freeman, 2013) and consequences (lower FDI) of arbitration (Allee and Peinhardt, 2011).

This paper simply attempts to replicate aspects of Franck's study as part of a replication workshop. I do several things to improve replicability and validity of the results. First, I correct some coding errors in Franck's publicly available data. Second, I omit arbitrator demographic variables to present simpler 2 by 2 contingency tables. Third, I present un-winsorized results (which the author utilized to reduce skewing, but which I argue can be better addressed through statistical techniques to evaluate non-normal distributions). Fourth, I aggregate certain descriptive statistics rather than presenting means.

Finally, I alter the country classification scheme assumption in Franck's paper. In some of Franck's country specifications, some Eastern European, Latin American and Middle Eastern states are grouped in with "Western" counterparts, due in part to these countries' recent record of income growth or OECD membership. I aim to reclassify countries into the "West and the Rest." This is based on the insight from the theoretical and historical literature that transnational and extraterritorial legalization regimes arise at moments of significant political change in "non-Western countries." Early investor-state arbitration was used by Western European investors against Soviet (and poorer) Eastern neighbors' governments (Bockstiegel, 1965), many of whom were ideologically opposed to "Western-style" property norms (Marks, 2008: 21). Even earlier, state-state arbitration was imposed on Latin American countries (Posner and Yoo, 2005: 32), where U.S. and UK heads of state presided (Greenberg et al., 2010: 6). These states also diverged from Western preferences regarding legal procedure around property claim through reliance on the Calvo Doctrine (Sornarajah, 2010: 475-480).[10] Turkey and Middle Eastern countries had Western legal practices imposed on them during the 1800s (Kayaoğlu, 2010). When these were abolished in 1949, investors began to insist on including and using arbitration provisions in their mineral contracts with states (Shalakany, 2000: 432-433). Arbitrators began insisting that "general principles of law" from Western states' practice would govern the contracts, even though Western countries' procurement contracts were not subject to international law forums and were unilaterally alterable (Anghie, 2007: 222-235). In sum, country differentiations that group developed countries with Mexico, Chile, Middle Eastern and Eastern European economies miss a theoretically and historically important diffusion dynamic.

Data

I use Franck's publicly available data.[11] This includes information on 49 finalized disputes over 1990-2006, including case outcomes and award amounts. The data is a 102 by 206 matrix with information about arbitrator nationality, country type and case proceedings. I subset the 49 finalized case, and correct and fill in missing data for various observations.

[10] These states resisted moves to investor-state arbitration until quite recently. The Washington Convention was finalized over Latin American countries' objections – an outcome facilitated by the common treaty dynamic that countries who object do not have to join (Parra, 2012: 67, 122).
[11] These can be accessed here: http://law.wlu.edu/faculty/page.asp?pageid=1185

Results

None of the six tables in Franck's 2009 paper are replicable on the basis of her publicly available data. With two corrections to the data that Franck agreed were oversights,[12] Table 1 (although no other tables) are fully replicable.[13] Franck's Table 1 is reproduced here.

	Non-OECD Respondent	OECD Respondent	Total
Non-OECD Arbitrator	10	3	13
OECD Arbitrator	21	15	36
Total	31	18	49

Table 1: Participants in IIA Arbitration

When I recode the variables using my modified country designations, developing countries increase from 63 percent to 86 percent of the respondents.

	Non-Western Respondent	Western Respondent	Total
Non-Western Arbitrator	11	2	13
Western Arbitrator	31	5	36
Total	42	7	49

Table 2: Participants in IIA Arbitration

Franck then moves to an analysis of the outcomes of arbitration decisions. I present the descriptive statistics in Table 3, which does not exactly match Franck's paper, due to a coding inconsistency.[14]

[12] According to her 2009 paper (note 111), arbitrator info was unavailable in Nykomb Synergistics Technology Holding AB v. Latvia, CCL v. Kazakhstan, and Nagel v. Czech Republic. However, to get results in her tables, she seems to have assumed arbitrator nationality in Nagel and Nykomb, which was borne out by other sources: http://www.iiapp.org/arbitrator/bjorn-haug; http://www.iiapp.org/arbitrator/hans-danelius/. She confirmed the miscoding in the publicly available information in correspondence with me on March 8, 2013.

