

Poor States or Poor Governance? Explaining Outcomes in Investment Treaty Arbitration

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Abstract. Critics of the international investment regime have claimed that its institution of arbitration is biased against developing states. Others have countered by arguing that any difference in treatment is better explained by the lack of democratic governance in developing states. This paper uses the largest dataset on concluded investment treaty arbitrations compiled to date to test these competing assertions of development bias and governance conflation. Beginning with a theoretical framework for both hypotheses, it argues that we need to disaggregate the potential causal mechanism, which includes replacing the idea of democratic governance with that of governmental quality. Empirically, the paper finds that the development status of a respondent state is a consistently powerful and statistically significant explanation of investment treaty arbitration outcome. Even after the introduction of a range of control variables and finely-tuned quality of governance variables, poorer states remain vastly more likely to lose in arbitration than wealthier states. However, some caution is needed in interpreting these results and more precise research is needed on competing development bias theories.

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I. INTRODUCTION

Treaty-based disputes involving claims between foreign investors and host states continue to gain wide attention. The vast majority of the more than 3500 international investment agreements (IIAs) signed in the past fifty years include investor-state dispute settlement (ISDS) provisions. These provisions have produced over 750 cases to date and the enthusiasm for litigation shows no sign of abating. Fifty percent of the cases have been initiated in the past five years, and more than 250 cases remain pending. A number of these claims by foreign investors have stirred considerable public controversy, and can be considered the key component driving what some refer to as a ‘legitimacy crisis’ in investment treaty arbitration (first noted in Brower, 2003; Afilalo, 2004-20015; Franck, 2005).¹

This web of IIAs including ISDS has led some to speak of the treaties and the disputes based on them as an emerging global regime (Salacuse, 2010). Whether a regime or not, IIAs are primarily bilateral in nature and therefore differ considerably from other centralized international economic regimes such as that established for multilateral global trade. Due to its bilateral structure, some have also claimed that the international investment regime is particularly prone to the (ab)use of power by economically and otherwise strong states and economic agents (Allee and Peinhardt, 2014; Simmons, 2014; Poulsen, 2015). This is enhanced by the prevalence of strong ISDS provisions that provide private standing to foreign investors and, according to some, the potential for frivolous claims and excessive litigation (Pelc, 2016).

This claim that certain agents have disproportionate levels of power over the governance and decision-making in the regime lies at the heart of the legitimacy debate around the use of investment treaty arbitration. In the context of arbitration, claims of a resultant regime bias can be divided into three categories: pro-investor, pro-investment, and anti-developing state. The *pro-investor* worry is that foreign investors are unfairly favoured in arbitration regardless of the particular state they are bringing the claim against (Van Harten, 2012). The *pro-investment* critique is that when protection of investment collides with other public policy concerns (environment, human rights, control of corruption, macroeconomic management), the specialist investment treaty arbitration comes down on the side of foreign investment

¹ For a historical overview of the narrative of ‘legitimacy crisis’ in the field of investment arbitration see Langford and Behn (2016). The term became particularly established in the literature after Waibel, Kaushal, Chung, and Balchin (2010).

protection (Koskenniemi and Leino, 2002; Suda, 2006; Langford, 2011; Peterson, 2006). The *anti-developing state* critique holds that foreign investors from developed states are more successful in litigation against host states in the developing world.

This article addresses the last claim, the concern that investment treaty arbitration is rigged against developing states. Thus, we ask, is there an *anti-developing state* bias in investment treaty arbitration? So far, there have been only a few tentative efforts towards empirically assessing this type of bias in investment treaty arbitration; and they tend to gravitate towards either criticizing or supporting the regime.

On the one side, analyzing the expansiveness of arbitrator interpretation of highly contestable terms such as ‘corporate person investor,’ ‘investment,’ ‘permissibility of investment,’ and ‘scope of MFN’ in 140 cases, Van Harten (2012) found that tribunals were more likely to side with foreign investors in disputes against developing states. Schneiderman (2008) has likewise claimed that investment treaty arbitration strengthens and reinforces inequalities between wealthy developed and poorer developing economies; and Schultz and Dupont (2014) more recently suggest in balancing between the property rights of foreign investors versus the need for host states to regulate in the public interest, investment treaty arbitration tribunals, tend to favour foreign investors from richer home states over poorer developing host states.

On the other side, some scholars are skeptical to the claim of an anti-developing state bias. In a series of insightful empirical analyses of investment treaty arbitration, Franck and colleagues consistently find that there is no demonstrable relationship between development status and outcomes in investment treaty arbitration (Franck and Wylie, 2015; Franck, 2014, 2007). Acknowledging that their empirical evidence is not bullet proof, an alternative argument was recently advanced: development status may be masking differences in levels of democratic governance amongst states, particularly the rule of law. The concern is that statistical analyses have “conflated development concerns with concerns that relate to democratic governance or a state’s internal good governance practices” (Franck, 2014: 55).

This notion of conflation has important implications for our understanding of variations in outcomes in investment treaty arbitration. However, determining and measuring the relationship between arbitration outcomes and state characteristics or attributes is extremely challenging. The exercise not only raises *methodological* questions about the proper conceptualization and categorization case outcomes (together with the effects of limited

sample size), but also *theoretical* questions about the actual mechanisms in which state attributes could influence case outcomes.

Drawing attention to both the methodology and theoretical dimensions of the development puzzle is important given the normative implications of these analyses. If a development bias is an artefact of the poor quality of a developing state's government (the conflation claim), we should not be perturbed. The fact is that most IIAs are designed to trigger litigation for acts such as poorly managed expropriations, fair and equitable treatment, arbitrary and discriminatory treatment, or failure to provide physical security. However, if an anti-developing state bias is present and unrelated to remedying the weakness of domestic institutions in certain host states, then the use of IIAs by aggrieved foreign investors in developing host states has repercussions for the legitimacy of investment treaty arbitration as a tool for solving disputes in particular – and for the entirety of the international investment regime more generally. A system of international adjudication that is biased against economically disadvantaged states for no other reason than their development status would be deeply troubling.

This article has three principal objectives. The first is to test the conflation hypothesis against a much larger sample of investment treaty arbitration cases. As has been pointed out by others (Gallagher and Shrestha, 2011; Pelc, 2016), the sample size applied by Franck (2007, 2014) is fairly limited. Using our novel PluriCourts Investment Treaty Arbitration Database (PITAD), we analyse 330 cases that have been finally resolved through 1 May 2016.² In light of recent findings that the regime has enhanced the degree of foreign investor protection over time (Schultz and Dupont, 2014), we believe that replicating previous studies with a larger sample sizes is particularly pertinent.

The second objective is to move the research agenda conceptually forward by establishing a more theory-grounded understanding of potential bias in investment treaty arbitration.³ This field of study is surprisingly atheoretical and often driven by anecdotal observation and data mining. In short, the mechanisms underlying the alleged anti-developing state bias are not

² PITAD will be made openly available in the very near future. It is continuously updated, and the figures cited here are as of 1 May 2016.

³ Quantitative hypothesis testing that is not guided by theory is problematic in that correlation is not the same as causation (King, Keohane and Verba, 1994). In other words, empirically explaining a relationship without grounding it in a basic theoretical understanding of the mechanisms that drive cause and effect is tantamount to explaining babies with the arrival of storks.

immediately evident. There might be multiple ways in which development status and quality of government interact to effect investment treaty arbitration outcomes. Moreover, if the conflation claim is correct, it is important from a policy perspective to understand what types of poorly governed domestic institutions drives this tendency.

We therefore theorize at different levels. We discuss specific mechanisms through which the anti-developing state bias may work and counter-hypotheses for why quality of government factors might explain this bias. At this point we depart from previous studies assessing the conflation of development and democracy. Instead of using catch-all conceptualizations for domestic institutions (such as the Polity IV indicator), we find it pertinent to distinguish quality of government from that of democracy. More specifically, we claim that one should focus on the impartiality of domestic institutions that exercise authority and that general notions of democracy are not particularly relevant to the exercise.

The third objective regards methodology. Using quantitative tools to study investment treaty arbitration is still a relative novelty, but we should be alert to the potential array of available data in measuring independent variables. We make the case for how using a continuous measure of development status (GDP per capita) allows us to utilize more information than previously-used categorical measures (such as World Bank income groups), and we apply a range of very specific proxies for quality of government. We also try to control for potential selection bias associated with the exclusion of settled or discontinued cases from the standard sample of finally resolved cases; and we introduce a range of controls in the multivariate analysis from both PITAD and external sources.

The article proceeds in the following way. Section 2 provides a brief introduction to the rise of the international investment regime and the explosion of treaty-based arbitration in the new millennium. Section 3 sets out two competing theories for how development status on the one side, and quality of government on the other might affect outcomes in investment treaty arbitration cases. Section 4 introduces PITAD and we discuss various ways in which investment treaty arbitration outcomes, development status and quality of government can be operationalized. Section 5 first offers some descriptive views on the caseload, before a series of analyses exploring the hypotheses are presented. Section 6 concludes with some caution, and suggests the way forward to a broader and holistic quantitative research agenda for empirical scholars.

