Home Country Attributes and Elite Evaluations of Political Risk Abroad*

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Abstract

The breaking of contracts with foreign investors by host governments is a heavily studied areas of research, yet with few clear conclusions on political factors shape these decisions. In this project we argue that some puzzling empirical findings in this literature are due to both to a focus of domestic factors, and a lack of attention to bilateral relations, as well as research design that can't directly test these theoretical mechanisms. We theorize that bilateral relations between states have major impacts on the risks of nationalization or expropriation of investors and test this theory with a conjoint survey experiment that targets professional underwriters and analysts working in the political risk insurance industry to analyze their risk perceptions. Our results indicate that bilateral factors, including foreign aid flows as well as bilateral investment treaties have a major impact on government decisions to expropriate from foreign investors. We conclude with qualitative interviews that further explore these theoretical mechanisms and provide alternative interpretations of some of our results.

*Notes and Acknowledgments: We pre-registered our research design with the Evidence in Governance and Politics (EGAP) Network (`http://www.egap.org`) prior to the fielding of the survey. This paper includes all of the analysis and all of the pre-registered tests and thus our analysis doesn't deviate from the pre-analysis plan. Our interviews were conducted after the analysis of our survey data. We thank Quan Li, Yotam Margalit, Carolina Moehlecke, Clint Peinhardt, Rachel Wellhausen and Stephen Weymouth for discussions on the research design. Thomas Flaherty, Quan Li, Ed Mansfield, Erica Owen, and participants at the 2018 Texas Triangle conference and UCSD and University of Pennsylvania speakers series provided comments. Numerous professionals in the political risk insurance industry provided suggestions on the design of the survey and provided contacts for survey participants.

1 Introduction

Companies investing abroad are exposed to tremendous political risk including the expropriation or nationalization of a company's assets or income streams (Vernon, 1971). The actions can be triggered from a change in government through regular elections, coups or revolutions.[1] In other cases, economic crisis can lead to the canceling of contracts (Cole and English, 1991; Petrova and Bates, 2012). Alternatively, high natural resource prices can make it even more tempting to take the assets of oil, gas, and mineral producers, or to indirectly expropriate their income streams by radically changing agreed upon royalty payments or tariff rates (Guriev, Kolotilin and Sonin, 2011).

Given the numerous government actions that can lead to political risk, political science scholarship has largely focused on the domestic institutions that can help constrain the ability of governments to renege on commitments to multinationals. Institutions such as the level of democracy (Jensen, 2003, 2006; Li and Resnick, 2003; Li, 2009), the power of independent courts (Staats and Biglaiser, 2012; Beazer and Blake, 2018), and existence of veto players (Henisz, 2000; Jensen and Young, 2008; Graham, Johnston and Kingsley, 2017) all shape the ability of governments to expropriate from investors.[2] Recent research has focused on the role of bilateral investments treaties (BITs) as an institution that can tie the hands of domestic governments, leading to lower levels of political risk for investors (Kerner, 2009; Tobin and Rose-Ackerman, 2011).

We build on this literature to further examine bilateral investments treaties, but in the context of a broader bilateral relationship between home governments of investors and the host governments of the investment location. We argue that, unlike the existing focus on host government institutions, bilateral relationships, specifically in the role of bilateral investment treaties and bilateral aid, both shape the incentives of governments to break contracts with multinationals.

[1] See Jensen et al. (2012) for a review.
[2] See Pandya (2016) for an excellent review.

We then test our theory by harnessing a conjoint survey of 75 elites working in the political risk insurance industry who have day to day responsibilities of analyzing and pricing political risk. We follow up our survey with interviews with political risk insurers to further examine the causal relationships between bilateral country relationships and political risk.

2 The Puzzle of Political Risk

Multinationals corporations, while mobile at the time of their investment decision, often pitting potential locations against each other, can suffer from an obsolescing bargain (Vernon, 1971). As soon as the firm commits capital to a location, this bargaining advantage can shift to the host government, allowing government to renegotiate contracts or even expropriate investments.

Early waves of optimism in the 1980s and 1990s that political risk, specifically expropriations, were all in the past (Minor, 1994) were shattered by major expropriations or "creeping expropriations" after 2000 (Koivumaeki, 2015; Graham, Johnston and Kingsley, 2017). In other cases, firms were threatened by expropriations, only to have governments reverse their decisions or negotiate a solution short of expropriation (Jensen et al., 2019). A survey by the World Bank in 2012 found that expropriation remains a major risk for foreign direct investors (Villar et al., 2013).

These risks remain so central to firms that a whole industry called political risk insurance has developed to help firms mitigate these risk. These risk insurers covered $64 billion in foreign direct investment, and insurers paid $234 million in insurance claims in 2018 (Vesteri et al., 2018, pg.7). This insurance is one way for firms to minimize these risks, although the costs and limitations of this coverage make it only one of a number of possible means to minimize political risk. Political risk remains an important factors for firms, yet despite the vast literature on these risks in political science, economics and management and number of puzzles endure.

