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COMMERCIAL DIPLOMACY AND POLITICAL RISK

Geoffrey Gertz

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Abstract:

The modern investor-state arbitration regime was explicitly designed to replace commercial diplomacy as a mechanism for protecting foreign investment. I argue, however, that diplomacy continues to play an important role in managing political risk, particularly in countries with weak rule of law. Yet since commercial diplomacy occurs primarily behind closed doors in confidential negotiations, it is difficult to observe, let alone test for its effects. To assess the effectiveness of contemporary commercial diplomacy, I exploit variation in vacancies among U.S. ambassadors to foreign countries—conditions which are determined overwhelmingly by U.S. domestic political factors, and thus represent a quasi-natural experiment for testing the effects of commercial diplomacy. I show that American investors are significantly more likely to initiate investor-state arbitration disputes when the position of U.S. ambassador to the host state is temporarily vacant, and that these effects are particularly strong in countries with weak rule of law. The results suggest American investors frequently seek assistance from the U.S. government in informally resolving incipient investment disputes; if diplomatic channels are unsuccessful or unavailable, investors then file formal arbitration cases. These findings have important implications not only for the investment protection regime but more broadly for understanding the role of commercial diplomacy in global economic governance.

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CONTENTS

Introduction	1
Commercial Diplomacy and Investment Protection	4
Measuring Access to Effective Commercial Diplomacy: Exploiting Ambassadorial Vacancies.	7
Empirical Approach	12
Analysis	15
Alternative Explanations	21
Conclusion	23
References	25
Appendix	31

FIGURES

Figure 1: Ambassador Vacancies, Investment Arbitrations and the Rule of Law.	19
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TABLES:

Table 1: Correlations of U.S. Ambassador Vacancies and Host State Characteristics	11
Table 2: Regression Results	18
Table A1: Descriptive Statistics	31
Table A2: Results When Splitting Sample by Rule of Law	32
Table A3: Results Including Additional Control Variables	33
Table A4: Results Using Alternative Models (I)	34
Table A5: Results Using Alternative Models (II)	35

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INTRODUCTION

Foreign investors face considerable policy risks when operating in developing countries that lack strong institutions for protecting property rights. Host state governments can expropriate investments, directly or indirectly; breach contracts; and impose new taxes and regulations on foreign investors. In response to these risks, firms rely on a range of political-, legal- and market-based institutions and strategies to minimize the likelihood and impact of adverse host state policy actions. These include forming joint ventures with local firms (Henisz 2000), integrating into supply chains (Johns and Wellhausen 2015), building political ties with host state policymakers (Henisz and Zelter 2005), partnering with politically powerful multilateral institutions (Nose 2014), purchasing political risk insurance (Moran 1998) and threatening and pursuing investor-state arbitration cases via the global network of investment treaties (Salacuse 2010; Allee and Peinhardt 2011;

Jandhyala and Weiner 2014; Kerner and Lawrence 2014; Simmons 2014; Wellhausen 2016).

This article focuses on an asset for managing political risk available to foreign investors which to date has received scant attention in the literature: access to political interventions from their home state governments.¹ It is well-known that firms with privileged access to domestic political actors and close ties to the state enjoy private advantages, and this appears to be particularly true in countries with weak institutions (Fisman 2001; Hellman, Jones and Kaufmann 2003; Faccio 2006; Truex 2014; Özcan and Gündüz 2015). Yet there is little systematic evidence on what effect, if any, foreign investors' access to political support from their home government has on their ability to manage political risk in foreign countries. Does greater access to commercial diplomacy from their home states benefit foreign investors? This article addresses this question in the context of investment disputes between American

¹ Exceptions in the literature for the post-Cold War period include Wells and Ahmed (2007), which addresses how energy companies investing in Indonesia turned to diplomats for support in the midst and aftermath of the 1998 crisis; Wellhausen (2014), which includes discussion of diplomatic interventions to support the property rights of foreign investors in Eastern Europe; and Duanmu (2014), which argues that Chinese state-owned enterprises are able to leverage the political influence of their home government to deter expropriation risk. Literature on the historical use of commercial diplomacy is discussed later in the text.

companies and developing country governments. I argue that U.S. firms rely on access to American diplomats for support in pressuring host state officials to informally settle investment disputes. Diplomats can facilitate dispute resolution by functioning as mediators and by pressuring host states to address investors' complaints by linking individual disputes to the broader bilateral diplomatic relationship. Commercial diplomacy is particularly important in countries with weak rule of law, where politicians and bureaucrats fail to apply rules and policies impartially, as such indeterminacy opens up more space for deals to be negotiated. When investors have access to a strong diplomatic presence able to help them resolve disputes through informal negotiations, they in turn are less likely to file formal investor-state arbitration cases.

Studies of the relationship between diplomatic interventions and investment protection are fundamentally challenged by a lack of observable data. Indeed, both the independent variable (the diplomatic intervention) and the dependent variable (the settlement of an investment dispute) are generally unobserved. When an ambassador calls a host state foreign minister and successfully convinces her to resolve a complaint lodged by a foreign investor, neither the intervention nor the dispute resolution is typically observed, as both occur behind closed doors. This lack of empirical material has contributed to a considerable gap in our understanding of commercial diplomacy and its role in contemporary investment protection.

This paper seeks to fill this gap. It uses a novel indicator to measure access to effective commercial diplomacy: temporary vacancies in the position of U.S. ambassador in American embassies abroad. Ambassadors play a crucial role in commercial diplomacy by personally

intervening with high-level government officials. When there is a resident ambassador in office, American investors have access to effective commercial diplomacy and are more likely to have their disputes resolved informally through diplomatic channels (which are unobserved). When the position of ambassador is temporarily vacant—conditions which are determined by U.S. domestic political and bureaucratic factors, and are thus plausibly exogenous to host country factors—this makes it more difficult for American investors to settle disputes informally. In these circumstances, investors are more likely to rely on formal legal arbitration (which is at least partially observed).² The findings suggest that despite the availability of investment arbitration, access to commercial diplomacy remains an important tool for settling investment disputes.

More generally, the arguments presented in this paper have broader implications for research on informal governance in the global economy and the role of diplomacy in contemporary world politics. In recent years the number and scope of formal institutions regulating international relations have significantly expanded and these organizations have become increasingly legalized (Abbott and Snidal 1998; Goldstein et al. 2000; Koremenos et al. 2001; Alter 2014; Johns 2015). This is particularly true of the international investment regime, where some 3,000 bilateral and multilateral treaties grant private actors direct access to legalized dispute resolution mechanisms. Yet the fact that diplomacy and informal power politics persist beneath the surface of the formal, legalized world of investment arbitration underlines that informal governance continues to operate even in highly legalized issue areas. These findings contribute to recent research on informal governance within formal international organizations (Christiansen and Piattoni 2003; Stone

² Not all arbitration cases are observed, as some are conducted privately and confidentially.

2011; Stone 2013; Kleine 2013), as well as the broader literature on informal institutions in comparative politics (O'Donnell 1996; Lauth 2000; Helmke and Levitsky 2004; Christiansen and Neuhold 2012). Similarly, the evidence that diplomatic interventions can promote the resolution of investment disputes should be of interest to academics studying the effect of diplomacy on economic relations (Rose 2007; Bayne and Woolcock 2011; Gray and Potter 2015; Poulsen and Aisbett 2016), while the focus on the personal interventions of ambassadors complements recent analyses of personal diplomacy in international affairs (Hall and Yahari-Miro 2012; Holmes 2013; Rathbun 2014; Lebovic and Saunders 2015).

The remainder of the paper proceeds as follows. The next section explains theoretically how commercial diplomacy promotes the informal settlement of investment disputes. The following section examines the role of ambassadors in conducting commercial diplomacy, and argues that ambassador vacancies represent a quasi-natural experiment for testing the effects of commercial diplomacy. The subsequent two sections introduce the data and present the model, results and robustness checks. The penultimate section considers alternative explanations of these empirical findings, while the final section concludes.

COMMERCIAL DIPLOMACY AND INVESTMENT PROTECTION

Throughout much of the 19th and 20th centuries, U.S. firms investing abroad frequently relied on American diplomatic interventions to help them resolve disputes with foreign governments (Krasner 1978; Lipson 1985; Veesser 2007; Maurer 2013). Since the widespread institutionalization of investor-state arbitration in the late 20th century, however, in principle investors no longer need to convince their home state diplomats to intervene on their behalf, as they now have direct recourse to pursue dispute settlement through legal arbitration (Shihata 1986; Schill 2010; Maurer 2013). The literature on contemporary investment dispute settlement and the investment regime generally focuses on these institutionalized approaches to resolving disputes, and tends to treat diplomatic interventions in investment disputes as relics of the “gunboat diplomacy” era of the late 19th and early 20th centuries (Johnson and Gimblett 2011).