II. THE INTERNATIONAL INVESTMENT REGIME – AN OVERVIEW

The oft-stated purpose for the signing of IIAs has been to overcome problems of time inconsistency and credible commitments.⁴ Some or many states were assumed to be incapable of attracting foreign direct investment (FDI) as their various domestic institutions were insufficiently developed. As FDI often includes higher sunk costs than portfolio investments, this gave rise to a *time inconsistency* problem as foreign investors were worried that once they had conducted their investments, they became captive to the actions of their host governments. IIAs therefore provided host states with a mechanism for making *credible commitments* to the foreign investor before the investment took place. They signaled to foreign investors that their investments would be treated fairly; and the inclusion of ISDS provisions turned this promise into a material guarantee.

This understanding of IIAs has some support when placed in a historical perspective. Certain developing states long argued that foreign investors should not be privileged with rights exceeding what were available to similarly situated nationals.⁵ However, the competition for investment, particularly in a global era, seemed to prompt a special interest in IIAs. Developing states moved *en masse* from their earlier principled opposition to investment treaties during the era of the ‘New International Economic Order’ in the 1960s and 1970s. There was articulated concern that foreign investors might shy away from investing in states they perceived as having inadequate levels of political and regulatory risk. Indeed, Elkins, Guzman and Simmons (2006) argue that it was strategic for states to maintain in public a principled opposition to the regime but defect privately and sign IIAs in an attempt to gain a competitive advantage.

This causal narrative is reflected in the legal development of the regime. While the first modern IIA was signed in 1959,⁶ it was not until a decade later that first treaty permitting investment treaty arbitration was signed⁷ and prior to the 1980s less than 10 treaties on

⁴ The notions of time inconsistency and credible commitment are derived from the early works of Vernon (1971) and Kobrin (1987). The risk-reducing (and thereby cost-reducing) function of IIAs and formalized systems for dispute resolution also lie at the base of most analyses of the economic effects of IIAs (see e.g. Allee and Peinhardt, 2012; Tobin and Rose-Ackerman, 2010; Yackee, 2010; Gallagher and Birch, 2006; Neumayer and Spess, 2005; Egger and Pfaffermayer, 2004).

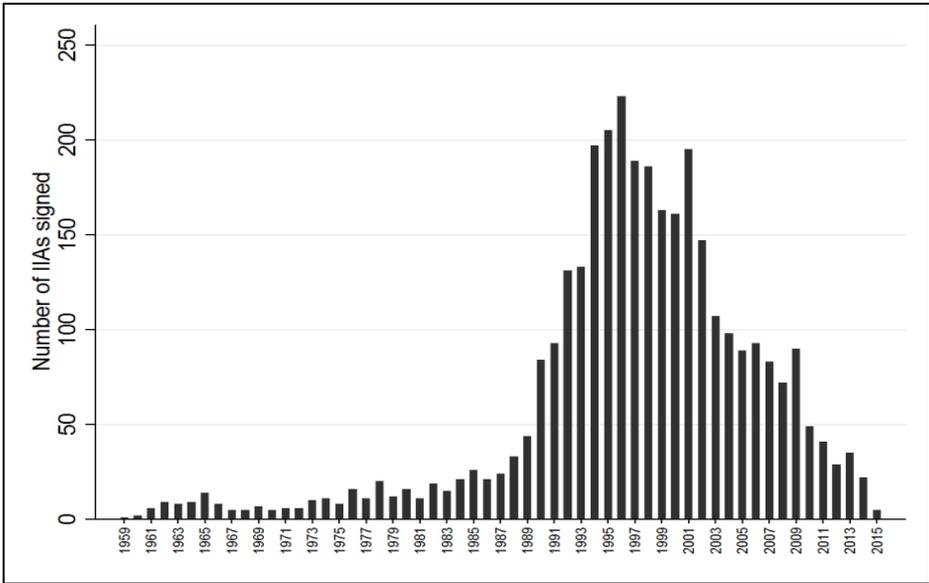
⁵ As evident in the work of Carlos Calvo, the clashes between some Latin American states and the US in nineteenth and early twentieth century.

⁶ Pakistan-Germany Bilateral Investment Treaty (BIT) (1959).

⁷ Chad-Italy BIT (1969).

average were signed per year. Yet, the era of globalization ushered in an explosion of treaty development and by the mid-1990s, more than 250 IIAs were being signed per year on average (see Figure 1 below).

Figure 1: IIAs Signed by Year (1959-2015)⁸



Of course, the credible commitments narrative has its limits. IIAs have often been promoted and driven by developed states rather than less developed states. The opening of new markets for their foreign investors was arguably the primary concern for developed states, rather than ensuring developing states could effectively compete for capital. Thus, a counter explanation to credible commitments would be *capital export*. Developed states wished to ensure that *their* foreign investors would be protected, especially in riskier environments. The resulting differential of interest and power is evident in the negotiation of the treaties. Studies suggest that developed states were largely the ‘rule-makers’ and developing states the ‘rule takers’ (Alschner and Skougariievsky, 2015); and certain developing or emerging economy states tended to not negotiate their IIAs – they signed what was put in front of them with little understanding of the economic consequences of the treaties (Poulsen, 2015, 2014; Poulsen and Aisbett, 2013). Moreover, Elkins, Guzman, and Simmons (2006) found that developing

⁸ These figures are compiled through merging the treaty lists of known IIAs from Alschner (forthcoming), Haftel and Thompson (2015), Allee and Peinhardt (2010), and UNCTAD’s Investment Treaty database. The list is used in Berge and Stiansen (forthcoming), and is part of a larger ongoing project to code the universe of IIAs for legal content.

states involved in IMF and World Bank debt relief programs were significantly more likely to sign these treaties.⁹

Whichever account of the rise of the international investment regime is the most persuasive is not a primary concern here.¹⁰ While the capital export thesis should certainly trigger a concern about asymmetries of power (to which we will return), what is notable about both theories is their underlying commonality: both the credible commitments and capital export theses presume that the quality of government in *lesser* developed states presents *higher* political and regulatory risks to foreign investment. IIAs provide an important guarantee that can meet these different interests.

Moving from this backdrop on the historical development, we turn to the reason why the international investment regime has garnered so much attention in recent years: it is not the treaties *per se* but the incidence of arbitration cases based on the ISDS provisions embedded in the majority of IIAs. These provisions provide foreign investors with procedural rights for enforcing the substantive protections¹¹ typically provided for in a treaty. Foreign investors are granted a standing offer to arbitrate a dispute should a treaty breach occur. Importantly, the structure of this system of adjudication means that an arbitration arising out of breaches of the underlying IIA will be composed on an *ad hoc* basis with relative autonomy from other disputes arising out of other IIAs; and most prominently, it allows private parties to bring direct claims against states, bypassing previous requirements of diplomatic espousal under international law. Combined, these structural characteristics of investment treaty arbitration make it a system of adjudication that is relatively novel in the history of international law.

With these treaty characteristics and the numerical rise of IIAs in the 1990s, it is unsurprising that we have seen an explosion of investment treaty arbitration in the past 10 years. While the

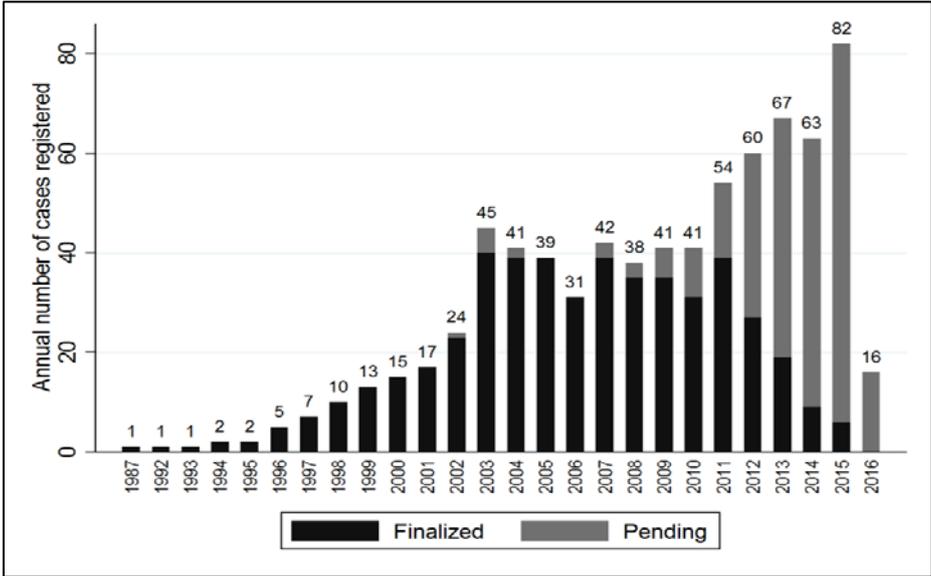
⁹ Of course, these conditions could be read in a paternalistic light, pushing developing states to make credible commitments in order to attract the FDI needed for growth and debt repayment. However, these two institutions were also dominated by Western developed states.