Although economic factors, such as financial crises, can impact political risk, the literature in political science has focused on how political factors can increase or decrease political risks. For example, there is a considerable debate on how democratic political institutions of host countries can affect the risk environment (Oneal, 1994; Jensen, 2003; Li and Resnick, 2003; Ahlquist, 2006). The findings from this literature suggest that democracy can affect foreign investors in a number of ways, although the weight of the evidence seems to suggest the democracies lower political risk. Unfortunately, as noted by Li, Owen and Mitchell (2018) this literature suffers from the potential of publication bias.

Less explored, and possibly even more important, are on how bilateral relations between firms affects political risk. In an influential management study, Ramamurti (2001) argues that rather than firm entry being a bargain between a firm and home government, bargaining is really a two-tiered process. In many cases, powerful home countries, such as the United States, bargain on behalf of their investors through the signing of bilateral investment treaties or preferential trade agreements, liberalizing markets and protecting investors by making expropriations illegal.

We build on this literature, although our focus is more broadly on the bilateral relationships between the home country of investors and potential investment environments. Our first focus is on the power of home countries, the countries of the investors, and how these home countries can protect their own investors abroad. We argue that the main mechanism of influence is foreign aid, where home governments can credibly threaten to suspend foreign aid to deter or reverse host country expropriation decisions. We develop this theory in more detail in the next section.

Equally important are bilateral institutions than can constrain the behavior of home government, namely the existing of bilateral investment treaties (BITs). Unfortunately, the theoretical and empirical literature on BITs is mixed, as we note in the next section. As argued by Kerner (2009), bilateral investment treaties can both signal a governments type as well as constrain the governments ability to break contracts. These alternative theoretical mechanisms, as well as the complexity of measuring political risk makes it difficult evaluating this evidence.[3] In this paper we hope to help adjudicate this conflicting evidence using both an experimental design as well as a more direct measure of political risk.

In the next section we develop a theory of how bilateral factors influence political risk for firms. Then in the following section we outline an experimental research design that helps overcome the limitations of many empirical projects on the topic.

3 Protecting Investors Through Bilateral Relations

Existing research on the political risk facing multinational investors has largely focused on host country (receiving investment) institutions affecting the risk environment for multinational corporations. These institutional studies are important for building the foundation for the study of political risk, although many of these institutions are time-invariant and do not explain variation in incentives over time.[4]

More recently, scholars have taken seriously how the nature of firms shapes the incentives to expropriate from foreign investors. Holburn and Zelner (2010) and Beazer and Blake (2018) show that a firm's home country environment shapes their ability to manage risks abroad. Wellhausen (2014, 2015) argues that firms can collectively organize to minimize thwart policy changes that threaten foreign firms' operations and that firms of the same home government nationality are more likely to overcome this collective action problem. Also important is involvement of local firms in the ownership of the firm (Henisz, 2000) and the structure of supply chains (Johns and

[3] For example, Kerner and Lawrence (2014) argue that aggregate FDI flows are an imprecise measure of the types of investment that are most suspectable to political risk and fixed. Jensen and Young (2008) argues that any measures of foreign direct investment flows is an indirect measure of political risk.

[4] Kobrin (1984) argues that nationalization declined as the technical capacity of governments increased and thus governments were better able to regulate firms as a means to harness private capital for economic development purposes.

Wellhausen, 2016) as well as the broader network for firm investments (Crasnic, Kalyanpur and Newman, 2017).

In this project, we focus on the power of home countries in the protection of their investors. We focus on three factors: the size of the home country, the flows of bilateral aid from home to host countries, and the existence of bilateral investment treaties in reducing risk. We believe these three factors are all important mechanisms in affecting risk that is linked to existing political science research. In our qualitative interviews and our conclusion we discuss other bilateral factors all shaping risk.

We specifically argue that US investors, due to the central role of the U.S. economy, are better protected that non-U.S. investors. This follows from work such as Maurer (2013) that shows that the U.S. government is willing to use diplomatic pressure to ensure the protection of investors abroad. Gertz (2018) argues that commercial diplomacy can be harnessed by governments and his clever research design explores how U.S. ambassador vacancies can lead to investment disputes. This formal role of the U.S. government in protecting investors was codified in the U.S. in the 1962 Hickenlooper Amendment which would require a suspension of U.S. foreign aid for any government expropriating from a U.S. firm. Other mechanisms of influence include the use of multilaterals such as the IMF to pressure governments to uphold the rule of law with U.S. firms Biglaiser, Lee and Staats (2016).[5]

In our empirical analysis we contrast the U.S. with that of other countries including China, the UK and Canada. Our theory can not make clear predictions about the relative size of the difference in risk assessments across these countries, only that we expect risk analysis to evaluate investments from the U.S. as less risky than investments from other countries.

This leads to our first hypothesis:

[5]Biglaiser (2007) also argue that the presence of military based can shape FDI decisions, although they only support for U.S. based increasing U.S. FDI.

Hypothesis 1 (H1): *Respondents will perceive that U.S. investments are less risky than equivalent investments from other countries.*

Our first hypothesis examines how country size affects political risk. Our next hypotheses specify the mechanism through which countries affect political risk. Work by Peinhardt and Allee (2016) shows that commercial ties, primarily foreign direct investment can help with the timely settlement of investment disputes, although they find no link between aid and dispute settlement. Conversely, Jensen et al. (2019) find that aid flows, as well as dependance on multilateral aid, lower expropriation risk for investors.