Yet there is reason to believe commercial diplomacy—government interventions to advance the commercial interests of their nationals’ firms operating abroad—has persisted as a tool for managing political risk. Investor-state arbitration is both costly and lengthy; on average claimants in cases before the International Centre for Settlement of Investment Disputes (ICSID) spend \$4.4 million in legal costs (Hodgson 2014), and the average length of a case is nearly five years (Raviv 2014). Furthermore, drawn out, acrimonious arbitration proceedings may make it difficult for investors to continue operating in the host state and win future government contracts. These costs imply there may still be demand on the part of investors for commercial diplomacy as a mechanism for informally settling disputes. Similarly, the U.S. government continues to profess its interest in supporting American firms through commer-

cial diplomacy. During a 2008 congressional hearing, the State Department’s David Nelson reported that the “department encourages active embassy reporting on, and involvement in, claims and disputes of U.S. nationals against foreign governments... The resolution of investment disputes is a priority for the Department” (U.S. Congress 2008, 12).

While in previous eras commercial diplomacy could rise to the level of military interventions, today commercial diplomacy most often takes the form of private discussions in high-level meetings and visits by diplomatic officials (Kopp 2003; Gray and Potter 2015). This type of active commercial diplomacy can foster the settlement of investment disputes in two ways.

First, diplomats can serve as informal mediators of disputes, helping the two parties—the foreign investor and the host state government—arrive at a mutually acceptable negotiated outcome, which prevents the need for international arbitration. In an investment dispute both the investor and host state may have private information and incentives to bluff, which can make achieving a negotiated settlement more difficult (Fearon 1995). Mediators who are able to provide information to the disputing sides and thereby reduce uncertainty can thus help promote dispute resolution (Rauchhaus 2006; Savun 2008). In the context of investor-state disputes, embassy-based diplomats are well-placed to be effective mediators, as their relationships with both their nationals’ firms and host state government officials give them important relevant information, such as how strong an aggrieved investor’s case is and how willing and able a host state is to pay compensation. Similarly, diplomats can help structure negotiations by organizing meetings both individually and jointly with aggrieved investors and government officials, improving access and enhancing the flow of information between the two parties. In this role as me-

diplomats American diplomats are likely to be biased, preferring an outcome that benefits the investor, as part of their consular mandate is to represent and defend the interests of Americans overseas. Yet the literature on mediation suggests if anything this bias may make them more effective mediators (see, e.g., Kydd 2003, Rauchhaus 2006; Savun 2008; Svensson 2013).

Beyond simply acting as mediators, diplomats can also pressure host states to settle investment disputes by linking specific investor complaints to the broader diplomatic relationship, thereby expanding what's at stake in an individual dispute. This could involve explicitly linking the resolution of a particular dispute to a specific policy objective desired by the host state, such as securing aid or trade benefits. While the U.S. frequently relied on such tactics through the mid-20th century (Maurer 2013), more recently the government appears to only rarely use explicit issue linkage in investment diplomacy (Gertz, Jandhyala, and Poulsen 2016). More commonly, American diplomats implicitly link the settlement of a dispute to an improved diplomatic relationship and the prospects of benefits from future cooperation. Diplomats will bring up specific investor complaints during high-level meetings, making it clear to host state officials that the U.S. is following a particular dispute and has an interest in seeing it resolved.

Even without explicit credible threats, these diplomatic interventions can shift host state incentives. Given their multiple interactions over a disparate range of issues, diplomats and host state government officials are engaged in a repeated game, where negotiations over a specific event are shaped by a broader set of past interactions and in turn shape future interactions. Issue linkage across these negotiations is at the heart

of modern diplomacy (McGinnis 1986; Axelrod and Keohane 1985; Davis 2009; Poast 2012). When diplomats weigh in to request the settlement of a specific dispute, they signal that a host state's actions in this case could affect future cooperation. Given that the stakes in any individual dispute are often relatively low, personal relationships and the shadow of the future can shape the decisions of host state officials: even if a minister may otherwise be disinclined to pay an American investor a few million dollars to settle a dispute, she may be willing to do so if she believes it will foster a closer relationship with U.S. diplomats, which in turn will lead to further bilateral cooperation in the future. In a private interview, a former high-ranking State Department official responsible for commercial diplomacy confirmed that "the implied need to maintain good relations with the U.S." was often enough to compel host states to settle disputes, without any explicit mention of carrots or sticks.³

The ability of diplomats to use mediation and issue-linkage to encourage the informal settlement of investment disputes leads to the first key hypothesis:

H1: When investors have access to effective commercial diplomacy they are less likely to file formal investor-state arbitration cases, as disputes are resolved informally through diplomatic channels.

Though American diplomats carry out commercial diplomacy across the world, the importance of commercial diplomacy for managing political risk will be greater in some countries than in others. Specifically, commercial diplomacy is likely to be particularly influential in countries with weak rule of law. While the rule of law is a highly contested concept (Carothers 2006; Ginsburg

³ Interview with former State Department official, July 2015.

2011; Hadfield and Weingast 2014), I use the term to refer to the impartial exercise of government authority (Rothstein and Teorell 2008).⁴ In countries with strong rule of law, rules, and policies are clear, consistent and publicly announced, and are implemented impartially by public officials, irrespective of special relationships and personal preferences. Laws are applied consistently across similar cases, without taking into consideration anything about the citizen/case that is not expressly stipulated beforehand in the policy or law. In the context of firm-government relations, the rule of law affects what Hallward-Driemeier and Pritchett (2015) describe as the difference between “deals” and “rules” in the developing world. Where the rule of law is strong, all firms face the same rules, as official formal policies are implemented impartially; where the rule of law is weak, however, “the rules bend and become more like individuated ‘deals’ where outcomes are not the result of a neutral application of policy to the facts but rather have to be negotiated case by case” (135).

It is precisely when foreign investors find themselves negotiating individuated deals, rather than facing the impartial application of the rule of law, where access to commercial diplomacy is particularly valuable.⁵ If rules and policies are applied with complete impartiality, then whether or not a diplomat weighs in with support will have little effect on the outcome of an investment dispute—the specific features of the dispute itself will be determinative. However where rules and policies are applied inconsistently and partially, there is scope

for commercial diplomats to exert influence over the outcome of an investment dispute. Where the rules and procedures for treating foreign investors are malleable, there is an opening for diplomatic mediation and issue linkage to sway host state policymaking to the benefit of favored investors. In these instances dispute outcomes may turn on the personal interventions of high-ranking host state officials; exactly the type of officials that commercial diplomats meet with in private closed-door meetings.

Conversely, in countries with strong rule of law disputes are more likely to be resolved by the impartial application of rules through formally established legal and bureaucratic channels, leaving less scope for effective diplomacy to influence the dispute resolution process. Indeed, when effective these legal and bureaucratic mechanisms often sideline commercial diplomacy. For instance, American diplomats are instructed to be very cautious about weighing in on any ongoing local court case which arises out of an investment dispute, as they do not want to be seen interfering with independent judicial systems (Department of State 2014a, section 7 FAM 671).

This leads to the second key hypothesis:

H2: The effect of commercial diplomacy on investment protection will be greater in host states with weaker rule of law.

⁴ Rothstein and Teorell (2008) argue impartiality is the core feature of quality government, and note that their conception of impartiality encompasses the rule of law and also extends into other areas of government service provision (181-82).

⁵ Studies of the impact of firms' domestic political connections also tend to find the effects are particularly strong in countries with weak rule of law; see, for instance, Hellman, Jones and Kaufmann (2003).

MEASURING ACCESS TO EFFECTIVE COMMERCIAL DIPLOMACY: EXPLOITING AMBASSADORIAL VACANCIES

As the discussion above suggests, much commercial diplomacy takes place behind closed doors in informal, off-the-record meetings. This naturally makes it difficult to observe—let alone quantify—commercial diplomacy, and thus difficult to test for its effects. To overcome this obstacle, I introduce a novel measurement of access to effective commercial diplomacy: temporary vacancies in the position of U.S. ambassador to the host state. American ambassadors serving abroad leave their posts on average every two and a half years; there is always a gap between when one ambassador leaves and the next arrives, ranging from less than a week to over a year. Ambassador vacancies are a useful measurement of access to commercial diplomacy for two reasons. First, ambassadors are substantively important for the conduct of commercial diplomacy, and thus ambassador vacancies are a suitable proxy for poor access to commercial diplomacy. Second, from a methodological viewpoint, ambassador turnovers and vacancies are overwhelmingly driven by U.S. domestic political factors, and thus plausibly exogenous to host state economic and political conditions. Both claims are considered below.

The Role of Ambassadors in Conducting Commercial Diplomacy

While commercial diplomacy is carried out both by traveling diplomatic delegations (Nitsch 2007; Gray and Potter 2015; Lebovic and Saunders 2016) and by country-based embassy staff (Rose 2007), am-

bassadors have a crucial role in implementing day-to-day diplomacy (Ronning and Vannucci 1987; Malone 2013; Hollibaugh 2015). Ambassadors are the managers—or, in the words of the State Department's 2010 *Quadrennial Diplomacy and Development Review*, the CEOs—of bilateral diplomatic relationships. There are four specific reasons why ambassadors matter for effective commercial diplomacy.