[13] For simplicity, I do not report my reproductions of Franck's World Bank-based case outcomes. The paper reports one case classified as a claimant win when it should be a respondent win (Feldman or Metalclad). Also, it appears that the high income respondent state in the Mondev, Nagel, Lauder, Loewen, Soufraki, Methanex or Genin cases was reported in the paper as lower middle income. The first miscoding affects both the OECD and World Bank breakdowns; the second miscoding affects only the World Bank breakdown.

[14] One of the variables in Row 3 is miscoded as claimant win when her table shows respondent win. Note also that the "n" drops by two, since "the chi-square analyses omitted two awards that involved settlement agreements" (note 111, 135). These are the Goetz and Lemire cases.

	Claimant Win	Respondent Win	Total
Non-OECD Arb/Resp	5	5	10
Non-OECD Arb/OECD Resp	2	1	3
OECD Arb/Non-OECD Resp	8	11	19
OECD Arb/Resp	5	10	15
Total	20	27	47

Table 3: Participants and Outcomes in IIA Arbitration

Franck then splits the 4 by 2 contingency table into 2 by 2 contingency tables in order to calculate the chi-square statistic. For non-OECD arbitrators, she reports no pattern relationship ($\chi 2$ (1) =.258; p = .61; n = 13).[15] She reports an effect size (Φ) of .14, or potentially trivial under Cohen's conventions. In an a priori power analysis, she suggests that a sample size (S) of 343 would be needed to find this effect size with .80 power. She then suggests that to re-impose this power on the 4 by 2 contingency table requires N=(S/2)*4. (It is unclear where this formula is sourced from, as it increases power requirements substantially.) She reports N=686.[16]

For OECD arbitrators, she reports no pattern relationship ($\chi 2$ (1) =.045; p = .83; n = 34),[17] with Φ= .04, or smaller than a small effect.[18] Her a priori power analysis reports S=781 and N=1,562.[19]

With my recoded "West versus the Rest", I get the following table and results.

	Claimant Win	Respondent Win	Total
Non-Western Arb/Resp	6	5	11
Non-Western Arb/Western Resp	1	1	2
Western Arb/Non-Western Resp	11	18	29
Western Arb/Resp	2	3	5
Total	20	27	47

Table 4: Participants and Outcomes in IIA Arbitration

For non-Western arbitrators, I see no pattern relationship: ($\chi 2$ (1) =.014; p = .90; n = 13), with Φ= .09. (Because some of the expected count cells are under 5, I also report the Fisher's exact

[15] Because the expected values of three of the four cells are under 5, she should have instead reported Fisher's exact test, or a p=.53.
[16] There appears to be a rounding error in what she reported: for an effect size of .15, it should be S=349 and N=698. Using the exact effect size of .141, we get S=395 and N=790.
[17] Fisher's exact test would not need to be used for this test, since all expected cell counts are over 5.
[18] However, when one uses the data that she actually makes available, the results change to ($\chi 2$ (1) =.273; p = .60, n = 34). The effect size was .09.
[19] With the coding errors are corrected for but her data are otherwise used, S=969, N=1,938.

test of p=1.183213.) My a priori power analysis produces S=969, N=1,938. For advanced arbitrators, ($\chi 2$ (1) =.008; p = .93; n = 34), with Φ= .09. (Because of low expected cell counts, I report Fisher's exact test p=.919.)

I also tested for an association between non-Western status and losing, without regard to arbitrator nationality. The results are reported in Table 4a, which shows that non-advanced economies accounted for 85 percent of the winners and losers of IIA arbitration. For the chi-square analysis, I get the following results: ($\chi 2$ (1) =.000; p = .99, n = 47), Φ= .00. With such a low effect size, I didn't calculate the a priori power analysis.

	Claimant Win	Respondent Win	Total
Non-Advanced Respondent	17	23	40
Advanced Respondent	3	4	7
Total	20	27	47

Table 4a: States and Outcomes in IIA Arbitration

Franck also runs ANOVA analysis for winsorized damages awarded.