We argue that bilateral economic ties, namely foreign aid, can help influence host country actions before an investment dispute is even initiated. Foreign aid, unlike trade, is a policy lever that is directly under the control of a home government that can be suspended. Although the credibility of these aid suspensions vary (Dunning, 2004; Swedlund, 2017), we predict that country dependence on aid from the donor provides additional leverage to the home country of the investor.

Thus we theorize that one mechanism through which countries can leverage host governments to uphold contracts with multinationals is through the use of suspension of foreign aid.[6] But this requires that the target country is susceptible to these threats.[7] Thus, countries that are more dependent on an investor's home country foreign aid are less likely to renege on contracts with these investors. This leads to our second hypothesis.

Hypothesis 2 (H2): *Respondents will perceive that investors from countries that are major aid donors are less risky than equivalent investments from other countries.*

Our final two hypotheses contribute to the growing literature on how the existence of bilateral investment treaties (BITs) reduce risks for foreign investors and test two potential mechanisms.

[6]See Asiedu, Jin and Nandwa (2009).

[7]See Duanmu (2014) for work on how economic dependence shapes political risk.

These treaties, in theory, have the potential to provide protections for multinational investors although testing this impact is difficult using observational data. One strand of literature argues that BITs are largely a signal of a country's willingness to uphold the rule of law with investors (Neumayer and Spess, 2005; Kerner, 2009; Lee and Johnston, 2016).[8] Thus, a country that signs BITs with any country is less likely to violate the contracts with foreign investors, even if the foreign investor isn't from a country that has signed and ratified such a treaty itself. Much of this work has focused on the indirect impact of international agreements by looking how bilateral treaties affect foreign direct investment flows (Neumayer and Spess, 2005; Büthe and Milner, 2008; Kerner, 2009; Haftel, 2010; Tobin and Rose-Ackerman, 2011; Peinhardt and Allee, 2012; Büthe and Milner, 2014) or how violations of BITs impact investors (Allee and Peinhardt, 2011; Minhas and Remmer, 2015).

These studies find mixed results on the impact of BITs on FDI and thus the impact of BITs on political risk, as well as the signaling versus hand-tying aspects of BITs. Our empirical contribution is to harness an experimental research design to first examine if the mere existence of BITs signals a country's openness to foreign investors and a signal of their protection of firms from expropriation. This leads to our third hypothesis.

Hypothesis 3 (H3): *Respondents will perceive that foreign investments into countries that have BITs with any country as less risky than equivalent investments from other countries.*

An alternative mechanism is that BITs are a legal mechanism that protect investors from signatory countries in that the arbitration mechanisms provide companies with recourse in the event of expropriation. Peinhardt and Allee (2016) explain that subrogation clauses in political risk insurance contracts can lead companies with claims turning over their investments to the

[8] For work on diffusion and bargaining over BITs see Elkins, Guzman and Simmons (2006), Allee and Peinhardt (2010), Blake (2013), Poulsen and Aisbett (2013), and Simmons (2014).

insurer after a claim has been paid. In case of state-owned political risk insurers, this transforms a dispute between private company and a host state into a dispute between a home state and a host state. This can both deter governments from expropriation, and in the event of an expropriation, provide a company with legal avenues of challenging the government and demanding compensation for expropriation. Thus, a bilateral investment treaty reduces political risk for firms covered by the treaty. This leads to our final hypothesis.

Hypothesis 4 (H4): *Respondents will perceive that foreign investments into countries that have BITs with the country of origin of the investor are less risky than equivalent investments from other countries.*

4 Research Design

Our main contribution to this literature is to harness a novel sample of elites within an experimental setting to address how bilateral factors affect political risk.

Our first advantage over many other studies is that we are providing a direct test of political risk. Previous research has used a number of observational research designs to address political risk. One strategy has been to examine flows of foreign direct investment to analyze how political institutions shape the risk environment for firms. In recent work, Li, Owen and Mitchell (2018) perform a meta-analysis of studies of political institutions and foreign investment, finding evidence of publication bias in the use of FDI flows data. Studies using FDI as a percentage of GDP often find that democratic countries attract more FDI, consistent with the work of Jensen (2003) while studies that rely on logged FDI amounts find that democracy reduces FDI, consistent with Li and Resnick (2003). Using meta-regression analysis, they find evidence that suggests publication bias has led to these two diverging patterns of findings.

Equally problematic in looking at flows data is that the measure of political risk is indirect. Additional studies have tested the impact of political risk by looking at political risk insurance ratings (Jensen and Young, 2008), surveys of investors (Biglaiser and Staats, 2010; Staats and Biglaiser, 2012), arbitration claims (Minhas and Remmer, 2015; Wellhausen, 2016; Pelc, 2017; Aisbett, Busse and Nunnenkamp, 2018), or expropriation events (Li, 2009; Guriev, Kolotilin and Sonin, 2011; Wilson and Wright, 2017).

Second, observational studies of bilateral risks, such as the study of bilateral investment treaties and investment disputes, are confronted with selection bias into which countries choose to sign BITs (Kerner, 2009) as well as selection bias into which investors enter into a country under different risk environments (Delios and Henisz, 2003; Blonigen, Oldenski and Sly, 2014). Our experimental approach sidesteps these issues of selection by fully randomizing all combinations of host countries.

