

MANUSCRIPT ID GINI-2017-1212 ENTITLED “THE REPUTATIONAL
IMPACT OF INVESTOR STATE DISPUTES”

Dear Professor Schneider,

We first would like to thank you for the opportunity to revise and resubmit our manuscript. We believe the manuscript has greatly benefited from the Reviewers’ helpful and thoughtful comments. We have thoroughly revised the manuscript, taking seriously each individual point raised by the Reviewers. The revision memo is organized by first responding to your comments and then addressing the reviewers’ points. Our comments and responses are shown in *BLUE* below each point.

We hope you agree that the manuscript has greatly improved through this helpful process and we are looking forward to your response.

Sincerely,

The Authors.

one more that you appear to have overlooked: Aisbett/Busse/Nunnenkamp (2016)

1. REVIEWER 1

1.1. Major Comments.

- (1) To what extent is the basic assumption plausible that ISDS claims tarnish reputation? A series of studies have shown that awareness of IIAs and more so of claims is very limited even among foreign investors - why would claims impact on reputation? Among well-informed investors, it has become known that a good number of claims are entirely without merits, so the fact that a state is hit by a claim does not necessarily mean that the state has done anything reproachable (the institution that has most suffered in terms of reputation lately is ISDS itself). There are so many more interactions between businesses and governments (and so few claims, overall and against individual countries) that contribute to reputation, that noise probably covers any sign that could come out of investment treaty claims. In all, the findings are likely to be artifacts.
 - *If there are additional robustness checks that the reviewer recommends we carry out we would be happy to do so. We have conducted empirical analysis on the effect of ICSID disputes using reputational measures from three different sources. In addition, we have presented evidence with regards to the increasing awareness of ICSID through newspaper reports and the development of a number of highly popular blogs.*
- (2) One key problem of the design is the use of FDI data (and in particular the highly volatile flow data) for the econometric analysis. Although often repeated, the use of this dataset is highly problematic for the purpose of the study, as has been

recognized for a decade now (see first Robert E. LIPSEY (2007), “Defining and measuring the location of FDI output” Sjoerd BEUGELSDIJK/Jean-Francois HEN-NART/Arjen SLANGEN/Roger SMEETS (2010), “Why and how FDI stocks are a biased measure of MNE affiliate activity”; and later Andrew KERNER (2014), “What We Talk About When We Talk About Foreign Direct Investment” and Andrew KERNER/Jane LAWRENCE (2012)). Many econometric studies that seek to assess treaty effects still use this data for lack of other available data or due to ignorance, but this is not a good reason to use this data without any discussion on its validity and implications for the exercise.

- *There has been a notable literature that has developed around the problems with using this type of FDI measure as the reviewer clearly states. The argument that this is currently the standard in the literature (which sadly it is), however, is not completely satisfactory to us either. This is we try to supplement the FDI analysis that we do with tests using various perceptual measures from the: ICRG, Heritage, and Fraser.*
- (3) Also: Why is the number of claims not normalised against the volume of investment that individual countries receive overall (a country that receives little investment from anywhere is unlikely to be exposed to a lot of claims, while a country that attracts a lot of foreign investment would normally be more likely to get hit by claims); those that perceive the reputation can be assumed to factor this in. Also, not all countries have concluded IIAs with countries from which they receive meaningful amounts of investment, so the exposure to such claims is very different. This is also a fact that would be known to those that know about claims.
- *Still need to draft a response here.*
- (4) At FN46, the authors express the surprising view that “we expect the number of ratified BITs to be positively related to reputation”. Many hold that the opposite is likely to be the case (at least among developing economies, but the text is unclear on whether advanced economies are included in the statement, given the statement after FN53). BITs would more likely be used by states to compensate for mixed reputation to international investors - see, e.g., the papers cited earlier at FN11 and FN12.
- *We acknowledge that there is wide debate in the literature about the effect of BITs. To better a*

Other Comments.

- (1) When the distinctive features of ICSID are described, the second item does not set ICSID apart. In fact, all arbitration institutions and rules, in combination with the IIAs, provide binding and enforceable awards. The legal authority of ICSID, if such a thing exists, appears irrelevant, as decisions are taken by the same kind of arbitrators that also adjudicate disputes under other rules and institutions. ICSID itself only facilitates the adjudication process.
- *Still need to draft a response here.*
- (2) Slicing off upper income nations (at FN40) for unspecific reasons (“significantly different role in the system” - why?) is not a plausible and satisfying way to address this issue. The fact that advanced economies are increasingly defendants of treaty claims (without their reputation being tarnished) is interesting and questions the basic assumptions. Canada is a case in point: It got hit by a large number of claims,

of which it lost some, and still does not have a “bad” reputation for foreign investors. How would you explain this fact?