First, ambassadors are explicitly trained and directed to promote American commercial interests as part of their jobs. According to the State Department's deputy assistant secretary in the Bureau of Economic, Energy, and Business Affairs, "The instructions every ambassador receives before assuming his or her responsibilities emphasize that support for U.S. investors and businesses overseas is a core diplomatic and consular function and a top priority for all U.S. economic agencies" (U.S. Congress 2008, 10). In private interviews both a former ambassador and a former high ranking Washington-based State Department official confirmed that ambassadors were trained to help resolve investment disputes.⁶ Similarly, the former U.S. ambassador to Singapore cites commercial diplomacy as one aspect of an embassy's work where ambassadors can have the greatest impact (quoted in DePillis 2013).

Second, commercial diplomacy relies on personal relationships developed through repeated interactions. Ambassadors have the authority to call meetings and develop personal relationships with high ranking host state government officials, while lower-ranked bureaucrats do not. Describing his relationship with then-Ukrainian President Leonid Kuchma, U.S. ambassador William Green Miller says Kuchma needed to "have constant engagement, that is, I had to meet him constantly to keep progress on agreed goals going. What

⁶ Interviews with former ambassador and State Department official, November and December 2015.

I have just described is evidence that an ambassador has great value, simply as a human presence, if he can keep the discussions going on the goals that both sides agree are important. There's no substitute for it" (ADST 2012, 71). This high-level access is important because heads of state and cabinet level officials have the decision-making power to settle disputes with foreign investors.

Third, persistent ambassadorial-level engagement in a dispute demonstrates that the home government is taking the issue seriously and that it has prioritized this particular investment dispute within the broader bilateral relationship. As one former diplomat notes about a successfully resolved dispute concerning intellectual property in China, "The fact that the ambassador, who enjoyed great respect in China, engaged himself personally and devoted extended time to the issue made a deep impression on the Chinese officials" (Kopp 2003, 75). Diplomatic interventions from lower-ranking embassy officials may be of a more technical nature, or a request for further information; conversely, when an ambassador raises a dispute in bilateral discussions, it is a signal that the issue is of political importance to the U.S.

Fourth and finally, when embassies are without ambassadors, there is likely to be greater overall uncertainty in the bilateral diplomatic relationship. As noted, the State Department envisions ambassadors functioning as CEOs, with responsibility for balancing and integrating the various American foreign policy objectives in

the host state. During periods of ambassador turnover, then, there will be uncertainty over the direction of the diplomatic relationship, and what issues should be prioritized in bilateral relations. To be sure, diplomacy does not stop when there is no ambassador—the bureaucrats based at the embassy continue their day to day work, led by the temporary chief of mission. But in the absence of a leader to set strategic priorities and manage the overall bilateral relationship, diplomacy is hamstrung, as the embassy staff wait for the appointment and arrival of a new ambassador, who may have their own particular interests and pet issues.⁷

For these four reasons, then, when an embassy lacks an ambassador, commercial diplomacy is likely to be less effective. American government officials appear to agree with this argument. A recent factsheet from the State Department's Bureau of Public Affairs explicitly links ambassadorial vacancies with commercial costs for U.S. businesses: "Without ambassadors in place, America's economic interests are compromised. U.S. businesses have sought embassy assistance in pursuing \$119 billion worth of contracts in countries currently without a U.S. ambassador. Last year, top-level diplomatic advocacy was responsible for more than \$5.5 billion worth of contracts awarded to U.S. companies by foreign governments" (U.S. Department of State 2014b). And speaking in 2006, during a debate in the Senate Foreign Relations Committee on ambassadorial appointments, then-Senator Joseph Biden noted, "We know from experience that leaving an embassy

⁷ While firms seeking commercial diplomatic support from an ambassador could also wait out ambassador vacancies until the arrival of the next appointee, there are costs to such waiting. To begin with, most U.S. investment treaties include restrictions which limit how long an aggrieved investor can wait after learning of an alleged breach before filing a claim. (For instance, the U.S. mining company Corona Materials LLC recently had its claim against the Dominican Republic dismissed at the jurisdiction phase because the statute of limitations had expired; see Sarmiento (2016)). Thus in the lengthy process of negotiating a settlement with the host state, if a firm waits for an extended period for a new ambassador to arrive the window for filing an arbitration claim could close. Moreover, there is some evidence that mediation is most effective at promoting resolution during the early stages of a dispute (Regan and Stam 2000; Beardsley 2008). Thus if there is no ambassador available to act as a mediator during the initial period following an alleged breach, positions on both sides could harden and an informal negotiated resolution may be less likely even once an ambassador is in place.

without an ambassador for an extended period of time is very bad for our interests because it reduces the amount of access to high levels of government for the U.S. embassy” (C-SPAN 2006). Yet the effects of ambassador vacancies have not yet been rigorously assessed.

Are Ambassador Vacancies Driven by Host State Conditions?

The second reason ambassador vacancies are a useful measurement for access to effective commercial diplomacy is that unlike many other diplomatic variables, such as the size of an embassy delegation or visits from the secretary of state, ambassador vacancies are plausibly exogenous to host state conditions. The vast majority of changes in ambassador and the length of ambassador vacancies are unrelated to host-country policies or bilateral relations between the two governments. This exogeneity allows us to treat ambassador vacancies as a quasi-natural experiment of weakened diplomacy in the host state.⁸

American ambassadors will typically leave their posts after two to three years because they are rotating to a new country, have taken a different job inside or outside of the U.S. government, or are retiring. Additionally, ambassador rotations partially follow

American political cycles, as political appointees—who account for approximately one-third of all ambassadorships—will frequently step down immediately or soon after a change in the U.S. administration (Arias and Smith 2015).⁹ In recent memory, there appear to be only a handful of instances in which the departure of an ambassador was directly related to host-country policies and bilateral relations: in 2005 the U.S. recalled its ambassador from Syria following the assassination of Rafik Hariri; in 2008 Evo Morales expelled the U.S. ambassador from Bolivia, accusing him of fomenting unrest; and in 2010 Hugo Chavez refused to accept the credentials of Larry Palmer, who had been nominated to be the next U.S. ambassador, after taking offense at a statement Palmer made concerning the Venezuelan military during his confirmation hearing before the U.S. Senate. Thus even in the very few instances in which ambassadorial turnovers are policy-driven, they are generally unrelated to investment protection policy (or even economic policy more broadly).

Similarly, in almost all cases the length of the gap between ambassadors is largely driven by U.S. bureaucratic processes and U.S. domestic politics, rather than host state factors. Before taking up a new posting, American ambassadors are first nominated by the president and then need to be confirmed by the U.S. Senate, a process which can be quite lengthy. The

⁸ To illustrate this point, consider the opposite condition: if countries experiencing economic distress or heightened political risk, for example, were more likely to see frequent and lengthy ambassador vacancies, this would be problematic for the research design, as these factors might also affect the total number of investment disputes in a given host state. In this situation a correlation between ambassador vacancies and investment arbitration cases could be spurious and driven by underlying changes in the host state, rather than any measure of the effect of commercial diplomacy.

⁹ In addition to differences in the timing of their tenures, there are other ways in which political appointee ambassadors may differ systematically from ambassadors who have spent their careers in the foreign service. In particular, some evidence suggests political appointees tend to be less effective diplomats than career foreign service officers (Hagland 2015). However, on the specific issue of commercial diplomacy, in separate private interviews two former high ranking State Department officials noted that the subset of political appointees who come from business backgrounds may actually have greater proclivity for commercial diplomacy, as they may be more at ease negotiating business deals than they are engaging in other aspects of diplomacy. While exploring this issue is an interesting avenue for future research, it is beyond the scope of this paper and thus in this analysis I do not distinguish between political appointee ambassadors and career foreign service ambassadors.

Senate may refuse to confirm a president's nominated ambassador because they disapprove of the individual selected, or, more generally, simply to block an initiative of the president. Even if the Senate does not oppose the nominee, there may be considerable delays in scheduling a hearing and vote, due to variations in the schedule of the Senate and what other legislation is prioritized ahead of an ambassadorial confirmation hearing. The president may exceptionally choose to appoint an ambassador while Congress is in recess; this temporarily obviates the need for Senate approval, however if Senate approval has not been granted by the end of the subsequent congressional term the ambassador must then be recalled (as recently occurred with the U.S. ambassador to Azerbaijan).