Third, our experiment focused on political risk insurance industry underwriters or analysts. Thus, we focus on the types of elites that are experts in political risk and their jobs is the comparison of political risk across countries. This sample is preferred to even company executives who may be involved in FDI decisions, but may be limited to a small set of countries or types of investments. These firm executives may outsource risk analysis to external consultants or internal groups within the company. In contrast, political risk insurance analysts and underwriters are involved in the analysis and pricing of political risk across countries. Our study includes political risk professions with a core job responsibility of analyzing and pricing political risk across borders.

Fourth, our study is what we believe is the first pre-registered experiment on the relationship on political risk. Given the evidence of potential publication bias (Li, Owen and Mitchell, 2018), we believe that both new data as well as a fully specified registration of our hypothesis and code for analysis provide both transparency and credibility of our approach.

Fifth, we utilize a conjoint design that allows for us to study multidimensions policy preferences

(Hainmueller, Hopkins and Yamamoto, 2014) that provides advantages over other survey methods (Hainmueller, Hangartner and Yamamoto, 2015). Previous work in international relations have used this research design to study global climate agreements (Bechtel and Scheve, 2013), international bailouts (Bechtel, Hainmueller and Margalit, 2014), and foreign aid (Heinrich and Kobayashi, 2018). To our knowledge only one other study in political risk has used this design, by examining the responses of Chinese investors to policy instability (Shi and Zhu, 2019).

We believe a conjoint is particularly valuable in our context where we included a number of traditional measure of risk, including country risk ratings and high-risk industries to compare how bilateral factors influence risk relative to firm and country specific factors that have been shown to be important drivers of political risk. For example, political risk experts find that natural resource industries are exposed to greater political risks (Vesteri et al., 2018, pg.28) as well as use country risk ratings by political risk insurance agencies Jensen and Young (2008). Our conjoint allows us to compare the importance of bilateral factors relative to industry and country level risk factors.

Finally, we complement our statistical analysis with follow-up interviews of political risk insurers to further examine how these insurers make investment decisions. These interview not only allow us to better explain the process through which evaluations are made, but it also addresses the external validity of our results, identifying if there were factors not included in our conjoint that can affect the interpretation of our results. These interviews were especially informative for our project where respondents provided an alternative interpretation of our empirical results as well as provided insight into broader factors that affect political risk.

4.1 Political Risk Insurance Underwriter Sample

To analyze the impact of bilateral political relations on firm risk we focus on professionals tasked with the pricing of political risk for firms. These professionals are part of the political risk insurance industry which includes multilateral lenders, government agencies, and private insurance companies all tasked with selling insurance to international investors. Specifically, this industry sells political risk insurance for acts of expropriation or non-payment by governments.

This is a specialized industry that includes government and multilateral agencies such as the U.S. Overseas Investment Protection Corporation (OPIC), Export Development Canada, and the World Bank's Multilateral Investment Guarantee Agency (MIGA). Specialized insurers also cover political risk insurance, including organizations such as Sovereign LLC. Other major insurers such as Lloyd's of London, Swiss RE, Zurich, and AIG have groups providing political risk insurance coverage.[9] It is estimated that there are 60 organization around the world provide political risk insurance products.[10]

Our sample includes elites that have worked in or are currently employed as underwriters or analysts in the political risk insurance industry. Thus, individuals contacted are tasked with analyzing and pricing political risk insurance contracts for investors. Our survey is subjective by design, where individual analysts are asked to evaluate pairs of potential investments in a conjoint survey design.

To recruit participants, we constructed a database of political risk insurance providers starting with the industry association, the Berne Union, as well as searching for political risk insurance conferences. We then collected as many names as possible from these websites for individuals with job titles of underwriter or in managerial positions in teams of underwriters. Our database included the names of 166 individuals across 39 political risk insurance providers. Through LinkedIn we searched these same provides for individuals acting as underwriters or analysts for these risk

[9] Our complete list of companies from the Berne Union include: AIG (U.S.), Atradius (Netherlands), Chubb (U.K.), Coface (France), Export Development Canada (Canada), EFIC Australia, Euler Hermes (Germany), EKF (Denmark), EKN (Sweden), Finnvera (Finland), GIEK (Norway), Hiscox (Bermuda), Liberty Specialty Insurance (U.K.), Lloyd's of London (U.K.) and associated syndicates, MIGA (World Bank), NEXI (Japan), OeKB (Austria), OPIC (U.S.), PwC Germany (Germany), Sace (Italy), Serv (Switzerland), Sovereign (Bermuda), U.K. Export Finance (U.K.), and Zurich (U.S.).

[10] See Berne Union Yearbook 2017, pg.17.

insurers. In total, we made 217 LinkedIn contacts with individuals with considerable overlap with the email list.[11] As a final recruitment we asked individuals who agreed to participate for additional contacts, leading to an additional 36 potential participants.[12] In total, 87 participants opened our survey from 9/8/2017 to 11/30/2017, although 12 individuals did not answer any comparison questions, and were not included in our survey.

These participants are experienced professionals with experience in the analysis and pricing of political risk. 71% from the private sectors risk insurers and the remaining respondents from government, quasi-government, or multinational institutions providing risk insurance. 64% of respondents indicated that "underwriter" was their main job description with the second most common category indicated "analyst" (11%). Additional categories include brokers (4%) and managers (4%). Some respondents indicated multiple categories. Our focus on senior political risk insurance professionals is reflective in the fact that 61% of respondents had worked in more than one political risk insurance organization.