¹⁰ Indeed, some other explanations for IIA development also exist. The low-intensity of IIA negotiations in the 1990s and early 2000s suggest a certain institutional isomorphism: IIAs were easy and attractive to sign. Only two states were required for an agreement, parliamentary assent was almost never required, and the whole event provided a perfect media event for visiting heads of state.

¹¹ While each IIA is a stand-alone agreement with considerable diversity, provisions typically cover prohibition against expropriation without adequate compensation, full protection and security, fair and equitable treatment, national treatment, most-favoured nation treatment and free transfer of capital. Each of these provisions provides protection to eligible foreign investors (from a home state party to the IIA) for investments made in a host state party to the same IIA.

number of IIAs signed per year has slowed significantly in the past decade, the number of investment treaty arbitrations being filed has increased exponentially. The past five years have seen more than 50 cases per year being registered (see Figure 2 below). This is a dramatic increase from no cases prior to 1987 and an average of less than 10 cases per year throughout the 1990s.

Figure 2: Investment Treaty Arbitrations Registered by Year (1987-2016)¹²



These cases arise when a foreign investor alleges that a state hosting their investment has violated one or more of the substantive provisions in an IIA their home state has signed with the same host state. With wide definitions of what constitutes a foreign investor and investment in most IIAs, the subject-matter and type of disputes that have arisen to date are considerably diverse. Many early disputes dealt with investments that had considerable sunk costs, such as in the extractive industries or infrastructure projects. This has changed considerably in the past decade. An increasingly large percentage of recent cases that have been initiated by claimant-investors include subject-matters in the financial, manufacturing and service sectors (Behn, 2015). But what is common to all cases that have been brought to date is that they in one way or another concern aggrieved foreign investors claiming that illegitimate government authority has been exercised.

¹² PITAD caseload as of 1 May 2016.

III. THEORIZING BIAS AND IMPARTIALITY

1. The ‘Null’ Development Hypothesis

The abovementioned pattern of investment treaty arbitration cases quickly gave rise to concerns that developing states had drawn a short straw. Whereas there is considerable variation in the development levels of respondent states, almost 85 percent of the 758 claims that have been initiated to date have been brought by foreign investors who originate in relatively developed economy home states (Table 1 below). And while there are some cases brought between claimant-investors from developing states against fellow developing host states, they are in the distinct minority. Development bias seemed to be the *raison d’etre* of the regime given the geographical division of litigation, a conclusion strengthened by the fact that some developing states have had claims brought against them disproportionately often (Figure 3 below).

Table 1: Registered Cases by Host State and Home State World Bank Income Categories¹³

		Investor home state			
		High income	Upper middle income	Lower middle income	Low income
Respondent state	High income	174 23,0 %	12 1,6 %	10 1,3 %	2 0,3 %
	Upper middle income	255 33,6 %	30 4,0 %	5 0,7 %	(-) 0,0 %
	Lower middle income	176 23,2 %	30 4,0 %	8 1,1 %	(-) 0,0 %
	Low income	45 5,9 %	10 1,3 %	1 0,1 %	(-) 0,0 %
Sum (all registered cases = 758)		650 85,8 %	82 10,8 %	24 3,2 %	2 0,3 %

However, this popular anti-developing state claim faces a number of challenges. Empirically, the volume of litigation has no necessary connection with the nature of outcomes. Foreign investors lose the slight majority of the claims they bring and these cases could be very well be against developing states.¹⁴ Moreover, there is an emerging diversification in the pattern of

¹³ These figures are calculated using cases and case information registered in PITAD. The World Bank’s four-category income groupings are applied for a simple overview of the development status of the parties. World Bank Country and Lending Groups, <http://data.worldbank.org/about/country-and-lending-groups> (accessed 1 May 2016).

¹⁴ See e.g. European Commission’s statement on ‘Incorrect claims about investor-state dispute settlement,’ 3 October 2013, http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151790.pdf (accessed 1 May 2016).

IAs. A growing number are signed between developed economies, between developed and emerging economies, and between emerging and developing economies. Indeed, as emerging economies shift from being primarily capital-importing states to hybrid capital importing and exporting states, we are already noticing a potential for a rise in investment treaty arbitrations being initiated by foreign investors in these states. Logically, we might expect the causal connection to be the reverse. Following legal opportunity structure theory (Hilson, 2002), greater losses by developing states may encourage more litigation against them (rather than the reverse). Or, focusing on the actual claims brought against states, Freeman (2013) finds that states with greater domestic institutional capacity and better investor protection experience have fewer disputes than states with lower institutional capacity.¹⁵

In our view, there might be three plausible ways in which development matters for investment treaty arbitration: (a) *differential* legal and bureaucratic *capacity*; (b) *arbitrator bias*; and (c) the legal and economic *patterns* of investment treaty making and FDI flows. The first stems from the fundamental ability of respondent states to adequately pursue and finance arbitral proceedings. The second relates to a potential bias in arbitrator perception towards certain developing states acting as respondent. The third touches on the fact that historically certain states have been relative capital importers and certain states have been relative capital exporters.

All of these mechanisms may relate directly to the relative economic status of states responding to claims by claimant-investors, but they may also be masking the real underlying reason for differences in outcomes: quality of government. In the following, we detail why the development status of a state *per se* (not as a proxy for other state characteristics) may directly correlate with investment treaty arbitration outcomes. In the next section, we produce an alternative hypothesis for explaining outcome in investment treaty arbitration: the quality of government hypothesis.

A. Legal Capacity

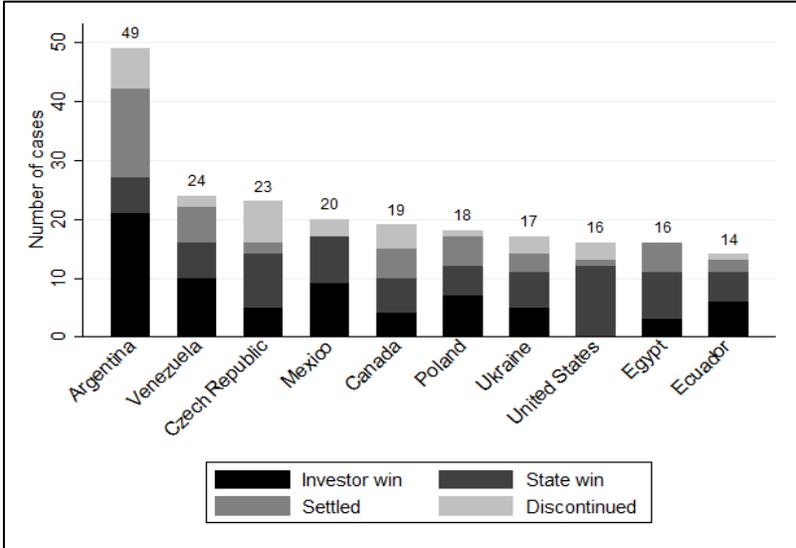
First, developing states may face an uneven playing field in investment treaty arbitration due to an inequality of arms, both as regards experience and legal funds available. On the one side, adapting Galanter (1969), foreign investors from developed home states may be

¹⁵ His findings leads him to conclude that although IAs are tools meant to overcome the issues of time inconsistency and credible commitment for states with less credible domestic institutions, it is precisely in these states that the costs of compliance with the international investment regime are the highest.

perceived as the ‘haves’ in arbitration: they tend to be strategic and well-resourced litigation players (although not always). Most developing states would appear to be the ‘have nots’ – under-resourced and relatively inexperienced in responding to high stakes international litigation (although not always). Overall, there is an argument to make concerning whether the development status of a state responding to an investment treaty arbitration claim might place it in a disadvantageous position due to its relative economic status.

However, there is also evidence that developing states have put significant resources towards litigating investment treaty arbitration claims for both strategic and financial reasons. Further, there is an argument that certain states that have experienced a high number of investment treaty arbitrations may become more experienced litigators of these types of cases than the claimant-investors initiating them. Some developing states have had to defend themselves against a high number of investment treaty arbitration claims and have developed their own litigation teams (e.g. Argentina, Canada and the US) to reduce overall litigation costs; and most importantly, a respondent state may become so experienced in litigating these types of cases that it creates a distinct advantage over certain claimant-investors that have never brought an investment treaty arbitration case before. This perspective may actually hold to some degree because there are many more repeat respondent states in investment treaty arbitration than repeat claimant-investors (Figure 3 below).

Figure 3: Top 10 Repeat Respondent States¹⁶



¹⁶ PITAD caseload as of 1 May 2016.

In addition to the issues of legal capacity and experience, there is also an argument that the mere cost of litigating an investment treaty arbitration claim may place a developing state at a disadvantage. According to Franck and Wylie (2015), the quality of legal counsel the parties are able to secure may be of importance to case outcomes. The core competency in investment treaty arbitration to date has been held predominately by a small group of global law firms with specialized practices focusing on investment treaty arbitration claims. It is well-known that these claims can also be particularly expensive to fund. A survey conducted by the OECD (2012) actually found the legal costs (not including tribunal fees) for each party to be on average USD 8 million per case, with the costs in certain cases exceeding USD 30 million.¹⁷ This cost threshold in itself might severely hamper states with small or limited public budgets' to acquire counsel to defend themselves against claims.