Perhaps surprisingly, even ambassadors awaiting confirmation to important strategic allies can face long delays. The U.S. ambassador to Australia was vacant for a 510 day stretch in 2005-2006, the ambassador to the United Kingdom was vacant for a 495 day stretch in 2004-2005, and the ambassador to Saudi Arabia was vacant for a 486 day stretch in 2001-2002. (To be sure, it is not only strategic allies who face long vacancies—some other countries who have recently experienced particularly long U.S. ambassador vacancies include Bahamas, El Salvador, Eritrea, Gambia, Guyana, Mozambique, and Turkmenistan.) There are a few instances of particularly long ambassadorial vacancies

reflecting poor diplomatic relations, yet this occurs only in extreme conditions with countries the U.S. considers “rogue states,” such as Burma, Libya, and Syria.¹⁰

Both the timing and the length of ambassadorial vacancies, then, are primarily driven by U.S. domestic factors rather than by host-state factors. As a basic examination of the relationship between host-state variables and ambassadorial vacancies, Table 1 presents a number of simple correlations. The table shows the correlations of both *Ambassador Turnover* (a 0/1 measure of whether the U.S. ambassador to the country stepped down during the year) and *Ambassador Vacancy* (the percentage of the year the position of ambassador was vacant) with various economic and political characteristics of host states and the U.S.-host state bilateral relationship. These include *GDP*, *GDP per capita*, *GDP growth*, *Population*, *Natural Resource Rents*, *Political Risk Rating*, *Democracy*, a measure of *Cooperative Bilateral Relations*, *U.S. Imports from Country*, *U.S. Exports to Country*, *U.S. foreign direct investment (FDI) in Country*, *U.S. Economic Aid to Country* and *U.S. Military Aid to Country*.¹¹

As expected, correlations between ambassador vacancies and host state variables are extremely low. Looking at ambassador turnovers, the absolute value of the correlation doesn't exceed 0.05 for any host state variables.¹² Correlations between the percentage

¹⁰ The results presented in this paper are robust to whether or not these politically-motivated vacancies are included in the data. Countries to which the U.S. refuses to appoint an ambassador as a political statement tend to host very little U.S.-sourced foreign investment—often because they also are subject to U.S. sanctions—thus there is very low potential for investment disputes, regardless of the presence or absence of an ambassador.

¹¹ The GDP, population and natural resource variables are all from World Bank (2015). The political risk score is the total political risk score from PRS (2015). The democracy variable is the net Polity IV score (Marshall et al 2014). The cooperative bilateral relations variable is a measure of net cooperation based on events data in the Global Database of Events, Language, and Tone (2015); the author thanks Wendy Wang for sharing her coding of this data. Import, export, and FDI data are from the U.S. Bureau of Economic Analysis (2015). Economic and military aid data are from the USAid Greenbook (USAID 2015).

¹² This finding appears to be persistent throughout American history; studying a much longer time period (since 1779), Arias and Smith (2015) find that American political factors are overwhelmingly the most important factor in explaining the length of U.S. ambassadors' tenure, and that host state characteristics or changes in the bilateral relationship have either no effect or substantively small effects.

of the year the position of ambassador is vacant and host state variables are only slightly stronger, with absolute values never exceeding 0.10. There is some evidence that the U.S. is less likely to leave the position of ambassador vacant for longer periods in democracies rather than autocracies, and in countries with which the U.S. has poor bilateral relations, though these results are driven by a few outlying countries; excluding Burma, Syria, and Libya, the correlations for democracy and bilateral relations diminish from -0.10 and -0.06, respectively, to -0.05 and -0.04. For the most part, the data suggests ambassadorial vacancies are largely independent of host state characteristics; there is no evidence that U.S. ambassadorial vacancies are

more or less likely in big or small economies, rich or poor countries, countries with high or low political risk, countries with whom the U.S. trades and invests a lot or a little, or countries to whom the U.S. sends lots of economic aid.

In sum, ambassadors are substantively important to the effectiveness of commercial diplomacy and, from the perspective of a host state, ambassadorial vacancies are exogenous events. This paper seeks to exploit the exogenous variation in these vacancies to test the role of commercial diplomacy on the settlement of investment disputes.

Table 1: Correlations of U.S. Ambassador Vacancies and Host State Characteristics

Host Country Variables							
	GDP	GDP per capita	GDP growth	Population	Natural Resource Rents as % of GDP	Political Risk Rating (ICRG)	Democracy
Ambassador Turnover	-0.00	0.01	0.04	-0.01	0.00	0.01	0.02
Ambassador Vacancy	-0.03	0.01	-0.01	-0.03	0.01	-0.03	-0.10
U.S.-Host Country Relationship Variables							
	Cooperative Bilateral Relations	U.S. Imports from Country	U.S. Exports to Country	U.S. FDI in Country	U.S. Economic Aid to Country	U.S. Military Aid to Country	
Ambassador Turnover	0.00	-0.02	-0.01	-0.01	0.03	0.04	
Ambassador Vacancy	-0.06	-0.04	-0.04	-0.01	-0.05	-0.05	

EMPIRICAL APPROACH

Ideally, we would study the effect of commercial diplomacy on investment dispute resolution by observing if effective diplomacy was associated with a greater likelihood of disputes being resolved through informal negotiations. There is some anecdotal evidence that suggests this is the case. For instance, the State Department reports that in the late 1990s U.S. Ambassador John Holzman helped the American power company AES settle a dispute with Bangladesh (U.S. Department of State 2001). AES had won two separate bids for power generation, but the Bangladesh government was threatening to cancel one on the grounds that a single company should not be awarded both contracts, despite the fact that this was not stipulated anywhere in the procurement regulations. Ambassador Holzman met with the Bangladesh prime minister and other high ranking Bangladeshi officials, and argued that “this was akin to changing the rules after the fact” and “that Bangladesh’s image as a destination for investment would suffer if AES were unfairly denied the project,” linking this individual case to the broader investment climate (U.S. Department of State 2001). Ultimately the Bangladesh government agreed, and did not cancel AES’ winning bid.

Similarly in Indonesia, the U.S. embassy aggressively pressed host state officials to settle disputes with the American energy companies Edison and General Electric (Wells and Ahmed 2007, 131-136, 183-84, 190-191). The Indonesian government had alleged that the American investors had bribed the previous government to win the contract to operate the Paiton power project, and had initiated a local court case charging the investors with corruption. The American companies insisted this was simply an effort to void their contract.

Then-U.S. Ambassador to Indonesia Robert Gelbard repeatedly intervened in the dispute, including personally negotiating with the Indonesian state utility regulator to convince them to drop the corruption case (Waldman 2004). This decision was controversial in Indonesia at the time, with multiple officials resigning over the issue and the speaker of the Indonesian parliament summoning officials to explain the decision (Wells and Ahmed 2007, 184). The following month the American investors and Indonesian utility regulator reached an interim agreement to their dispute, which was fully settled the next year. In their analysis of the case, Wells and Ahmed (2007) find that American diplomatic pressure was an important factor in Indonesia’s decision to drop the corruption case and ultimately settle the dispute.

These examples from Bangladesh and Indonesia demonstrate how ambassadors can use mediation and issue linkage to encourage investment dispute resolution. Yet most disputes that are resolved through informal diplomatic negotiations are never publicly reported—as both sides may have strong preferences to keep them private—and it is unlikely that those which are publicly known are representative of the universe of investor-state disputes. To provide a more generalized test of the effectiveness of commercial diplomacy, I therefore focus on observed disputes which were *not* resolved by commercial diplomacy: those in which American investors filed investor-state arbitration claims. The assumption is that investment arbitration and commercial diplomacy represent alternative means of dispute resolution: all else equal, if we observe more investors seeking to resolve investment disputes through arbitration, we can infer investors are having less success resolving disputes through commercial diplomacy.¹³

¹³ An alternative explanation is that the total number of disputes increases with ambassador vacancies, rather than the rate at which they are resolved informally decreasing; this is discussed further below.

Dependent Variable

The dependent variable is derived from an original dataset of treaty-based investment arbitration cases initiated by American companies and individuals. The dataset is limited to developing country host states and the period between 2000 and 2013.¹⁴ The arbitration cases were obtained from four sources: the list of completed and pending cases on the ICSID website (ICSID 2015); the list of treaty-based arbitrations on *italaw.com* (italaw.com 2015); reporting in *Investment Arbitration Reporter* (IAReporter.com); and the list of ongoing treaty-based arbitrations in the “Arbitration Scorecard” published biannually since 2003 by *American Lawyer* (Goldfarber 2003 2005, 2007, 2009, 2011, 2013).

The dataset includes American companies or individuals initiating arbitration. Unlike most previous studies of investment arbitration, the nationality of the investor is not simply taken as the nationality listed in arbitral proceedings. Large multinational companies based in the U.S. can use subsidiaries based in third countries to gain jurisdictional access to investment treaty protections.¹⁵ Such “treaty shopping” can mask the true nationality of investors pursuing arbitration. In this study investors are considered American if they pursue arbitration under an American treaty (either a bilateral

investment treaty (BIT) or an investment chapter of a trade agreement, such as those included in NAFTA and Dominican Republic-Central America FTA¹⁶) or if they are a subsidiary of a company headquartered in the U.S., identified through tracing parent-subsidiary relationships using the S&P Capital IQ (S&P 2015) database of private companies.

The dataset consists of 112 arbitrations between American investors and developing country governments. Of these, 21—or 19 percent—were initiated under treaties to which the United States is not a signatory, highlighting the importance of identifying parent companies of seemingly non-American companies. Of particular interest is the case of Venezuela, which has faced 12 treaty claims from American investors despite the fact that there is no U.S.-Venezuela BIT.

Independent Variable

Data on U.S. ambassadorial appointments are available from the Office of the Historian of the U.S. Department of State (2015), which provides a list of all current and previous American ambassadors. For a given country the position of ambassador is considered occupied for the period between the day on which an ambassador presents her credentials and the day

¹⁴ The analysis is limited to the period 2000-2013 because there were only a handful of arbitration cases before 2000; extending the dataset to the earlier period would thus further exacerbate modeling difficulties associated with inflated zeroes, discussed below. Developing countries defined as all countries except for those classified as “OECD High Income” by the World Bank. Results hold if the data is extended to also include developed countries; see robustness results in Table A4 of the appendix.