4.2 Conjoint Survey Design

The experiment looks to discern whether and to what degree investor- and location-specific attributes of a given hypothetical investment are determining risk perception. Since any determination of risk would be contingent upon a set of attributes, we designed a conjoint experiment. The conjoint design allowed us to isolate the effect of individual attributes by explicitly providing a range of relevant and potentially associated aspects of the investment. In doing so, we reduced the

[11] We searched LinkedIn for individuals with job titles of "political risk insurance underwriters" and individuals with equivalent job titles that were members of the following groups: Political Risk Assessment (4,890 members) Trade Credit and Political Risk Insurance Professionals (5,680 members) and Country Risk (3,025 members). The vast majority of these members are not involved in the pricing of political risk, since these are industry associations. Some analysts and underwriters price other forms of political risk such as trade credit insurance. Our sample only includes analysts and underwriters focusing on the provisions of insurance for foreign direct investment.

[12] Some organizations indicated a willingness to share this survey with other members of their underwriting team. We included a number of screening questions at the end of the survey to assure that our sample only consisted of individuals who have been involved in the writing of political risk insurance contracts as part of their professional capacity in one of these organizations.

necessary amount of satisficing respondents typically engage in, because explicit reference of associated relevant information lowers the cognitive burden on the respondent (Hainmueller, Hopkins and Yamamoto, 2014). To further facilitate comprehension of the task at hand, respondents were presented with investor and location attributes in two adjacent sections.

Our conjoint survey design further enabled us to estimate the relative importance of different attributes for risk assessment. We employed a paired conjoint with forced choice repeated up to 12 times.[13] At each comparison, respondents were asked to either choose which hypothetical investment they perceived to be less risky, or indicate that they no longer wanted to continue with the comparisons. For each respondent, we randomized the order of attributes for the first comparison, and then fixed this attribute order for the remainder of the experiment. This approach balances assuring that question order effects are not driving our results, while at the same time freeing the respondents from the burden of continually adjusting to a new attribute order. We made these design choices to minimize the amount of time required for our elites to conduct the survey, and to maintain high levels of alertness and interest in responding to our comparisons.

For all investments, we randomized which attribute levels characterized the investment. Below we present a table of these attributes, and attribute levels. Note that the iterative nature of this design allows us to examine how each single factor (or level) contributes to the overall risk rating by observing several counterfactuals for each respondent that remain unobserved in single-treatment designs.

Due to the nature of the paired design, individuals were presented with two comparisons in an online Qualtrics survey. Obviously, any paired conjoint experiment requires choices on the relevant comparisons. For example, comparing companies that are manufacturing versus oil and gas extraction may subconsciously lead respondents to think of different sets of potential host

[13] See Hainmueller, Hopkins and Yamamoto (2014) for a comparison of vignette and conjoint research designs.

Investor Attributes	
Size of investor parent company	Large (Fortune 500) Medium Small
Country of origin	U.S. Canada U.K. China
Industry of investor	Manufacturing for export Manufacturing for domestic production Oil and gas extraction
Location Attributes	
Bilateral Investment Treaties	None Treaties with countries other than (country of origin) Treaties with countries including (country of origin)
Level of country risk	OECD Country risk rating of 4 (1=lowest risk, 7=highest risk) OECD Country risk rating of 5 (1=lowest risk, 7=highest risk)
Major source of foreign aid	U.S. Canada U.K. China

Table 1: Overview of Treatment Attributes and Levels

countries. Many of these potential issues aren't serious concerns for our work, since our main hypotheses relate to country of origin, foreign aid, and bilateral investment treaties and these attributes and their levels are randomized independently. These randomized comparisons were disseminated via an anonymous survey link that was emailed directly to participants. We provide an example of one of these comparisons in Appendix A. To further preserve anonymity we did not collect geographic information based on the users' IP address, and limited the collection of demographic information to the questions provided in Appendix B.

4.3 Pre-registered Research Design and Results

We pre-registered our hypotheses, data collection protocol, and analysis plan at the Evidence in Governance and Politics (EGAP) registry on 9/7/2017, prior to fielding our survey.[14]

Following our registration document, we estimate and present the Average Marginal Component Effects (AMCEs) and test our hypotheses by analyzing the 95% confidence intervals consistent with the hypotheses presented in the paper. Our pre-registration included a mock graph, included in Appendix E, where we present our expectations. Our analysis strictly follows this pre-analysis plan and we present our results in Figure 1.

The results of our study are best presented in terms of probabilities of an investment being perceived as the less risky. First a number of obvious trends emerge. Investments in oil and gas extraction are seen as 17.7% less likely to be selected as less risky relative to manufacturing for the domestic market. We find that large investors are considered less risky (4.0%) although this impact is relatively small and isn't statistically significant.

Perhaps the most obvious is that countries that are rated a 5 in terms of OECD country risk ratings are 11.1% less likely to be selected than countries rated a 4. We believe that this country

[14] http://www.egap.org/registration/2801

risk rating shift (from 4 to 5) is a useful comparison. Interviews with insurers indicate that this is a large shift in risk, in that the risks are non-linear and a shift form 4 to 5 is substantially larger than shifts from 1 to 2, or 2 to 3.