B. Arbitrator Bias

Secondly, we might expect that developed states receive more favorable treatment due to some form of arbitrator bias. Claims and evidence about international adjudicator bias is nothing new. In the context of the International Court of Justice (ICJ), Posner and Figueredo (2005: 623) reported that permanent judges on average are more likely to vote for a disputing state that shares a similar level of economic development and democracy with their home state: 24 and 29 percent respectively. The same patterns repeated, but to a much lesser extent, with shared religion and language (Posner and Figueredo 2005: 624). They also showed that these statist correlations explain a remarkable 60 to 70 percent of variance amongst individual judicial votes (Posner, 2004: 19-20). The explanations proffered by Posner and Figueredo are realist (judges vote in accordance with the interests of home states who share interests with similar states) and sociological (judges feel more 'sympathy' with comparable states).¹⁸ This sociological finding might be surprising but we know that individuals are more likely to engage in collective action when they "experience fraternal, or group-based, deprivation" (Zomer, Postmes and Russell, 2008: 505).¹⁹

¹⁷ For a more recent overview of the costs associated with litigating investment treaty arbitration cases, see Global Arbitration Review, 24 March 2014, http://www.allenoverly.com/SiteCollectionDocuments/Counting_the_costs_of_investment_treaty.pdf (accessed 1 May 2016).

¹⁸ In addition, the authors consider a new institutionalist explanation, whereby judges are disciplined by the threat of non-reappointment, but do not find conclusive evidence (Posner, 2004: 19-20).

¹⁹ As discussed in Knoke (1988: 316).

We could plausibly extend these findings to investment treaty arbitrators – particularly the sociological identification with comparable states. ICSID (2016: 18) reports that arbitrators from Western Europe and North America made up a total of 69 percent of all appointees to first instance tribunals and *ad hoc* annulment committees as per 1 December 2015. If the identification mechanism is in play, the disproportionate representation of Western state arbitrators may lead to more deference being paid to the arguments of defense by Western and developed respondent states (*favoritism*) or less deference being paid to developing respondent states (*prejudice*). This phenomenon may also be inflected by the fact that most claimant-investors originate in the West. While the presence of a developed state claimant-investor may cancel out the favoritism effect in cases concerning developed states, it might strengthen the prejudice effect in cases concerning developing ones.

The extent of this sociological identification might be contested. It is a strong claim to make that arbitrators engage in such biased decision-making. However, it might be strengthened by a conscious but seemingly fair use of development status. Arbitrators might use development as a proxy for quality of governance but err in the application. In other words, there is a conscious perception error which translates into a bias.

C. Treaty Terms and Economic Structure

The final explanatory factors for a possible anti-developing state bias may be less specific to arbitration. Instead, it is the broader legal and economic context that is determinative. Developing states may be disadvantaged by the *nature* of the treaties they have signed. Investment treaty arbitration outcomes may thus reflect an underlying systemic bias against developing states that is built into the regime from the get-go. Another aspect relating to historic trends in FDI flows relates to the relatively high rates to which FDI in developing states are in the extractive industries. This may be an important factor in determining an anti-developing state bias. This is because one might expect that there may be a correlation between the incidence of extractive industry-related arbitration case in developing states and negative outcomes for these states in these cases. A partial theoretical explanation for this would be that policies relating to the extractive industries often involve varying degrees of nationalization where a state subject to an arbitration claim goes into the case knowing that the case is not about liability but levels of compensation.

Given these three mechanisms, there are some good arguments as to why investment treaty arbitration outcomes may be structurally biased against developing states. However, there are

also a similar number of arguments as to why the development status of a state may either be a mere proxy for other state characteristics or attributes that are more likely to actually affect outcome or that the development status of a state is actually unrelated to investment treaty arbitration outcome. In the next section we discuss how the quality of government or *impartiality* of the legal and regulatory systems in respondent states may have more explanatory force in explaining differences in arbitration outcome.

2. The Quality of Government Hypothesis

One aspect of the normative legitimacy of the international investment regime stems from its perceived ability to increase FDI – and through that aid the economic development of states in need of investment capital. As has been discussed widely in the context of economic development in general²⁰ – the ability to attract FDI is not just a function of human or physical capital, it is very much related to political institutions. One recurring component in this institutions and growth literature is the importance of property rights protection and fair and accessible courts in states that are seeking to attract FDI. This strand of the institutions-argument can be extended to a host states' ability to treat foreign investors in a fair, impartial, non-arbitrary and even-handed manner in general. In short, the degree to which host states should be liable for breaches their IIA commitments is likely depend on the quality and impartiality of certain domestic institutions.

Previous empirical analyses of investment treaty arbitration outcomes (Franck 2014, Franck and Wylie 2015, Pelc 2016) hold that the level of democracy is the most relevant political institution in this context. Moreover, the argument is made that the alleged anti-developing state bias in investment treaty arbitration is driven by a conflation of democracy levels and development status – the reasoning being that levels of economic development and quality of domestic institutions are closely interlinked. The argument, to a certain degree, makes sense given that democratic states on average are governed in more open, transparent manner than non-democracies. If a foreign investor's interests are negatively affected by the acts of democratic governments, these type of respondent host states should be better able to demonstrate that the foreign investor was treated fairly and reasonable, afforded sufficient due process, and that any negative affect on the foreign investor is justifiable as a proportionate measure taken in the public interest. Accordingly, even if the foreign investor's rights are

²⁰ See Knack and Keefer (1997); Clague et al., (1999); Evans and Rauch (1999); Hall and Jones (1999); Acemoglu, Johnson and Robinson (2001); Easterly (2001); Easterly and Levine (2003); Rodrik et al., (2004).

negatively affected, democratic states may be more likely to affirm that their actions do not constitute a breach of an IIA than non-democracies.

In addition, it may be reasonable to assume that democracies treat foreign investors more fairly than non-democracies. Better levels of representation, participation or deliberation should ensure that foreign investors on average are subject to less arbitrary treatment – as countervailing domestic voices and interests are taken into account and the executive is dependent on the continuing support of his or her legislature to stay in office.

However, it is not clear that the effect of democracy will always work in such a unidirectional manner. There are both theoretical and empirical reasons for why the notion of democracy does not suffice to capture the institutions that actually matter to foreign investors. Stable autocratic governments might for example outperform democracies in constraining public, bureaucratic or domestic interference with foreign investors, especially unstable democracies but even stable ones. With higher levels of centralized coordination and less space for public uproar, autocracies may create less risk of political and regulatory instability – something that is of great interest to foreign investors. Some of the most well-known investment treaty arbitration cases were indeed driven by bottom-up public agitation against foreign investors in electoral democracies.²¹

Moreover, there are no guarantees that a democratically elected majority will adhere to their popular mandate. Studies find that democracy is curvilinearly related to levels of corruption (Montiola and Jackman, 2002; Sung, 2004). In some cases democratization is found to worsen impartiality in the exercise of public power,²² whereas certain undemocratic states have been successful in curbing corruption and building relatively impartial bureaucracies.²³ Democracies also have very patchy track-records in producing well-esteemed social outcomes such as economic growth (Kurzman et al., 2002; Przeworski and Limongi, 1993), human development (Gerring et al., 2005; Ross, 2006), and civil peace (Hegre et al., 2001). To be sure, “knowing the extent to which a country is democratic or not cannot help in explaining the multitude of highly valued economic and social consequences of QoG [quality of government] documented in the literature” (Rothstein and Teorell, 2008: 179).

²¹ See e.g. *Bilcon of Delaware Inc. et al v. Canada*, Award on Jurisdiction and Liability, 17 March 2015.

²² This was for example the case for Peru under the democratically elected President Fujimori. See McMillan and Zoido (2004).

²³ For a historical example, see the discussion of the Prussian state by Fukuyama (2014: 66-80). For more current examples, see the discussions of Hong Kong and Singapore in Root (1996).

The point is that democracy is a multifaceted concept, and one that is very difficult to define conceptually. While the divergent empirical findings on bias in investment treaty arbitration might be driven by methodology and sample size issues – we find that controlling for the catch-all notion of democracy to be misleading. A conflation theory of investment treaty arbitration outcomes should rather focus on the quality of those specific state-level institutions that may affect the chances that a state will breach their treaty commitments.

We depart from this notion of democracy as driving bias, and focus on what has been labelled variously as quality of democracy or quality of government (Morlino, 2004; Beetham et al., 2008; Levine and Molina, 2011).²⁴ In short, we are more concerned with the actual performance of governments in their exercise of authority *vis-à-vis* foreign investors, than the system in which they are elected. We further hold that the specific aspects to quality of government that are interesting stem from the *impartiality* in which public authority is exercised. Impartiality in the public exercise of power in this context builds on the legal notion of impartiality, and is defined by Rothstein and Teorell (2008: 170) as: “when implementing laws and policies, government officials shall not take into consideration anything about the citizen/case that is not beforehand stipulated in the policy or the law,” and thus “impartiality is first and foremost an attribute of the actions taken by judges, civil servants, politicians and the like.”