¹⁵ For example, Exxon Mobil restructured its investments in Venezuela to be based out of the Netherlands, explicitly for the purpose of gaining access to the Netherlands-Venezuela BIT, ultimately filing for arbitration under this treaty in 2007. In its ruling on jurisdiction, the tribunal in the case declared that “As stated by the Claimants, the aim of the restructuring of their investments in Venezuela through a Dutch holding was to protect those investments against breaches of their rights by the Venezuelan authorities by gaining access to ICSID arbitration through the BIT. The Tribunal considers that this was a perfectly legitimate goal as far as it concerned future disputes” (*Venezuela Holdings, B.V. and others v. Venezuela*, para 204).

¹⁶ U.S. treaties that provide recourse to investment treaty arbitration include all U.S. BITs, NAFTA, U.S.-Chile FTA, U.S.-Colombia FTA, CAFTA-DR, U.S.-Korea FTA, U.S.-Morocco FTA, U.S.-Oman FTA, U.S.-Panama FTA, U.S.-Peru FTA, and U.S.-Singapore FTA.

on which that ambassador's mission is terminated. The position of ambassador is considered vacant for the period between the termination of an outgoing ambassador's mission and the presentation of credentials of an incoming ambassador.

From 2000 to 2013, there were a total of 595 ambassadorial vacancies for the 136 developing countries,

which had a resident U.S. ambassador for at least part of this period. The average gap between ambassadors was 193.45 days—or slightly over six months—with a standard deviation of 254.37 days. There were 70 gaps of more than a year, and 71 gaps of less than a month. The average length of an ambassadorial appointment was 864.19 days, or slightly less than 2.5 years.

ANALYSIS

Before turning to econometric analysis of the data, I first simply consider whether a disproportionate number of arbitration cases are filed during ambassador vacancies. Across the 136 countries included in this study, the position of ambassador was vacant for 113,518 days during the 2000-2013 period. A total of 23 arbitration cases were initiated during such vacancies, giving an annualized rate of 0.0740 cases per country. During the remaining 553,897 days when an ambassador was in office, this figure drops to 0.0586. Thus the expected number of arbitration cases is 26 percent higher during an ambassador vacancy relative to periods when ambassadors are present.

Of course, this is only a rough estimate, as this analysis does not control for any other factors likely to be associated with the filing of arbitration cases, such as whether there is a ratified U.S. investment treaty with the host country or the quality of the host country's investment climate. But as an initial inquiry, these findings suggest a moderate but still significant effect of commercial diplomacy on the likelihood of investment arbitration cases.

Model

To further test the effect of commercial diplomacy on the use of investment arbitration, I run a series of zero-inflated poisson (ZIP) regression models. The dependent variable is the count of the number of arbitration cases filed by American investors against a particular country in a particular year. This variable is characterized by excess zeros, as most countries in most years do not face any arbitration claims from American investors. The ZIP model simultaneously estimates two separate relationships, a logit model

to predict excess zeroes and a poisson count model. The logit model predicts those cases which will never have a positive value, and are thus always zero; of the cases that are not necessarily always zero, the poisson model predicts the observed value, which may or may not be zero. The choice of a zero-inflated model is grounded in theory, as there are some country-years which are highly unlikely to ever experience investor-state arbitration cases, for example because they host very little U.S. FDI, and other country-years which have the potential for arbitration cases, which may or may not be realized. Similar zero-inflated models are used to model investment arbitration cases by Williams (2014) and Freeman (2013), and by Copelovitch and Pevehouse (2012) and Sattler and Bernauer (2011) to model World Trade Organization (WTO) cases.

The primary explanatory variable is *Ambassador Vacancies*, the share of the year the position of U.S. ambassador is vacant. I also consider an alternative measure of access to commercial diplomacy, *Extended Ambassador Vacancy*, a binary measure of whether the position of ambassador was vacant for more than six months of the year. In any year with such an extended vacancy there is likely to be substantial uncertainty in the diplomatic relationship; moreover, following lengthy vacancies, even once an ambassador is in place it may take some time to reestablish work on diplomatic priorities and achieve diplomatic successes. If access to effective commercial diplomacy is helping investors informally settle investment disputes, then we would expect both the *Ambassador Vacancies* and the *Extended Ambassador Vacancy* to be positively and significantly associated with formal arbitration cases filed by American investors.

To test the second hypothesis, that commercial diplomacy will matter less in countries where laws and policies are implemented impartially, the independent

variable is interacted with the *Rule of Law* metric from the World Governance Indicators (WGI). While there are significant conceptual and practical challenges to measuring the rule of law, the WGI measure is the most widely used such indicator in social science research (Ginsburg 2011; Versteeg and Ginsburg 2017). It is designed to capture the extent to which agents have confidence in and abide by the formal rules and policies in society, and includes indicators measuring judicial independence, the degree of observance of contractual terms, and whether the state exercises arbitrary pressure on private property, amongst others.¹⁷ I expect that the interaction between *Ambassador Vacancies* and *Rule of Law* will be negative.

In addition to these core variables of interest, I include a select set of control variables in the inflation and count models which theory and previous research suggest may be associated with investment arbitration cases. In the inflation model, I include two variables related to whether investors have the possibility of filing arbitration claims: *U.S. Ratified BIT*, a dummy variable for the presence of a ratified investment treaty (or trade agreement with investor-state dispute settlement) between the host state and the U.S., and the *U.S. FDI Stock (log)* located in the host country. As noted earlier, while in some cases American investors can initiate treaty-based arbitration claims by routing investment through subsidiaries in third-party countries, this is not an option for all investors, and it is still the case that it is significantly easier for American investors to initiate arbitration cases against host states which have a ratified treaty with the U.S. (Freeman 2013). Similarly, if there is only minimal U.S. FDI in a particular country, then the potential for investment arbitration cases in

that country will be very low (Freeman 2013, Williams 2014). Since the inflation model predicts which cases are always zero, I expect the coefficients on *U.S. Ratified BIT* and *U.S. FDI Stock (log)* to be negative, meaning they are associated with a greater likelihood of experiencing claims.

In the count model I include a number of control variables which predict the number of arbitration cases likely to be filed by American investors. I include an index of the *Investment Climate* (from the *International Country Risk Group* (PRS 2015)), which is a composite measure of the risk of contract breach, expropriation, and transfer restrictions in the host state. The index is based on expert surveys; if experts are influenced by news of arbitration filings, this variable may be endogenous with the count of claims filed. To account for this possibility, the *Investment Climate* variable is lagged one year. Countries with a poor investment climate are expected to have more claims (Freeman 2013, Dupont et al 2016). I also include *Disputes (lagged)*, a one period lag of the dependent variable, as a claim in a given country in one year often predicts claims in the following year (Simmons 2014). I include *Democracy* from the Polity IV database, which may be correlated to claims but whose expected sign is indeterminate: on the one hand democratic leaders may be more constrained in taking capricious action against foreign investors, on the other hand some government actions leading to investment claims—such as introducing arguably discriminatory new environmental regulations—may be taken in response to public pressure which a democratic government will feel more strongly (Williams 2014; Kim 2016).¹⁸ As the natural resource sector is often a source of arbitration cases, I include

¹⁷ The full list of concepts included in the measure's construction is available from info.worldbank.org/governance/wgi.

¹⁸ The inclusion of democracy in the model also accounts for any concerns arising from the fact that the ambassador vacancy variable is weakly negatively correlated with democracy.

a measure of *Natural Resource Rents (log)*.¹⁹ I include both *GDP PC (log)* and its squared value, as previous evidence suggests the effect of GDP per capita may follow an inverse-U pattern on the likelihood of facing an arbitration claim, with middle-income countries more likely to face claims than either low-income or high-income countries (Jensen et al 2014 and Williams 2014). Finally, I also include year fixed effects, given a slight upward trend in ambassadorial vacancies and the general upward trend in the filing of arbitration cases (the latter perhaps reflecting greater awareness on the part of investors of the remedies available under BITs). In all models robust standard errors are clustered by country.

Descriptive statistics of the dependent variable, key independent variables and control variables are provided in Table A1 of the appendix.

Results

Regression results are presented in Table 2. Model 1 reveals that there is a positive, statistically significant relationship between ambassador vacancies and investment arbitration claims: the greater the share of the year the position of U.S. ambassador is vacant, the more investment disputes likely to be filed by American investors in that country-year. For developing countries with a ratified U.S. BIT, when the position of ambassador is occupied for the entire year the predicted number of arbitration claims initiated by American investors is 0.17. When the position of ambassador is vacant 90 percent of the year, the predicted number of disputes rises to 0.34, effectively doubling the expected number of arbitration claims.

Model 2 builds on this analysis by including the interaction effect between ambassador vacancies and the rule of law. The interaction effect is negative and statistically significant, suggesting that it is particularly in countries with a weak rule of law where ambassador vacancies have an important effect on the filing of arbitration claims. Figure 1 compares the effect of ambassador vacancies on the predicted number of arbitration claims for a developing country with strong rule of law and a developing country with weak rule of law. As can be seen, in countries with strong rule of law ambassador vacancy rates have no effect on the predicted number of claims. In countries with weak rule of law; however, ambassador vacancies are significantly correlated with arbitration claims.