Our second set of results are interesting non-findings. We tested the impact of investors from the U.S., Canada, China and the U.K. on subjective risk ratings. We find no statistically significant impact on these ratings and that any impact is relatively small. Thus, investors from a country, such as the United States, are not exposed to more or less risks than investors from countries such as the Canada. This is inconsistent with Hypothesis 1. Our interviews presented in the next section provide additional evidence that this null result isn't simply due to statistical power but rather a result of heterogeneous responses of participants.

Our final set of results relates to our main variables of interest for this paper: the role of bilateral aid and bilateral investment treaties (BITs). We find that a country that is dependent on the investor country for foreign aid is less as 6.8% more likely to be selected as less risky. Our substantially largest finding is that the role of bilateral investment treaties has a massive impact on political risk. Countries that sign BITs with any country are seen as 7.8% less risky (evidence of signaling) and firms investment in countries with a BIT in force are seen as 21.4% less risky (evidence of a reduction of risk). We summarize these findings in Table 2.

Attribute level	**Change in Probability**
Signed BIT with investor country	21.4%
Oil and gas investments	-17.7%
OECD Country rating (move from 4 to 5)	-11.1%
Signed BITs with other countries	7.8%
Foreign Aid from Investor Country	6.8%

Table 2: Change in probability of being selected as less risky investment

These results indicate that bilateral relationships, specifically the signing of investment treaties and dependence on foreign aid all have a major impact on risk assessments.

We include a number of demographic variables as controls including industry experience that we utilize to verify the qualifications of the respondents. In our pre-specified robustness checks we drop any respondents who: a) do not have direct experience as an underwriter or analyst (Appendix B, Question 1) or b) spent less than 10 seconds on the comparisons. To keep track of timing, we included a timer in that ran in the background of the survey. As our final test we compute Average Component Interaction Effects (ACIEs) on the interactions between origin and aid level, to test if there are differential effects of aid dependence based if the donor is Canada, China, the U.K. or the U.S. Consistent with what appeared to be a strong substantive interest among respondents (the average respondent engaged in more than 10 comparisons), we find that no respondent spent less than 10 seconds on the comparisons on average. A more stringent test would be to drop any responses that took less than 10 seconds on any single question. This applies to a total of 6 of the 75 respondents that make up the sample. Similarly, all but 11 of our respondents indicated that they had worked as either underwriters or analysts within the last 10 years. The original results are largely confirmed, although the smaller sample does affect the statistical power of our tests.

As a final test, we interact the country of origin with the recipient's major aid donor, and BITs attribute levels to examine if BITs or aid flows are more effective in reducing risk from powerful countries. This test does not yield additional nuance to our overall results, providing further evidence for our null results on our Hypothesis 1. We present these robustness tests in Appendix F.

In the next section, we present qualitative evidence based on elite interviews with respondents working in the political risk insurance industry to explore the mechanisms linking the aforementioned factors to subjective risk assessments.

5 Interview Results

Our statistical analysis points to the importance of bilateral factors in shaping political risk. In December 2017, we began interviewing political risk insurers that we had contacted about our survey. All interview participants were recruited via email and were sent six open-ended questions (see Appendix C). Our questions are aimed at exploring the relationship between country of origin, bilateral investment treaties, and foreign aid on political risk. We completed 11 interviews via email and phone.[15] We first discuss the results of these questions and then discuss additional interesting findings from these interviews and provide the dates for all interviews in Appendix C.

This relatively small number of interviews in some contexts, but we believe that these interviews provide further evidence on political risk insurance pricing. First, political risk insurance is dominated by a number of large providers, and our interviews include risk insurers covering a large percentage of the political risk insurance market. Second, we asked questions about each individual analysts views, but also asked follow-up questions on their organization's process of pricing political risk. Third, brokers serve as an important feedback mechanism that leads to similar pricing of political risk across industries. Thus we believe that our 11 interviews provides a generalizable picture of the political risk insurance pricing.

When asking respondents about the importance of country of origin of the investment, the results were both definitive and nuanced. No respondent believed that a country, such as the U.S., would universally have lower risks for their investors due to the power of the country. Thus, our null result based on Hypothesis 1 was confirmed by all interviews.

Yet almost all responses indicated bilateral relationships across the home and host country as an important consideration, with numerous examples of how colonial relationships, regional agreements, and country animosity can all affect investors. More importantly, respondents provided

[15] All interviews were conducted by Nate Jensen.

some details on the importance of foreign aid and bilateral investment treaties.

Nine of the eleven respondents indicated that foreign aid dependence on the investor's country of origin can indeed minimize expropriation behavior, consistent with Hypothesis 2.[16] The one interesting caveat is that overall foreign aid dependence can be a sign of weakness of the host government.[17] Thus foreign aid dependence by no means universally decreases political risk. Rather the potential suspension of aid can thwart government actions against multinationals, although dependence on aid can be a signal of fragility. This suggests that observational studies testing the link between aid and political risk may fail to account for the conflicting impacts of aid dependence on the probability of expropriation.