Through a broad reading of the claims that have been initiated to date,²⁵ it is evident that almost all of them stem from regulatory or administrative agency action or unfair treatment in domestic justice systems (and to a much lesser degree, legislative changes) – rather than aspects that are linked with the electoral system in respondent host states. In other words, the actions that lead to claims have very little direct connection to whether the state is a stable democracy. The notion of impartiality also fits well with the very basis or purposes of the international investment regime – providing legal protections for foreign investors in relation to various aspects of political and regulatory risk.

The question then becomes: what types of *impartiality* or quality of government measures may be conflated with a state’s development status? We believe that IIA breaches may stem

²⁴ The idea of quality of democracy as something that both conceptually and practically differs from minimalist conceptions of democracy builds on Dahl’s notions of *polyarchy* and *political equality* (Dahl, 1971, 1989) and Lijphardt’s early measures of the quality of democracy (Lijphardt, 1999).

²⁵ See UNCTAD’s Investment Dispute Settlement Navigator for an overview of most known investment treaty arbitration cases, <http://investmentpolicyhub.unctad.org/ISDS> (accessed 1 May 2016).

from impartiality in all branches of government, and thus we have chosen to focus on impartiality in the executive, legislative and judicial branches of state governments. In addition, we discuss the overarching and pervasive impartiality that stems from corruption. We therefore divide our measures of impartiality and quality of government into four categories: (a) executive constraints; (b) impartial and meritocratic bureaucracies; (c) judicial independence; and (d) political corruption.

A. Executive Constraints

Many of the cases brought under IIAs involve foreign investors claiming some sort of wrongdoing by the executive branch of their host state government. The most obvious claims might relate to uncompensated direct expropriations. However, there are a whole host of claims that could arise out of unfettered executive action. The hypothesis here holds that an executive branch (including the head of government, executive cabinet and various administrative agencies) that is constrained by both the legislative and judicial branches is less likely to take actions that would violate IIA commitments. However, while such constraints would not necessarily ensure that a state would take action (i.e. through legislative measures) that diminishes the value of a foreign investor's investment, we claim that executive constraints would reduce the likelihood of arbitrary executive action that would both diminish a foreign investor's investment *and* violate or breach an IIA.

To sum up, we would assume that an anti-developing state bias in investment treaty arbitration should be curbed by the ability of host states to constrain their executive's room to exercise authority arbitrarily and without constraint or oversight.

B. Impartial and Meritocratic Bureaucracies

The idea of impartiality is deeply entrenched in the concept of regulatory effectiveness. It is, for example, easy to make the case for why an impartial bureaucracy should be more efficient in carrying out and overseeing laws and regulations than one that experiences frequent political interference. The simple idea is that if you regulate by law, without having to take (erratic and arbitrary) political preferences into account, you are more likely to succeed in coordinating adherence with your legal commitments. Moreover, a meritocratic recruitment

structure in the civil service, rather than one based on clientelism, is likely to create a bureaucracy less prone to neopatrimonialism and corruption.²⁶

More generally, a strong and impartial domestic bureaucracy that is autonomous from political pressure should be better at governing without drastic changes in government, policy or services, than a politically influenced bureaucracy. Impartial and meritocratic bureaucracies should therefore minimize the risk of abrupt policy changes that might negatively affect foreign investors through various measures that result in directly or indirectly expropriating profits or holdings, arbitrarily or unreasonably interfering with or diminishing the value of an investment, or giving preferential treatment to domestic investors.

Another issue that might be directly related to the effectiveness by which bureaucracies operate and outcomes in investment treaty arbitration deal with how the foreign investor was treated (i.e. governmental decision-making is done in a way that affords the foreign investor adequate due process in a transparent and even-handed manner) and the type of evidence required in investment treaty arbitration cases. We would expect that impartial and transparent bureaucracies would afford foreign investors higher levels of due process relating to actions that might diminish the value of their investments. This is a critical issue in investment treaty arbitration as most of the substantive protections afforded to foreign investors under IIAs relate directly to treatment that deal with *how* (i.e., process-based) a foreign investor was treated. Further, we would expect states with highly functioning bureaucracies to be more transparent and capable of providing a ‘paper trail’ of evidence indicating that the foreign investor was treated in a manner that did not breach a relevant provision of an IIA.

Summed up, we expect the impartiality of, and meritocratic recruitment structure in, host state bureaucracies will help explain variance in arbitration outcomes.

C. Judicial Independence

Judicial independence is intrinsically linked to both the Rule of Law and to many of the substantive protections found in IIAs. Indeed, Rose (2004) holds that one of the important constituent elements of the Rule of Law is “the need for instrumentalities of impartial justice-courts.” What we mean by judicial independence in this context is a judiciary’s ability to be screened from various forms of political influence.

²⁶ See e.g. Rauch and Evans (2000) for an empirical analysis of how a meritocratic recruitment structure in developing states affects regulatory efficiency and levels of corruption.

In the context of investment treaty arbitration cases, the role of judicial independence is most likely to arise in fair and equitable treatment standard claims that embed within it the customary international law principle of denial of justice. While it is true that the number of denial of justice claims in investment treaty arbitration are limited, it is reasonable to assume that a state with a low level of judicial independence might be more likely to deny justice to a foreign investor. On the other hand, a state with a high level of judicial independence might be considered to apply the law in an impartial manner that is consistent with (both thin and thick) notions of the Rule of Law. We would predict that the level of judicial independence in a state is a good benchmark for assessing the likelihood that an IIA breach might occur.

However, it is very important to make a distinction here. As with the other quality of government indicators described in this section, one must be careful in confusing the difference between a state attribute that might give rise to an investment treaty arbitration claim and a state attribute that might indicate whether or not the state would be able to successfully defend against that claim. So, in the context of judicial independence, one might assume that a state with low levels of judicial independence might attract more investment treaty arbitration claims because foreign investors would seek to avoid the use of domestic courts in these states. Such a claim, however, has no relation to whether a state would be more or less likely to win such a case. As with impartial bureaucracies and various levels of executive constraint, judicial independence is relevant for our anti-developing state hypothesis to the degree that better or worse levels of judicial independence would give rise to a substantive breach of an IIA and whether the state being sued would be more or less likely to successfully defend itself from such a claim.

To sum up, we would assume that an anti-developing state bias in investment treaty arbitration could be captured by the ability of states to maintain an independent judiciary.

D. Political Corruption

Finally, corruption concerns the abuse of public office for personal gain, and may occur in all three branches of government. The type of corruption that we are concerned with “involves a holder of public office violating the impartiality principle in order to achieve private gain,” and conversely non-corruption implies that “a state ought to treat equally those who deserve equally” (Kurer, 2005: 230, 223). The norm violated through corruption as defined in this manner is the impartiality principle in the exercise of government authority. We would expect a government with high levels of political corruption to be less capable of achieving high

levels of impartiality in all levels of governmental activity. In the context of investment treaty arbitration, one might expect states with high levels of political corruption to be less capable of providing a secure and stable environment for foreign investments. A highly corrupt government might be more likely to behave arbitrarily and to act discriminatorily – or alternatively, more favorably – in relation to the treatment of certain types of foreign investors. Higher levels of political corruption tend to destabilize expectations and can lead to disparate, non-transparent and negative treatment of foreign investors. Under such a scenario, we could imagine that a state with high levels of corruption would be less likely to successfully defend itself against a claim by a foreign investor because of the arbitrariness, non-transparency and lack of due process associated with various types of corrupt practices.

Thus, any structural anti-developing state bias against developing states in investment treaty arbitration could be explained by the degree to which states effectively control corruption.

IV. DATA

To assess whether an alleged anti-developing state bias in investment treaty arbitration stems from a conflation of development and quality of government, we apply highly specified proxies for the impartiality of domestic governmental institutions, and a set of control variables identified through a careful review of previous studies. All state-level variables are lagged one year from the date the case was registered to assure a proper cause-effect relationship.

1. Dependent Variable – Investment Treaty Arbitration Outcome

Our units of analysis are investment treaty arbitrations in which information on case conclusion is known as of 1 May 2016. The complete set of available cases has been collected and gathered from a wide array of sources and coded in PITAD. We only include cases that are based on a treaty (as opposed to a contract or a state's foreign investment law), and each case was coded by a minimum of two researchers.²⁷ To our knowledge, PITAD is the most extensive database of all known investment treaty arbitration cases.²⁸

²⁷ The inter-code agreement was at 95 percent, and all disagreements were resolved through dialogue between coders and a senior researcher.

²⁸ However, to assess the validity of our results, we also use data available from UNCTAD's Investment Dispute Settlement Navigator, <http://investmentpolicyhub.unctad.org/ISDS> (accessed 1 May 2016). The results from these analyses are reported in Section 5.