Finally, Model 3 replaces the *Ambassador Vacancy* variable with the alternative binary variable *Extended Ambassador Vacancy*. The results are consistent with earlier findings, as both *Extended Ambassador Vacancy* and its interaction with the *Rule of Law* are significant.

The control variables perform as expected. In the inflation model, a ratified U.S. investment treaty and the stock of U.S. FDI both significantly predict the possibility of countries experiencing any arbitration claims. In the count model, a weak investment climate is strongly associated with more arbitration claims. Similarly, countries are likely to face more arbitration claims if they are more democratic, have more natural resources and have moderate levels of GDP per capita.

Given the small size of the dataset of investment treaty claims initiated by American investors—an inherent

¹⁹ The figure is derived from the World Bank's World Development Indicators, and calculated by multiplying the Natural Resource Rents as a Share of GDP (%) variable by the Constant GDP \$ variable, and then logging according to the formula $\ln(1 + \text{Total Resource Rents})$; this ensures that for the countries with \$0 resource rents, the log value is $\ln(1)=0$, rather than $\ln(0)=\text{undefined}$.

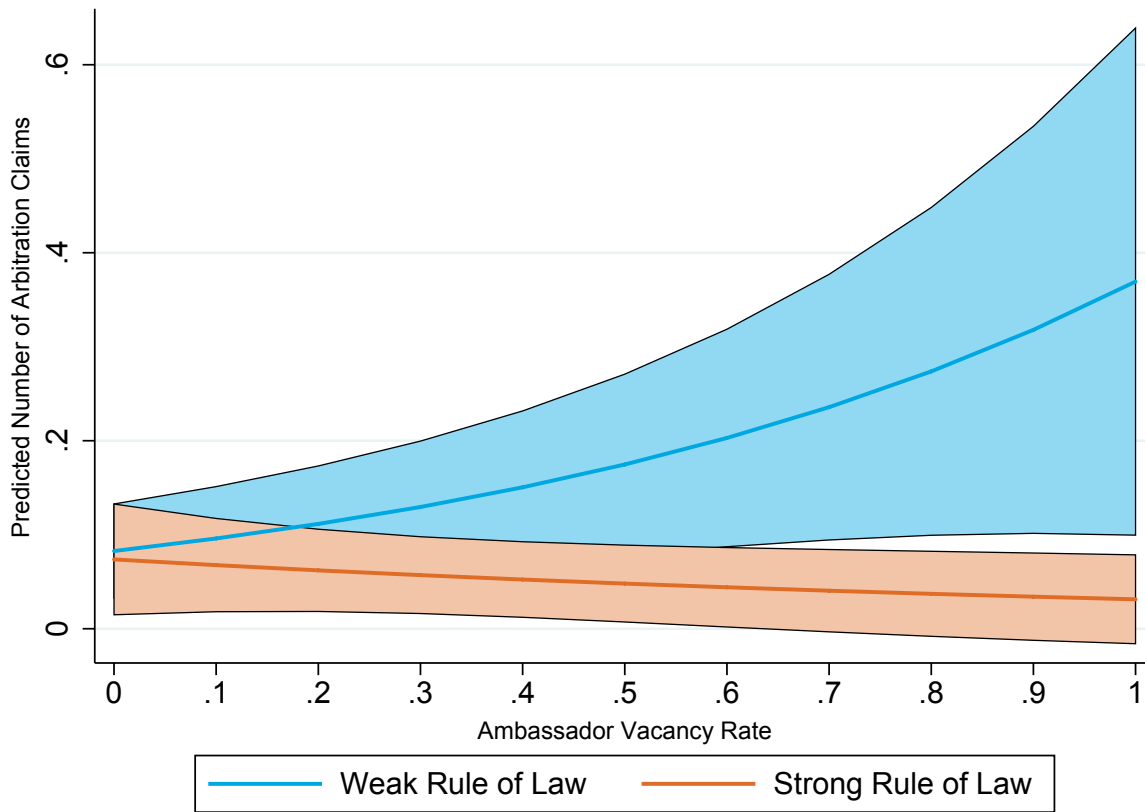
Table 2: Regression Results

DV: Investment Arbitration Claims	1	2	3
<i>Count Model</i>			
Ambassador Vacancies	0.793** (0.392)	2.886*** (1.042)	
Ambassador Vacancies * Rule of Law		-1.219* (0.628)	
Extended Ambassador Vacancy			1.911** (0.764)
Extended Ambassador Vacancy * Rule of Law			-0.824* (0.469)
Rule of Law		-0.059 (0.403)	-0.21 (0.388)
Investment Climate	-0.212*** (0.072)	-0.172** (0.077)	-0.188** (0.075)
Arbitration Claims (lagged)	0.148 (0.128)	0.137 (0.123)	0.133 (0.120)
Democracy	0.047* (0.026)	0.059** (0.027)	0.052* (0.027)
Natural Resource Rents	0.314** (0.134)	0.274** (0.140)	0.255* (0.141)
GDP PC (log)	7.617** (3.598)	7.665** (3.834)	7.331* (3.765)
GDP PC ² (log)	-0.456** (0.222)	-0.459* (0.235)	-0.435* (0.230)
Constant	-39.035** (16.095)	-38.487** (16.899)	-36.460** (16.524)
<i>Inflation Model</i>			
Ratified BIT	-3.612*** (0.707)	-3.615*** (0.738)	-3.534*** (0.748)
U.S. FDI Stock (log)	-0.438** (0.206)	-0.488** (0.235)	-0.482** (0.234)
Constant	11.887*** (4.273)	12.936*** (4.939)	12.784*** (4.927)
<i>Year Fixed Effects</i>	Yes	Yes	Yes
<i>Robust SE clustered by country</i>	Yes	Yes	Yes
<i>N</i>	1052	1052	1052

Note: Standard errors in parentheses

* p<0.1, ** p<0.05, *** p<0.01

Figure 1: Ambassador Vacancies, Investment Arbitrations and the Rule of Law



NOTE: Weak Rule of Law defined as the 10th percentile among developing countries of the World Bank’s World Governance Indicators Rule of Law index, while Strong Rule of Law is the 90th percentile among developing countries. The figure is based on results of Model 2. Shaded areas show 90 percent confidence intervals.

limitation of any statistical analysis of investment arbitrations—the results presented here should be interpreted cautiously. Bearing this in mind, however, the best available evidence suggests that American investors are more likely to initiate arbitration cases against host state governments during periods when there is no U.S. ambassador to the host state, particularly in countries with weak rule of law. These findings suggest that behind the scenes of the formal, legalized investment regime ambassadors continue to intervene in investment disputes to push for informal settlement.

As a test of the effect of commercial diplomacy, it is worth underlining that the results presented here show the *difference* in the effectiveness of commercial diplomacy when there is an ambassador vs. when there is not. Given that commercial diplomacy continues when there is no ambassador present, these results thus substantially understate the *total* effect of commercial diplomacy on the informal settlement of investment disputes.

Robustness Checks

In order to confirm these results, I run a series of robustness checks, which are included in the appendix. First, as an alternative test of the moderating effect of the rule of law on the relationship between ambassador vacancies and arbitration claims, I re-run Model 1 splitting the sample into countries with above and below average rule of law scores. The results are presented in Models 4 and 5 of Table A2 and are consistent with earlier findings and Figure 1: ambassador vacancies have a significant positive effect on the filing of arbitration claims in the weak rule of law sample, but no significant effect in the strong rule of law sample. This confirms that the effect of commercial diplomacy on political risk is highly concentrated in countries with a weak rule of law. Second, I consider whether a number of additional variables might influence the results. In Model 6, I include the number of *Total Ratified BITs* a host state has ratified, as a large network of BITs may create more opportunities for U.S. investors to pursue claims via subsidiaries in third party countries (Williams 2014). In Model 7, I include a measure of bilateral *Cooperative Relations*, while in Model 8 I include *U.S. Aid* to the host state as a share of GDP; both of these variables may affect the diplomatic relationship and influence of the U.S. in the host state. Results are presented in Table A3; none of the additional variables are statistically significant, and results for key independent variables are broadly consistent with earlier findings, though in Model 8 fall slightly short of statistical significance.

I also consider a number of alternative modelling and data sampling methods. Given that there may be unobserved country-level variables associated with investment disputes, in Model 9 I include country fixed effects in the count model.²⁰ In Model 10 I test a logit model using an alternative binary measure of the dependent variable, coded 1 if there are any arbitration claims in a given country-year and 0 otherwise. I extend the sample to also include high-income OECD countries as well as developing countries in Model 11 and exclude from the data disputes which were filed under a treaty to which the U.S. is not a signatory in Model 12, while Model 13 incorporates both of these changes. Finally, I also examine a number of alternative options related to the zero-inflation model. In Model 14 I include the *BIT Ratified* and *U.S. FDI Stock (log)* variables in both the inflation model and the count model, as they could conceivably affect both relationships. And though Vuong tests of zero-inflation and log likelihood ratio tests that the dispersion parameter alpha is equal to zero confirm that the zero-inflated poisson model best fits the data, I also test three alternative model specifications: a simple poisson count model (Model 15), a negative binomial model, which allows for over-dispersion but not zero-inflation (Model 16) and a zero-inflated negative binomial model, which allows for over-dispersion in addition to zero-inflation (Model 17).²¹ Results for all of these robustness tests are included in Tables A4 and A5, and again are consistent with the main findings.