	Mean	Standard Deviation	Total
Non-OECD Arb/Resp	$1,808,556	$2,676,996	10
Non-OECD Arb/OECD Resp	$1,896,110	$3,150,611	3
OECD Arb/Non-OECD Resp	$1,214,762	$1,858,198	21
OECD Arb/Resp	$1,045,078	$2,035,499	15
Total	NA	NA	49

Table 5: Participants and Damages Awarded in IIA Arbitration (Winsorized)

She finds no statistically significant interaction among the OECD status of the respondent state, the OECD status of the presiding arbitrator, and the amount that tribunals awarded (F (1, 45) = .001; p = .97). The effect size was tiny at r = .01. A minimum sample of 781 cases would be needed to assess any effect reliably. (I was unable to replicate these exact numbers, instead getting (F (1, 45) = .0257; p = .87), and an effect size of r = -.005.)

When testing for the main effect on dollar amount awarded of OECD status of the government respondent, she finds none: (F (1, 45) = .005; p =.94). The effect size was tiny at r = .01. A minimum sample of 781 cases would be needed to assess any effect reliably. (I was unable to replicate these exact numbers, instead getting (F (1, 45) = .0243; p = .87), and an effect size of r = -.004.)

When testing for a main effect on dollar amount awarded of OECD status of the presiding arbitrator, she finds none: (F (1, 45) = .900; p = .35), except a non-statistically significant findings that non-OECD presiding arbitrators tended to award higher amounts. The effect size was larger than small at r = .14. A minimum sample of 343 cases would be needed to assess any

effect reliably. (I was unable to replicate these exact numbers, instead getting (F (1, 45) = .0137; p = .91), and an effect size of r = -.004.)

Table 5a presents the figures utilizing raw data, which shows higher means and standard deviations.

	Mean	Standard Deviation	Total
Non-OECD Arb/Resp	$21,479,250	$45,126,092	10
Non-OECD Arb/OECD Resp	$1,896,110	$3,150,611	3
OECD Arb/Non-OECD Resp	$1,337,721	$2,208,056	21
OECD Arb/Resp	$19,388,273	$69,410,462	15
Total	NA	NA	49

Table 5a: Participants and Damages Awarded in IIA Arbitration (Raw)

In Table 6, I present damages awarded by my country classification scheme.

	Mean	Standard Deviation	Total
Non-Western Arb/Resp	$20,029,592	$43,079,511	11
Non-Western Arb/Advanced Resp	$77,657	$109,824	2
Western Arb/Non-Western Resp	$10,178,031	$48,305,477	31
Western Arb/Resp	$679,456	$1,303,437	5
Total	NA	NA	49

Table 6: Participants and Damages Awarded in IIA Arbitration (Raw)

In Table 6a, I present damages awarded by my country classification scheme, without arbitrator information.

	Mean	Standard Deviation	Total
Non-Western Respondent	$12,758,202	$46,682,371	42
Western Respondent	$507,514	$1,104,931	7
Total	NA	NA	49

Table 6a: States and Damages Awarded in IIA Arbitration (Raw)

In Table 6b, I present aggregates.

	Sum	Number of Cases
Non-Advanced Respondent	$535,844,474	42
Advanced Respondent	$3,552,596	7
Total	NA	49

Table 6b: States and Damages Awarded in IIA Arbitration (Raw)

Now, a clearer picture emerges. The average award against a developing country was over $12.8 million, versus less than half a million for developed countries. A total of $535.8 million was awarded against developing countries, versus only $3.6 million against developed countries.

Running t-tests for the data in Table6a, I can report that non-Western countries were hit with higher awards: $t(41.00)=1.7668$. This is a modestly significant result at $p=.08$, with an almost medium-sized effect at $r=.27$. If I instead use the Mann-Whitney test for non-normal distributions, I get even starker results: $U=137$, $Z=-3.44$,$p<0.00$, $r=-0.49$.

Conclusion

As Susan Franck's work shows, there does not appear to be a pattern of arbitrators from rich countries systematically ruling against developing nations. Indeed, arbitrator nationality does not seem to matter for case outcomes, as my results from the "West versus the Rest" also support. However, my replication is consistent with the theory that non-Western countries pay out more than Western countries, even though they do not seem to lose more often than Western countries. The data through 2006 is very limited, and future work coding the outcomes of more recent awards is necessary to see if patterns change.

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