First, it should be said that measuring investment treaty arbitration outcomes is complicated, and there are a number of in-data issues that may create sample selection biases. Regardless of how outcome is operationalized however, there is likely to be a structural bias in cases that are not made publicly available,²⁹ and in cases that do not reach a final award. The sample bias introduced by case secrecy is difficult to circumvent, but given that we have information on registered cases that are settled, discontinued or otherwise ended before a final award – it is theoretically possible to model the factors that determine selection into finally resolved cases that result in a final award.³⁰

As for how outcome is captured, there are many ways to Rome. In previous empirical studies of investment treaty arbitration outcomes,³¹ two main approaches to conceptualizing outcome have been discussed and applied. The first approach entails using absolute, categorical measures of case outcome. The principal way to do this is through the creation of a binary variable measuring any claimant-investor win and no claimant-investor win, based on whether the given tribunal did or did not find a breach or violation of the relevant IIA.³² The second approach allows for the assessment of relative claimant-investor success, either through using a claimed-to-awarded damages ratio, or through assessing how many of the substantive IIA breaches an claimant-investor claimed compared to how many the tribunal actually found to be meritorious.

Due to the problems associated with claimant-investors over-claiming on both compensation and alleged treaty breaches in their pleadings, we chose to work with a disaggregated measure of case outcome. But there is still the issue of what actually counts as a claimant-investor win or state loss. In order to overcome some of these challenges, we use data from PITAD, and expert analysis of all cases in our sample, to refine the standard win-loss dichotomy into a three category outcome variables. We code a full claimant-investor win as (2), a partial claimant-investor win as (1), and a claimant-investor loss as (0). A full win for the claimant-investor are awards where the claimant-investor's claims are successful. That is to say, the investor is made whole by the outcome – even if there is not success on all claims or that the

²⁹ Although evidence suggests that as time has passed, most awards now tend to be public (Franck, 2007: 19-20; Van Harten, 2007: viii).

³⁰ We discuss this more in Section 5.

³¹ As opposed to analyses of definitional issues within cases (Van Harten, 2012) or treaty-based arbitral claims (Freeman, 2013).

³² Cases that are settled, discontinued or ended otherwise are thus dropped from the sample (Franck, 2007: 38-39).

valuation of damages is less than what the claimant-investor asked for. A partial win for the claimant-investor is where the claimant-investor is not made whole by the outcome, meaning the investor is only awarded damages on some parts of the investment or where the damage assessment is equal to zero but the tribunal found a breach or violation of the relevant IIA. The important qualifier here is that full and partial wins for the claimant-investor are not based on the amounts that claimant-investor's claim in their pleadings; nor are they based on the number of claims that the investor is successful on (i.e. wins on their fair and equitable treatment claim, but loses on expropriation).³³

The set of investment treaty arbitration cases that were finally resolved³⁴ through an award produces a universe of finally resolved cases totaling 330. These 330 cases run from the first treaty-based award on 21 June 1990 (*AAPL v. Sri Lanka*) to the most recent award dated 15 April 2016 (*Vestey Group v. Venezuela*). The claimant-investor won on jurisdiction in 249 of the cases and lost on jurisdiction in 81. On the merits, the claimant-investor won in full in 80 cases and in part in 75 cases and lost in 175 cases (see Figure 4 below).³⁵

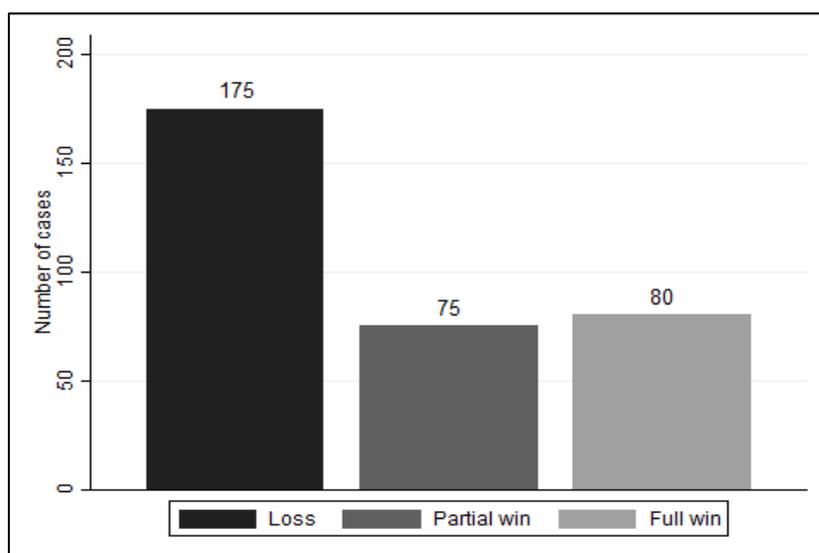
It should be noted that the investment treaty arbitration universe is expanding quickly, and as of 1 May 2016 there have been 758 investment treaty arbitrations registered. Of these cases, 263 are pending, of which 25 cases have a jurisdictional award rendered in favor of the claimant-investor. In addition to the pending cases, there are 49 cases that have been discontinued and 116 cases that have been settled. Of the 330 finally resolved cases in the dataset, there have been 82 different respondent states. Of the 758 registered cases, there are 111 different respondent states.

³³ In order to ensure that the coding of full and partial investor wins does not distort or skew our results, we have also run the below analysis with a dataset that collapses the investor win categories into a single claimant-investor win category (i.e. any win is coded as 1 and a loss is coded as 0). Using this dependent variable does not distort the results presented in the current analysis significantly, as discussed in Section 5 below.

³⁴ The caveat in regard to the use of the world finally resolved is that we also include liability awards that find the state liable for a breach or violation of the IIA but the quantification of quantum in the form of a damages award remains pending.

³⁵ More specifically, these 330 finally resolved cases include the following three types of outcomes: (a) claimant-investor loses on jurisdiction; (b) claimant-investor wins on the merits or through a liability award (divided into full and partial wins); and (c) claimant-investor loses on the merits.

Figure 4: Win-loss Ratios in All Finally Resolved Cases (1990-2016)³⁶



2. Independent Variables – Development and Quality of Government

The core of the conflation hypothesis concerns whether the effect of economic development on investment treaty arbitration case outcome is explained by domestic quality of governance in respondent states. In the previous section, we identified four quality of government aspects that should explain this potential conflation: constraints on the executive; impartiality of the bureaucracy; judicial independence; and levels of political corruption. We describe our operationalization of these theoretical concepts as well as for economic development below.

A. Economic Development

To measure the economic development levels of the respondent state, our core measure is GDP per capita, as reported per country-year in the World Bank’s World Development Indicators.³⁷ Using a continuous measure like this retains the most information, and is also the measure most frequently used in the institutions and growth literature (see, e.g., Knutsen, 2013). Due to the inherent skewness in this variable, we chose to log-transform it. For estimating predicted probabilities and for simpler comparison with previous studies of

³⁶ PITAD caseload as of 1 May 2016.

³⁷ See World Bank WDI at: <http://databank.worldbank.org/data/reports.aspx?source=2&Topic=3> (accessed 1 May 2016).

investment treaty arbitration outcomes, we also run our analyses using the World Bank's four-category income group measure of economic development.³⁸

B. Quality of Government

The first quality of government variable is *executive constraint*. We hypothesize that the degree to which domestic executives affect states' liability under IIAs may be closely related to whether the executive's power is curbed. To capture executive constraint, we utilize data from the novel and new Varieties of Democracy (V-Dem) data project (Coppedge et al., 2016).³⁹ The V-Dem project represents a new approach to the conceptualization and measuring of democracy, and supplies open access to both aggregates indices and disaggregated country-year data on a wide variety of aspects pertaining to quality of government. To measure constraints on the executive, we estimate the average country-year value of two pre-prepared indices from the V-Dem dataset: (a) judicial constraints on the executive – tapping into the extent to which the executive respect the constitution and comply with court rulings; and (b) legislative constraints on the executive index – capturing the extent to which the legislature and government agencies are capable of questioning, investigating and exercising oversight over the executive.

The second quality of government aspect we suspect may explain state liability under IIAs is the impartiality of domestic *bureaucracies*, and here we are especially interested in capturing the degree to which civil servants are free from political influence, and whether the recruitment structure in the civil service is based on merits. We therefore apply the Bureaucracy Quality index from the International Country Risk Guide (ICRG).⁴⁰ The index runs from 0 to 4. High scores indicate autonomous bureaucracies, with a meritocratic recruitment structure, and the strength and expertise to govern without drastic changes in policy or interruptions in government services. Low scores indicate bureaucracies that are prone to political interference and arbitrary regulation and administration.

³⁸ The World Bank's income groups are based on Gross National Income (GNI) per capita, rather than GDP per capita. The four categories are: (a) high income; (b) upper middle income; (c) lower middle income; and (d) low income. See <http://data.worldbank.org/news/new-country-classifications-2015> (accessed 1 May 2016).

³⁹ See the Varieties of Democracy project at: <https://v-dem.net/en/> (accessed 1 May 2016).

⁴⁰ ICRG is a for-profit organization supplying a wide variety of annual country risk measures to prospective investors and academics. Their codebook is available at: <https://www.prsgroup.com/about-us/our-two-methodologies/icrg> (accessed 1 May 2016).

The third quality of government variable is *judicial independence*. A core trait of domestic justice systems that may affect whether states are liable under IIAs is the independence of their domestic judiciary. To measure judicial independence, we use disaggregated data from the V-Dem dataset to create specific indices for the exact theoretical concepts we intend to measure. We retained the country year-scores from an exploratory factor analysis of four separate aspects: (a) judicial reform – capturing whether the judiciary’s formal powers were altered in ways that affect its ability to control the arbitrary use of state authority in any given year; (b) judicial purges – capturing if judges were removed arbitrarily or for political reasons; (c) government attacks on the judiciary – measuring how often the government attacked the judiciary’s integrity in public; and (d) court packing – capturing whether the size of the judiciary was increased for purely political reasons.