²⁰ In order for the model to achieve convergence when including country-level dummy variables it is necessary to simplify the model, thus a number of control variables which have only minimal within-country variation in the dataset are excluded, including *Democracy*, *Natural Resource Rents* and *GDP PC*.

²¹ In comparison between a zero-inflated poisson model and a poisson model, a Vuong test confirms that the zero-inflated model is preferred ($p=0.0003$). In comparison between a zero-inflated poisson model and a zero-inflated negative binomial model, the likelihood ratio test that the dispersion parameter alpha is equal to zero cannot be rejected, and thus there is no strong evidence that the over-dispersion model should be preferred to the simpler poisson distribution.

ALTERNATIVE EXPLANATIONS

Results presented in the previous section demonstrate that U.S. investors are significantly more likely to file investor-state arbitration claims when American commercial diplomacy in the host state is hamstrung, namely when the position of ambassador is vacant. Are there other theoretical explanations consistent with this pattern, and how realistic are they? Two in particular merit further discussion: that American firms are more likely to be targeted by host states during ambassador vacancies, or that American diplomats are less likely to pressure U.S. firms to avoid filing arbitration cases during ambassador vacancies. Both are considered below.

I argue that commercial diplomacy is less effective at informally resolving investment disputes during ambassador vacancies. A separate, but related, possibility is that ambassador vacancies are correlated with the number of disputes experienced by American companies: host states choose to target American firms more when there is no ambassador present. That is, effective commercial diplomacy serves as a deterrent of investment disputes, rather than as means of informal dispute resolution. Parsing between these two hypotheses is difficult. Conceptually, the line between dispute resolution and dispute deterrence is blurry: if American diplomats are known to push aggressively for the resolution of investment disputes, rational host state bureaucrats might respond by initiating fewer disputes when U.S. diplomacy is effective, and more when it is not. Empirically, we can note that ambassador vacancies are not significantly correlated with observable measures of political risk; vacancies do not coincide with overall worsening of the investment climate, and there is no evidence that countries with particularly poor investment climates, those experiencing economic shocks, or those with a worse bilateral

relationship with the U.S. are more likely to experience frequent or lengthy ambassador vacancies. But it is still possible that during ambassador vacancies host states are more likely to subtly target American investors in ways that do not show up in these measures of political risk. Ultimately both arguments are consistent with the theory that a stronger diplomatic presence helps firms manage political risks, and they could both be true. Substantial qualitative evidence and anecdotal data—including instructions in the State Department’s manual for embassy staff abroad (U.S. Department of State 2014a), testimony from State Department officials to Congress (U.S. Congress 2008) and media reporting of particular disputes—suggest that ambassadors do intervene to encourage the resolution of investment disputes. I am not aware of any similar evidence to suggest that host states target U.S. firms during periods of ambassador vacancies, but cannot rule out it is a possibility.

A second potential alternative explanation consistent with the econometric results is that rather than ambassadors helping firms manage political risks, they in fact pressure American firms to avoid filing arbitration claims, fearing these claims will upset bilateral relations. Some host states have clearly viewed the filing of arbitration claims as hostile political acts—for example, in denouncing the ICSID Convention, Ecuador President Rafael Correa declared ICSID “signifies colonialism, slavery with respect to transnationals, with respect to Washington, with respect to the World Bank and we cannot tolerate this” (quoted in Diaz 2009). It is thus not a stretch to imagine diplomats eager to maintain friendly relations may have an interest in suppressing arbitration claims.

Yet the idea that diplomats are significantly pressuring firms to avoid arbitration against the firm’s own interests—that firms have better options for managing

political risk when ambassadors are absent, as they have more freedom to pursue arbitration claims—seems unlikely for a number of reasons. First, it should be underlined that the investor-state arbitration regime explicitly allows investors to initiate arbitration claims without the support of their home government, and even against the wishes of the home government. Thus though it's feasible American diplomats could place some pressure on U.S. firms not to pursue arbitration cases, there are no formal means through which the U.S. government could prevent claims from going forward. More importantly, if U.S. diplomats are actively seeking to curtail American firms' rights to pursue investor-state arbitration claims, this would be considerably at odds with substantial American policy and rhetoric regarding supporting U.S. firms operating overseas. State Department officials routinely iden-

tify commercial diplomacy as an important priority for the agency, both publicly and privately, and the U.S. has continued to push for the expansion of the investor-state arbitration regime, even as backlash against the regime has grown. It's conceivable there may have been individual instances of ambassadors encouraging an investor not to file an arbitration claim—where such an action at a particular moment in a particular country threatened to disrupt a political objective of the State Department—but this is unlikely to account for the broader empirical relationship between ambassador vacancies and arbitration claims. While diplomats' preference for fewer arbitration claims should not be discounted, the notion that they pursue this interest primarily by pressuring American companies not to file arbitration claims—rather than by pressuring host states to settle disputes—is improbable.

CONCLUSION

This paper sheds light on a little-explored corner of the investment protection regime: the contemporary use of commercial diplomacy in the settlement of investment disputes. I argue that diplomats use mediation and issue linkage to encourage host state officials to resolve the complaints of foreign firms, thus avoiding formal arbitration. I show that American investors are more likely to initiate formal investor-state arbitration cases when they lack access to effective diplomacy, i.e., when they are unable to turn to an ambassador for support. These effects are most pronounced in host countries with weak rule of law, where the partial and inconsistent application of policies makes such behind-the-scenes negotiations more important. Despite the rise of investment treaties and investor-state arbitration, access to commercial diplomacy remains a valuable asset for firms seeking to manage political risks abroad.

These findings have important implications for our understanding of the modern international investment regime. The literature on the investment regime is largely focused on investment treaties and investor-state dispute settlement. Yet investor-state arbitration is only the most visible tip of the iceberg in investment protection, and is viewed as a last resort by most investors. There is substantial need for research that analyzes the world of investment protection beyond arbitration, including a deeper understanding on the role and limits of commercial diplomacy.²² For instance, future research should examine in closer detail the array of specific actions and mechanisms diplomats use to encourage dispute settlement, and what explains variation in the intensity and frequency of diplomatic

engagement in investment disputes. What motivates governments to intervene in disputes on behalf of their investors abroad? How do investors value commercial diplomacy as a mechanism for protecting investment relative to other legal- and market-based tools? Furthermore, while this paper has focused on the U.S. government and U.S. investors, there are a number of reasons why the U.S. may not be representative of other capital exporting countries. Thus further research is necessary to determine if American commercial diplomacy is exceptional, or if other countries similarly support their investors abroad.

More broadly, these findings suggest the need for greater research and attention to how diplomacy functions as a pillar of informal governance in the global economy. There is an extensive literature on the origins, designs, and effects of formal international institutions for managing economic globalization, such as the WTO, International Monetary Fund, and World Bank. Yet much of the day-to-day management of conflict and cooperation in the global economy occurs outside of (though often in the shadow of) these formal institutions, in informal negotiations amongst private actors, diplomats and other government officials. Indeed, in recent years many countries have reformed their diplomatic services to place greater emphasis on advancing the commercial interests of their nationals' firms (Lee and Hudson 2004). More research is needed to understand the use and effectiveness of commercial diplomacy in the modern global economy, and to situate the contemporary period amongst historical antecedents. Specifically, to what extent and in what ways has the increasing legalization and institutionalization of rules for governing international economic relations altered earlier informal means of governing the global econ-

²² See also Peinhardt and Allee (2016), which makes a similar argument in the context of disputes resolved through political risk insurance.

omy through diplomatic exchanges? Under what conditions is informal diplomacy an effective mechanism for managing economic tensions, and when are more formalized and legalized alternatives preferred? To what extent do continuing informal exchanges complement, accommodate, substitute for, or compete with the formal institutions governing the global economy (Helmke and Levitsky 2004)? A deeper understanding of contemporary commercial diplomacy will contribute to a richer debate on how states manage processes of economic globalization.

Finally, the arguments and evidence presented here also have important policy implications for American diplomacy. State Department leaders and others sup-

porting a large American presence overseas often assert that an engaged and internationalist U.S. foreign policy produces tangible benefits for American businesses. These results provide some evidence to support such claims. At the same time, these findings suggest the warnings of the State Department and Senator Biden are borne out in the data: American interests suffer when there is no U.S. ambassador to a host state. Future research should explore what, if any, other dimensions of American foreign policy are affected by ambassadorial vacancies. And policymakers eager to gain domestic political leverage by withholding consent for new ambassador appointments should weigh the costs of these vacancies as they craft their political strategies.