- *We follow standard practice in the literature here. The reason most restrict their analysis of these institutions to developing countries is that OECD economies such as the United States and Canada are not expected to face the same type of effects from ICSID disputes or even signing BITs. Further to make sure that our research is comparable with current findings, when possible we have tried to follow the dominant approach used in the extant literature.*
- (3) Figure 1 arguably has a normalisation problem: the overall number of newspaper articles referenced on LexisNexis probably goes up every year, so a potentially useful measure of public attention would be the priority - relative frequency of mentioning - that “ICSID” gets in the news. This could be measured as a percentage of articles mentioning “ICSID” in a given year in all referenced articles in that given year. It is likely to show quite a different graph, and is more meaningful than the absolute number. The axis-title “frequency” should also be amended, as a frequency cannot be expressed in absolute numbers (“occurrences” would probably be better for this graph, but “proportion” or “share of” would be probably required if the graph was normalised as proposed here.
- *Still need to draft a response here.*
- (4) Why is population size (FN48) assumed to be positively correlated with international reputation? The countries with the largest populations do not normally feature on top in this regard. In the top 20, only three countries would be considered by most as having an above average reputation in foreign investors’ eyes, and these are all advanced economies (and excluded from the study).
- *Still need to draft a response here.*
- (5) A large number of claims are now brought under multilateral arrangements (e.g. Energy Charter Treaty, NAFTA, CAFTA-DR) that have almost identical features as BITs and FTAs with respect to investment protection. Focusing exclusively on bilateral arrangements is an interesting choice in this regard (but admittedly, UNCTAD does not provide the required dataset off the shelf).
- *Our data encompasses disputes initiated at ICSID from these sources.*

2. REVIEWER 2

2.1. Major Comments.

- (1) Substantively, I invite the authors to revise and update the discussions in pages 5-7. The authors said that the previous studies have found that the simple fact that a private firm brings a claim against a state on potential treaty violations regardless of the actual verdicts damages the states reputation as a law-abiding member of the international community in the previous section. Now, the authors say that the ISDS processs unique characteristics of being case-specific, decentralized, uncertain, and non-transparent may not lead to a significant reputation loss because reputations are sticky and constructed around multiple observations. These two claims seem not consistent. If only the fact that claims against a state are made matters, why do we need to care about the variations in specific designs in ISDS across treaties? If you are trying to reveal the inconsistency among the existing literatures claims, please

revise your writing in this part. Currently, it is not very clear what you are trying to establish in this part.

- *hi world* .
- (2) For the sake of clarity, please state hypotheses in a separate section right below the theory part, for example. With the current format, it is somewhat hard to follow.
 - *hi world* .
 - (3) If simply facing a dispute either at the ICSID nor at the Non-ICSID is not associated with a meaningful change in FDI flows, why does it matter in affecting the ICRG ratings? Could you elaborate on this gap more?
 - *hi world* .
 - (4) Regarding Tables 2, 3, and 4, authors report the results with country fixed effects. However, they are only showing within country variations. Do you have the pooled results? If so and if they are similar to country fixed effects, please mention in briefly at least.
 - *hi world* .
 - (5) What if you include cumulative ICSID (t-1) in the Models 1,2,(3,4) in Tables 2, 3, and 4? Recent counts of claims matter but you still need to control for the past history of claims in the model. And what about the potential endogeneity? It is possible that states with lower ICRG ratings tend to have more number of investment disputes.
 - *hi world* .
 - (6) Explain the scale of the ICRG ratings in more detail to help the readers understanding of the results.
 - *hi world* .
 - (7) What happens if you include ICSID and Non-ICSID in the same model so that you test their effects simultaneously?
 - *hi world* .
 - (8) Why one point estimate is in blue? If this is an error, please correct it in Figure 4.
 - *hi world* .
 - (9) Please rewrite the Introduction to clearly present what motivates your research, in what aspects you challenge the previous studies both theoretically and empirically, and what your arguments are and how you are going to prove them. The current format is not a very effective introduction for the readers.
 - *Per reviewer two's request, we have thoroughly rewritten the introduction to better highlight the motivation of our work here and our the contribution of our work.*