The last quality of government aspect we are interested in is the levels of political *corruption*. Corruption is a complex issue, but we are interested in a measure that captures corruption within the entirety of states’ government systems. We therefore apply the pre-prepared political corruption index from V-Dem (McMann et al., 2015). The index is centered on the pervasiveness of political corruption, and captures public sector corruption, executive corruption, legislative corruption and judicial corruption. Conceptually, the index taps into both petty and grand corruption, both bribery and theft, and both corruption aimed at influencing law-making as well as implementation of policy.

All quality of government indices applied run from low quality to high quality, with varying scaling. Descriptive statistics and bivariate correlations for all variables used are listed in the Appendix.

C. Control Variables

Investment treaty arbitration is a complex phenomenon, and we therefore control for a range of other aspects that may affect case outcomes. First, as a broad control for whether *arbitrator backgrounds* affect case outcome, we control for the GDP per capita of the tribunal president or chairperson’s home state. We use the economic data from the World Bank as described above, and log-transform the scores applied to correct for skewness in the variable.

Second, to control for the effect of what *legal counsel* the parties hire, we introduce two dummies to measuring some degree of counsel quality. These dummies take the value (1) if

the claimant-investor or respondent state counsel is from a Global 100 law firm,⁴¹ or if the respondent state has built up in-house legal teams to handle all investment treaty arbitration cases (Argentina, Canada and the US), and (0) otherwise. Although only a proxy, this should capture some degree of quality counsel. To not overshoot the effect of counsel, we assume the counsel *not* to be Global 100 in those cases where a party's legal representation is not disclosed. Third, to control for situations where specific events or circumstances create an artificially large caseload against a state in a short space of time, we use a *case-cluster* dummy. The dummy takes the value (1) if a respondent state has had five or more cases registered against it in a given year, and (0) otherwise. The case clusters in the full set of cases registered are: Argentina (2002, 2003, 2004), Czech Republic (2005), Ukraine (2008), Egypt (2011), and Venezuela (2011, 2012).

Fourth, to control for the fact that certain investments might induce structurally different cases, we apply a dummy measuring whether the investment leading to a claim is in the *extractive industries* or not. The dummy takes the value (1) if the investment is in upstream hydrocarbon and natural gas projects or mining projects. We assume that these types of cases might be more likely to favor claimant-investors for reasons articulated in Section 3.1 above. Fifth, we control for the effect of *previous exposure* to investment treaty arbitration to capture state learning. We assume the marginal effect of learning to diminish over time, and code how many cases any given respondent state has had filed against it at the time of case registration up until the tenth case. Thereafter, the investment treaty arbitration exposure variable is coded as 10.

Sixth, to control for the degree to which respondent states *invest in their public sector* we apply how large annual public budgets are as a percentage of GDP. Seventh, to control for the *dependence on FDI* we apply a measure of how large annual FDI inflows are as percentages of GDP. The FDI-GDP ratio is log-transformed to correct for skewness.⁴² Both of these variables are found in the World Bank economic data described above. Eighth, to control for the deteriorative effect of political instability and regime turnover on FDI, we apply the *Durable* variable from the Polity IV data project. This indicator measures “the number of years since the most recent regime change (defined by a three-point change in the

⁴¹ See American Lawyer, <http://www.americanlawyer.com/id=1202471809600/2015-Global-100-TopGrossing-Law-Firms-in-the-World-> (accessed 1 May 2016).

⁴² Because this measure in some instances take on negative values, and negative values have no natural logarithm, we apply a customized log-transformation used: $y = \ln\left(\frac{x + \sqrt{x^2 + 1}}{2}\right)$.

Polity score over a period of three years or less) or the end of transition period defined by the lack of stable political institutions (denoted by a standardized authority score)” (Marshall et al., 2013: 17). Lastly, to control for any *time specific trends* in investment treaty arbitration (Schultz and DuPont 2014), we introduce simple year dummies for each year in which there is one or more cases where a final outcome is rendered.

V. RESULTS

Because our main measure of case outcome is a three-category ordinal variable, we rely on an ordered logistic (ologit) regression model to assess whether economic development matters for investment treaty arbitration outcomes – or whether development is conflated with quality of government. The ologit model is similar to a logistic regression model, but allows categorical dependent variables with more than two outcomes. One of the assumptions underlying the ologit model is that the relationship between all outcome groups is the same. That is, the model assumes that the independent variable coefficients describing the relationship between the highest versus all lower categories on the outcome variable is the same as the coefficients that describe the relationship between the second highest outcome category and all lower categories. This is what is called the parallel lines assumption. In all of our models below, we have carried out likelihood ratio tests and Brant tests to assure that the parallel lines assumption holds.

Due to the fact that domestic institutions are inherently interlinked, estimating the effect of multiple institutional indices in the same models may cause multicollinearity.⁴³ Even though our tests indicate that entering all quality of government indicators in the same model does not create problematic levels of multicollinearity, we have chosen to enter them sequentially before regressing the full set of independent variables in tandem. For comparison, we estimate a baseline model without the quality of government indicators. All standard errors are clustered on respondent states.

⁴³ Multicollinearity occurs when two or more independent variables are approximately determined by a linear combination of other independent variables. The degree of multicollinearity can have different effects on estimations. When perfect collinearity occurs, that is, when one independent variable is a perfect linear combination of the others, it is impossible to obtain a unique estimate of regression coefficients with all the independent variables in the model. When high, but not perfect collinearity occurs, we may experience inflated standard errors and coefficients, rendering findings unreliable. An *ex ante* indication of multicollinearity issues in models is when the bivariate correlations between the independent variables are high. Find the bivariate correlations between our variables in Table A2 in the Appendix.

The coefficients shown in Table 2 below are odds ratios. In our baseline model that means (when holding all other variables constant): for one unit increase on the logarithmic GDP per capita scale in the year before a case was registered, the odds of full investor win (2) *versus* partial investor win (1) and investor loss (0) combined is 0.62 – or more intuitively perhaps, the chance of a full investor win as compared with partial win and loss is 42 percent lower with one unit increase in $\ln(\text{GDP per capita})_{(t-1)}$.⁴⁴ Equally, the chance of a full or partial claimant-investor win combined *versus* an claimant-investor loss drops 42 percent with one unit increase in $\ln(\text{GDP per capita})$. As we discussed in Section 2, this should not come as a surprise. The international investment regime was from early on meant as a remedy for foreign investors looking to invest in lesser developed states. The question then becomes if this finding is mitigated by controlling for respondent state quality of governance?

The findings are telling. Regardless of whether we control for our four quality of governance indicators sequentially (models 2 through 5) or in tandem (model 6) – the effect of respondent state development on a claimant-investor’s chances of winning an investment treaty arbitration case is persistent. The strength of the development effects remains close to unchanged and statistically significant throughout. In other words, claimant-investors fare much better against developing states than they do against developed states, even when controlling for the quality of the host state’s governance system. Moreover, the quality of respondent state governance does not seem to have any significant independent effect on case outcomes.

The control variable effects also yield some interesting insights. First, even though we will not be able to determine where the development bias stems from at this point, the controls for the investment treaty arbitration chairpersons’ or presidents’ home state development status (as measured by GDP per capita) and the parties’ legal counsel indicates that these may both affect how cases are decided. On arbitrator bias, an increase in the economic development status of the chairperson’s or president’s home state is associated with higher chances of claimant-investors winning in an investment treaty arbitration. The effect of hiring counsel from a Global 100 law firm only seems to matter for claimant-investors. Investors hiring counsel from a Global 100 law firm compared to those that do not can expect an on average a 23 percent higher chance of a full win in investment treaty arbitration.

⁴⁴ The odds ratio estimates the odds of being in of the highest category *vis-à-vis* the two lower categories. Therefore, when the odds ratio is below 1, the effect is negative. In this cases, the percentage change is 1 minus the odds ratio.