Our strongest result in our quantitative analysis is the role of bilateral investment treaties in mitigating political risks. Our interviews are not so definitive on this point. Numerous respondents indicated that the main reason that BITs lead to lower risk evaluations was that a BIT provides legal recourse for insurers that aids in the *recovery after expropriation.* For some interviews, respondents stated that BITs do not deter expropriation, only help in the eventual recovery after an expropriation event.[18] Others indicated that BITs can reduce risk *and* aid in recovery after expropriation.[19] Other elites were even more skeptical of the role of BITs, claiming that BITs were not part of the calculation,[20] were a minor factor,[21] and given the expansion of BITs didn't really different countries from one another.[22]

We believe that this finding could help explain the inconsistent results across studies on the impact of investment agreements. First, there is genuine disagreement across political risk insurance

[16]Interview 3, 4, 5, 6, 7, 8 9, 10, 11. Interview 1 indicated this is not explicitly used for risk analysis but can introduced by analyst in a subjective evaluation.
[17]Interview 2, 6, 7.
[18]Interview 2.
[19]Interview 3. Interview 11 indicated that this helps in the negotiation during a conflict.
[20]Interview 5, 7.
[21]Interview 1, 10.
[22]Interview 4.

professionals on the importance of BITs.

Second, the majority of respondants do not believe that BITs constrain government behavior, and thus do not lower risks of expropriation. These results are consistent with qualitative interviews from Poulsen (2010) that BITs are generally not a precondition for risk insurance coverage, or even a major factor for most insurers. Thus we should expect that BITs have no impact on expropriation decisions of governments.

Yet some insurers do see BITs as means of recouping losses from expropriation, and thus lower the risk evaluations (and most likely prices) for insurance. Thus BITs do not tie the hands of governments, and are incapable of preventing expropriations. BITs simply make expropriations less costly for firms, and if they buy insurance, for the insurance providers. Thus it is

Given these findings, it is plausible that BITs lower risk for insurers but the aggregate impact on BITs on foreign direct investment flows is most likely very modest. But for a subset of investors that are subject to very high risks, such as firms in the oil and gas industry, BITs could lower the costs of coverage for their investments or give the firm legal recourse for the seeking of recoveries after an act of expropriation. This is consistent with work showing the firms in the oil and gas are willing to pay more for investments protected through investment agreements (Jandhyala and Weiner, 2014) and Bauerle Danzman (2016)'s finding that BITs don't increase FDI but they do increase infrastructure investment.

We note that these interviews were conducted after our survey experiment was complete and the results were known to the authors (but not the respondents). Thus, the purpose of these interviews isn't an additional test of the relationship between country of origin, foreign aid and bilateral investment treaties. Rather, these interviews are focused on understanding the process of evaluating political risk and how this subsample of respondents sees the country of origin, foreign aid, and BITs in shaping decision making in pricing political risk. These interviews provide some additional windows into the process of evaluating political risks by professionals that weren't apparent in our survey experiment. These interviews are consistent with our null finding for Hypothesis 1 and provide support of Hypothesis 2-4, but through mechanisms that were not outlined in our pre-registration. We believe that our pre-registered experiment along with our qualitative interviews provides strong evidence for how home country factors affect FDI, along with additional preliminary evidence on the process through which country of origin factors shape political risk.

6 Conclusion

In this paper, we provide evidence from our conjoint survey and interviews of political risk professionals. Our empirical results provide evidence for the important role for home countries in the lowering of risks for multinationals. Firms from powerful home countries, such as the United States, are not subject to lower risks than similar firms in other countries. But both dependence on bilateral aid and the signing of bilateral investment treaties both protect investors from host government expropriations. Our interviews suggest different mechanisms linking aid and treaties to lower levels of political risk.

Appendix A: Example comparison

Please select which investment you consider <u>lower risk</u> for expropriation or breach of contract:

	Investment A	Investment B
Location attributes		
Major source of foreign aid	China	Canada
Bilateral Investment Treaties	None	Treaties with countries other than Canada
Level of country risk	OECD Country risk rating of 5 (1=lowest risk, 7=highest risk)	OECD Country risk rating of 5 (1=lowest risk, 7=highest risk)
Investor attributes		
Country of origin	Investor is from Canada	Investor is from Canada
Industry of investor parent company	Manufacturing for export	Manufacturing for sale to host market
Size of investor parent company	Medium (Between 100-1000 employees)	Medium (Between 100-1000 employees)

Investment A

Investment B

I'm done, I don't want to do this anymore.

Figure 1: Conjoint survey section design

Appendix B: Demographic questionnaire

1. In the past 10 years which of the following job descriptions fit your role in the political risk insurance space (check all the apply)?
   - Underwriter
   - Analyst
   - Broker
   - Manager
   - Other (Please specify: ________)
2. How would you describe your current employer?
   - Private Sector
   - National Government Agency or Multilateral
   - Quasi-government agency
   - Other
3. What region, if any, have you specialized during your career in political risk insurance (check all that apply)?
   - Africa
   - East Asia and Pacific
   - Europe and Central Asia
   - Latin America and the Caribbean
   - Middle East and North Africa
   - South Asia
   - Other (Please specify: ________)
4. How many different organizations have you worked at that offer political risk insurance or related risk mitigation products?
   - 0
   - 1
   - 2
   - 3 or more