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APPENDIX

Table A1: Descriptive Statistics

Variable	Observations	Mean	Standard Deviation	Min	Max
Arbitrations (count)	1918	0.06	0.34	0.00	7.00
Ambassador Vacancy (% of year)	1862	0.18	0.28	0.00	1.00
Extended Ambassador Vacancy (yes/no)	1862	0.14	0.34	0.00	1.00
Rule of Law (index)	1876	2.03	0.72	0.39	4.27
U.S. Ratified BIT (yes/no)	1918	0.28	0.45	0.00	1.00
U.S. FDI stock (log)	1558	18.06	5.51	0.00	25.70
Investment Climate (index, lagged one year)	1442	7.99	2.14	0.00	12.00
Democracy (index)	1693	2.46	6.28	-10.00	10.00
Natural Resource Rents (\$, log)	1701	20.09	4.21	0.00	27.08
GDP PC (\$, log)	1839	7.69	1.35	4.82	11.39

Table A2: Results When Splitting Sample by Rule of Law

DV: Investment Arbitration Claims	4	5
<i>Count Model</i>		
Ambassador Vacancies	1.379*** (0.408)	0.59 (1.316)
Investment Climate	-0.364*** (0.096)	0.07 (0.138)
Arbitration Claims (lagged)	0.092 (0.105)	0.927* (0.489)
Democracy	-0.001 (0.034)	0.075* (0.041)
Natural Resource Rents	0.119 (0.134)	0.312* (0.172)
GDP PC (log)	15.367** (6.571)	5.012 (4.222)
GDP PC ² (log)	-0.914** (0.385)	-0.324 (0.265)
Constant	-64.751** (27.668)	-29.989 (18.983)
<i>Inflation Model</i>		
Ratified BIT	-9.779*** (2.784)	-4.346 (3.522)
U.S. FDI Stock (log)	-2.699*** (0.884)	-0.271** (0.127)
Constant	62.994*** (20.004)	7.336*** (2.071)
<i>Year Fixed Effects</i>	Yes	Yes
<i>Robust SE clustered by country</i>	Yes	Yes
<i>N</i>	494	552

Note: Standard errors in parentheses. Model 4 includes only observations with below average Rule of Law scores; Model 5 includes only observations with above average Rule of Law scores

* p<0.1, ** p<0.05, *** p<0.01

Table A3: Results Including Additional Control Variables

DV: Investment Arbitration Claims	6	7	8
<i>Count Model</i>			
Ambassador Vacancies	2.808*** (1.077)	2.931*** (1.055)	2.825 (1.957)
Ambassador Vacancies * Rule of Law	-1.153* (0.671)	-1.244* (0.651)	-0.997 (1.069)
Rule of Law	-0.349 (0.519)	-0.116 (0.436)	-0.199 (0.400)
Investment Climate	-0.132 (0.104)	-0.159** (0.079)	-0.149** (0.063)
Arbitration Claims (lagged)	0.121 (0.124)	0.142 (0.125)	0.094 (0.110)
Democracy	0.060** (0.027)	0.061** (0.027)	0.056* (0.031)
Natural Resource Rents	0.242 (0.156)	0.271* (0.145)	0.397*** (0.116)
GDP PC (log)	6.92 (4.484)	7.265* (3.965)	10.227** (4.468)
GDP PC^2 (log)	-0.409 (0.277)	-0.433* (0.243)	-0.615** (0.268)
Total BITs Ratified	0.008 (0.009)		
Cooperative Relations		0.12 (0.176)	
U.S. Aid			38.441 (32.191)
Constant	-35.022* (19.722)	-37.116** (17.412)	-51.527*** (18.754)
<i>Inflation Model</i>			
Ratified BIT	-3.576*** (0.764)	-3.618*** (0.751)	-4.092*** (0.726)
U.S. FDI Stock (log)	-0.482** (0.238)	-0.490** (0.237)	-0.393** (0.188)
Constant	12.690** (4.974)	12.921*** (4.934)	11.370*** (4.107)
<i>Year Fixed Effects</i>	Yes	Yes	Yes
<i>Robust SE clustered by country</i>	Yes	Yes	Yes
<i>N</i>	1052	1049	905

Note: Standard errors in parentheses

* p<0.1, ** p<0.05, *** p<0.01

Table A4: Results Using Alternative Models (I)

DV: Investment Arbitration Claims	9	10	11	12	13
Count Model					
Ambassador Vacancies	2.475* (1.347)	3.538** (1.638)	2.105*** (0.794)	4.09 (2.568)	3.869** (1.811)
Ambassador Vacancies * Rule of Law	-1.249* (0.739)	-1.596* (0.964)	-0.831** (0.415)	-1.754 (1.466)	-1.453 (0.938)
Rule of Law	0.138 (0.970)	0.266 (0.557)	0.197 (0.232)	-0.646 (0.492)	0.062 (0.244)
Investment Climate	-0.023 (0.142)	-0.143 (0.114)	-0.156** (0.073)	-0.151** (0.061)	-0.169** (0.071)
Arbitration Claims (lagged)	0.146 (0.112)	0.944** (0.401)	0.187* (0.110)	0.007 (0.093)	0.132 (0.111)
Democracy		0.057 (0.037)	0.070*** (0.025)	0.045 (0.034)	0.050+ (0.029)
Natural Resource Rents		0.301* (0.160)	0.377*** (0.086)	0.390*** (0.104)	0.406*** (0.120)
GDP PC (log)		4.255 (3.059)	3.340* (1.833)	18.644*** (4.652)	2.796 (2.600)
GDP PC^2 (log)		-0.251 (0.185)	-0.199* (0.110)	-1.111*** (0.275)	-0.152 (0.154)
Ratified BIT		2.202*** (0.637)			
U.S. FDI Stock (log)		0.168* (0.097)			
Constant	-1.265 (2.838)	-32.515*** (12.550)	-23.350*** (7.646)	-85.508*** (19.446)	-22.049* (12.271)
Inflation Model					
Ratified BIT		-2.652** (1.140)	-3.700*** (0.685)	-6.096*** (1.037)	-6.112*** (1.048)
U.S. FDI Stock (log)		-0.569*** (0.202)	-0.327*** (0.121)	-0.296* (0.180)	-0.255* (0.141)
Constant		13.058*** (4.615)	9.776*** (2.718)	11.194*** (3.994)	11.014*** (3.416)
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes
Country Fixed Effects	Yes	No	No	No	No
Model Type	ZIP	Logit	ZIP	ZIP	ZIP
Includes High Income Countries	No	No	Yes	No	Yes
Includes Disputes Filed Under Non-U.S. Treaties	Yes	Yes	Yes	No	No
Robust SE clustered by country	Yes	Yes	Yes	Yes	Yes
N	1218	1052	1418	1052	1,418

Note: Standard errors in parentheses

* p<0.1, ** p<0.05, *** p<0.01

Table A5: Results Using Alternative Models (II)

DV: Investment Arbitration Claims	14	15	16	17
<i>Count Model</i>				
Ambassador Vacancies	4.006*** (1.335)	3.924*** (1.308)	3.776*** (1.374)	2.886*** (1.041)
Ambassador Vacancies * Rule of Law	-1.811** (0.808)	-1.664** (0.797)	-1.579* (0.860)	-1.219* (0.628)
Rule of Law	-0.15 (0.474)	-0.245 (0.563)	-0.174 (0.606)	-0.059 (0.403)
Investment Climate	-0.204** (0.095)	-0.224*** (0.078)	-0.219*** (0.080)	-0.172** (0.077)
Arbitration Claims (lagged)	0.185** (0.084)	0.166 (0.109)	0.22 (0.174)	0.137 (0.123)
Democracy	0.044 (0.033)	0.029 (0.031)	0.032 (0.034)	0.059** (0.027)
Natural Resource Rents	0.292** (0.143)	0.236* (0.123)	0.244* (0.128)	0.274** (0.140)
GDP PC (log)	3.69 (3.885)	5.064 (3.141)	4.811 (3.164)	7.666** (3.834)
GDP PC^2 (log)	-0.2 (0.231)	-0.28 (0.185)	-0.268 (0.185)	-0.459* (0.235)
Ratified BIT	1.579** (0.660)	2.216*** (0.490)	2.219*** (0.507)	
U.S. FDI Stock (log)	-0.15 (0.130)	0.165* (0.090)	0.163* (0.090)	
Constant	-21.635 (16.574)	-33.844*** (12.730)	-32.904*** (12.623)	-38.491** (16.898)
<i>Inflation Model</i>				
Ratified BIT	-2.038* (1.171)			-3.615*** (0.738)
U.S. FDI Stock (log)	-0.725* (0.413)			-0.488** (0.235)
Constant	16.520* (9.015)			12.934*** (4.938)
Year Fixed Effects	Yes	Yes	Yes	Yes
Country Fixed Effects	No	No	No	No
Model Type	ZIP	Poisson	NBREG	ZINB
Includes High Income Countries	No	No	No	No
Includes Disputes Filed Under Non-U.S. Treaties	Yes	Yes	Yes	Yes
Robust SE clustered by country	Yes	Yes	Yes	Yes
N	1052	1052	1052	1052

Note: Standard errors in parentheses

* p<0.1, ** p<0.05, *** p<0.01



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