Table 2: Anti-Developing State Bias in Investment Treaty Arbitration

	(1)	(2)	(3)	(4)	(5)	(6)
Case outcome (0-2)	Baseline	Independent judiciary	Executive constraints	Impartial bureaucracy	Political corruption	Full
$\ln(\text{GDP per Cap})_{(t-1)}$	0.618*** (0.0972)	0.656** (0.115)	0.639*** (0.105)	0.644* (0.148)	0.580*** (0.108)	0.558** (0.136)
Independent judiciary _(t-1)		0.843 (0.204)				1.106 (0.332)
Executive constraints _(t-1)			0.763 (0.440)			0.164* (0.156)
Impartial bureaucracy _(t-1)				1.009 (0.222)		0.965 (0.295)
Political corruption _(t-1)					0.539 (0.360)	0.166 (0.199)
President home state dev.	1.229* (0.140)	1.237* (0.141)	1.229* (0.139)	1.267* (0.154)	1.232* (0.146)	1.281** (0.150)
Respondent counsel	1.245 (0.489)	1.218 (0.488)	1.238 (0.492)	1.327 (0.546)	1.198 (0.449)	1.296 (0.547)
Claimant counsel	1.857** (0.513)	1.881** (0.528)	1.893** (0.530)	1.783* (0.560)	1.832** (0.501)	1.862** (0.559)
Case cluster	1.509 (0.457)	1.341 (0.450)	1.523 (0.450)	1.713 (0.526)	1.554 (0.466)	1.974** (0.662)
Resources case	2.543*** (0.907)	2.465** (0.950)	2.473** (0.970)	2.573** (1.102)	2.719*** (1.001)	2.385** (1.040)
ISDS exposure	1.117** (0.0586)	1.111* (0.0604)	1.113** (0.0592)	1.103* (0.0600)	1.115** (0.0584)	1.105* (0.0618)
Gov. exp./GDP _(t-1)	1.077** (0.0355)	1.083** (0.0353)	1.081* (0.0386)	1.083** (0.0412)	1.069** (0.0348)	1.098** (0.0428)
$\ln(\text{FDI \% GDP})_{(t-1)}$	0.827 (0.136)	0.860 (0.153)	0.834 (0.134)	0.756 (0.145)	0.818 (0.139)	0.788 (0.170)
Regime stability _(t-1)	0.987** (0.00554)	0.988** (0.00569)	0.988** (0.00553)	0.987** (0.00550)	0.987** (0.00538)	0.987** (0.00506)
Constant 1	0.419 (0.519)	0.798 (1.120)	0.482 (0.593)	0.390 (0.489)	0.181 (0.303)	0.0274* (0.0579)
Constant 2	1.531 (1.920)	2.923 (4.077)	1.761 (2.191)	1.364 (1.717)	0.663 (1.110)	0.0971 (0.202)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Observations	320	317	317	291	317	289
Pseudo R ²	0.136	0.133	0.132	0.135	0.133	0.138

Ordered logistic regression models with exponentiated coefficients. Case outcome coded as: 0 = investor loss, 1 = partial investor win, 2 = full investor win. The N differs across models due to varying missingness in the independent variables. Standard errors in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Moreover our models indicate that: (a) claims based on investments in the extractive industries consistently have higher win chances than other types of claims; (b) respondent state exposure to investment treaty arbitration actually increases the chances of a claimant-investor win; (c) high government expenditure-to-GDP ratios in respondent states also increase the chances of a claimant-investor win in investment treaty arbitration; (d) the stability of the respondent state regime is associated with lower chances of an claimant-investor winning in investment treaty arbitration; and (e) high levels of FDI-to-GDP ratios seem to have no significant relationship with outcomes in investment treaty arbitration. This latter finding might indicate that respondent states that are economically dependent on FDI tend to behave better *vis-à-vis* foreign investors than those that are not as FDI-dependent.

A more intuitive view of the results pertaining to the development-governance nexus can be obtained by calculating the predicted probabilities of outcomes based on a categorical measure of respondent state development. Holding all other variables at their means, Table 3 below shows the predicted probability of any win by claimant-investors (both partial and full) across the World Bank’s four-category income groups.⁴⁵

Table 3: Predicted Claimant-Investor Win Rates (Any Win)

<i>Predicted investor win rates (any win)</i>	Baseline	Judicial independence	Executive constraints	Impartial bureaucracy	Political corruption	Full
Low income	68 %	66 %	67 %	60 %	70 %	65 %
Low middle income	53 %	53 %	53 %	49 %	46 %	52 %
High middle income	39 %	41 %	40 %	39 %	39 %	40 %
High income	26 %	29 %	28 %	29 %	24 %	28 %

These predictions paint the same picture as the regression estimates. Two trends are evident: (a) on balance, our models predict two times higher claimant-investor win rates against low income states than they do against high income states; and (b) the predicted claimant-investor win rates against each group of respondent states are fairly stable across all models. Thus the

⁴⁵ The models in Table 2 were also run using World Bank income groups instead of GDP per capita as a measure of respondent state development. Although the income groups are based on gross national income (GNI) rather than gross domestic product (GDP), the effect of development was surprisingly stable throughout all model specifications.

invalidation of the conflation hypothesis still stands. But if we break the probabilities down on the two degrees of claimant-investor wins (i.e., partial and full wins), the picture becomes a little more nuanced.

Table A1 (see Appendix) depicts the predicted probabilities for full wins and partial wins separately. The main difference in interpreting these predictions as compared to the ones based on any claimant-investor win is that they indicate that the anti-developing state bias might work a bit different from what the overall findings show us. If one looks at the predicted claimant-investor win rates against low income states (and keep in mind that the remaining percent within each cell-row represent the probability of a claimant-investor loss), we predict that a claimant-investor full win/partial win/loss rate is close to 0.33/0.33/0.33. To be sure, the predicted win rates for claimant-investors against low income states are almost equal for each of the three possible investment treaty arbitration outcomes. As we move down the rows however, the claimant-investor win rates drop substantially. One way of interpreting this is that the anti-developing state bias at play here might actually be a pro-developed state bias, rather than an anti-developed state bias; i.e., that the former are *favoured*. This is an important difference given the heated public debate about how the international investment regime actually functions. However, future research on the development hypothesis will need to examine this more closely.

To check the robustness of our findings, we have carried out a range of alternative model specifications and variable operationalizations. Our findings persist when collapsing the investment treaty arbitration outcome index to a binary win-loss variable. The findings are also robust to using the World Bank income groups as an alternative indicator of respondent state development. Using alternative regression models such as ordered probit regression and multinomial logistic regression does not alter our findings. For comparisons with studies using indicators of respondent state democracy levels rather than quality of democracy as a conflation variable (e.g., Franck, 2014), we also ran our models using the Polity2 regime indicator from the Polity IV dataset. The effect of development remained strong and significant. Lastly, as performed by Pelc (2016), using information about privacy and claimant-investors' prior experience in investment treaty arbitration as predictors of why cases reach the final award stage as opposed to being settled or discontinued, we estimated Heckman probit selection models. Correcting our findings for the odds of a case reaching a final award did not alter them in any significant way.

In sum therefore, and in direct contradiction to the findings of Franck (2014) and Franck and Wylie (2015), our analysis indicates that there is no observable conflation of respondent state development levels and quality of governance in predicting investment treaty arbitration outcomes. Claimant-investors fare significantly better in cases brought against lesser developed than more developed states. Although we cannot determine what drives this bias, we found some preliminary indications that there might be effects stemming from both arbitrator bias and quality of claimant's counsel. Lastly, we nuance the development bias by discussing findings that indicate what might be at stake is actually a pro-developed state bias rather than an anti-developing state bias.

VI. CONCLUSION

This article examined recent claims that any propensity for developing states to lose in investment treaty arbitration cases can be explained by the quality of their governance. Our research casts doubt on these findings. With a larger sample size, we found that our expanded multivariate models demonstrate a strong and consistent correlation between development status and investment treaty arbitration outcomes. These results held up despite our attempts to set out more specific and relevant theoretical hypotheses for the role of domestic governance and the identification of higher quality matching indicators to measure executive constraints, bureaucratic quality, judicial independence and corruption levels. The statistical picture remains clear: states with higher levels of economic development are less likely to lose investment treaty arbitration cases; and the inverse applies to states with lower levels of economic development.

Thus, the claim that developing states experience some sort of bias in litigating investment treaty arbitration cases may therefore not be without reason. It is a claim still yet to be disproved.

Moreover, these results also raise a new and interesting question: why development? In the beginning of the paper, we set out some general null hypotheses as to why development status might matter. These were: differential state capacity in litigation; arbitrator bias; and legal and economic structural differences. In our statistical work, only general undifferentiated controls were introduced for these development factors as our main focus was the conflation hypothesis. However, the fact that these development-oriented controls were all significant suggests that further investigation of these different hypotheses warrants further research.

Appendix

Table A1: Predicted Claimant-Investor Win Rates (Partial Win Versus Full Win)

	Baseline model		Judicial independence		Executive constraints		Impartial bureaucracy		Political corruption		Full model	
	Partial win	Full win	Partial win	Full win	Partial win	Full win	Partial win	Full win	Partial win	Full win	Partial win	Full win
Low income	31 %	37 %	31 %	35 %	31 %	36 %	29 %	31 %	30 %	40 %	30 %	35 %
Low middle income	29 %	24 %	29 %	24 %	29 %	24 %	27 %	22 %	30 %	26 %	28 %	24 %
High middle income	24 %	15 %	25 %	16 %	24 %	16 %	23 %	16 %	24 %	15 %	24 %	16 %
High income	17 %	9 %	19 %	10 %	18 %	10 %	18 %	11 %	16 %	8 %	18 %	10 %

Table A2: Correlation Matrix

	Regime stability	Independent judiciary	Executive constraints	Impartial bureaucracy	Political corruption
Regime stability	1				
Independent judiciary	0.393	1			
Executive constraints	0.336	0.660	1		
Impartial bureaucracy	0.523	0.588	0.693	1	
Political corruption	-0.512	-0.651	-0.789	-0.819	1

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