Appendix C: Interview questionnaire

- Question 1: In our survey we included countries that are a 4 or 5 in the OECD country risk ratings. In your opinion is a move from a 4 to a 5 a big jump in risk (for example, relative to a jump from 2-3).
- Question 2: Our survey included information on the country of origin of the investor. In your opinion, how does the country of the investor matter your risk analysis?
- Question 3: We included information on bilateral investment treaties. In your opinion, are these treaties important in your risk analysis? If yes, in what way do they matter?
- Question 4: Does foreign aid dependence affect your assessment of political risk?
- Question 5: Our survey mostly focused on investor factors (industry, country of investor) as opposed to country level factors. In your opinion, how important are country level factors relative to investor factors in evaluating risk?
- Question 6: Do you have advice on future studies of how subjective factors shape risk? This could include looking at different subjective factors.

Appendix D: Interview summary

Interview	Organization	Date
1	EDC/Multi	12/11/2017
2	Private	12/11/2017
3	Private	12/11/2017
4	EDC/Multi	12/11/2017
5	EDC/Multi	12/12/2017
6	Private	12/22/2017
7	Private	12/28/2017
8	Private	1/3/2018
9	Private	1/4/2018
10	Private	2/2/2018
11	Private	2/14/2018

Appendix E: Hypothesized vs. actual results

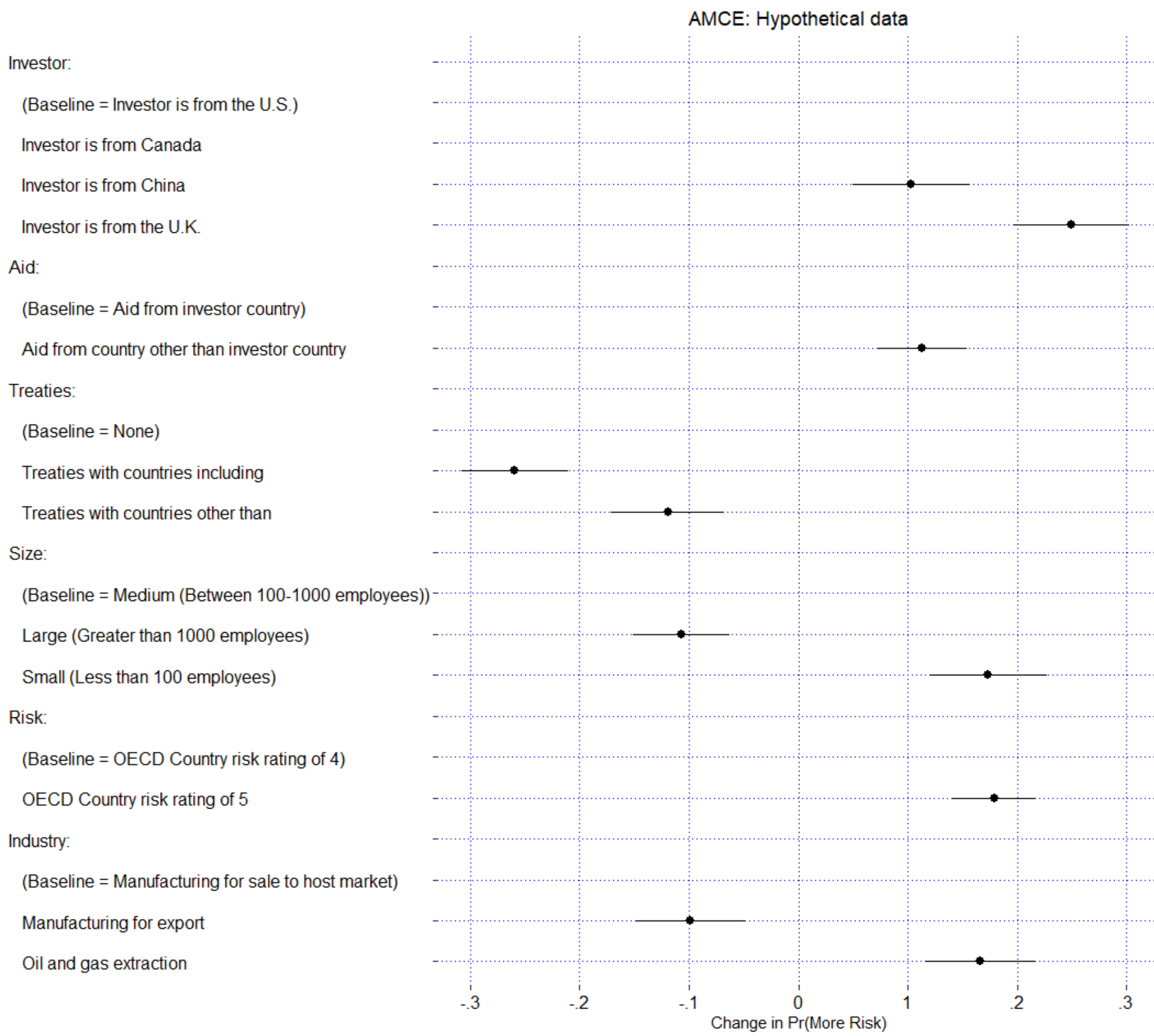

Figure 2: Graphic depiction of pre-registered hypotheses on simulated data

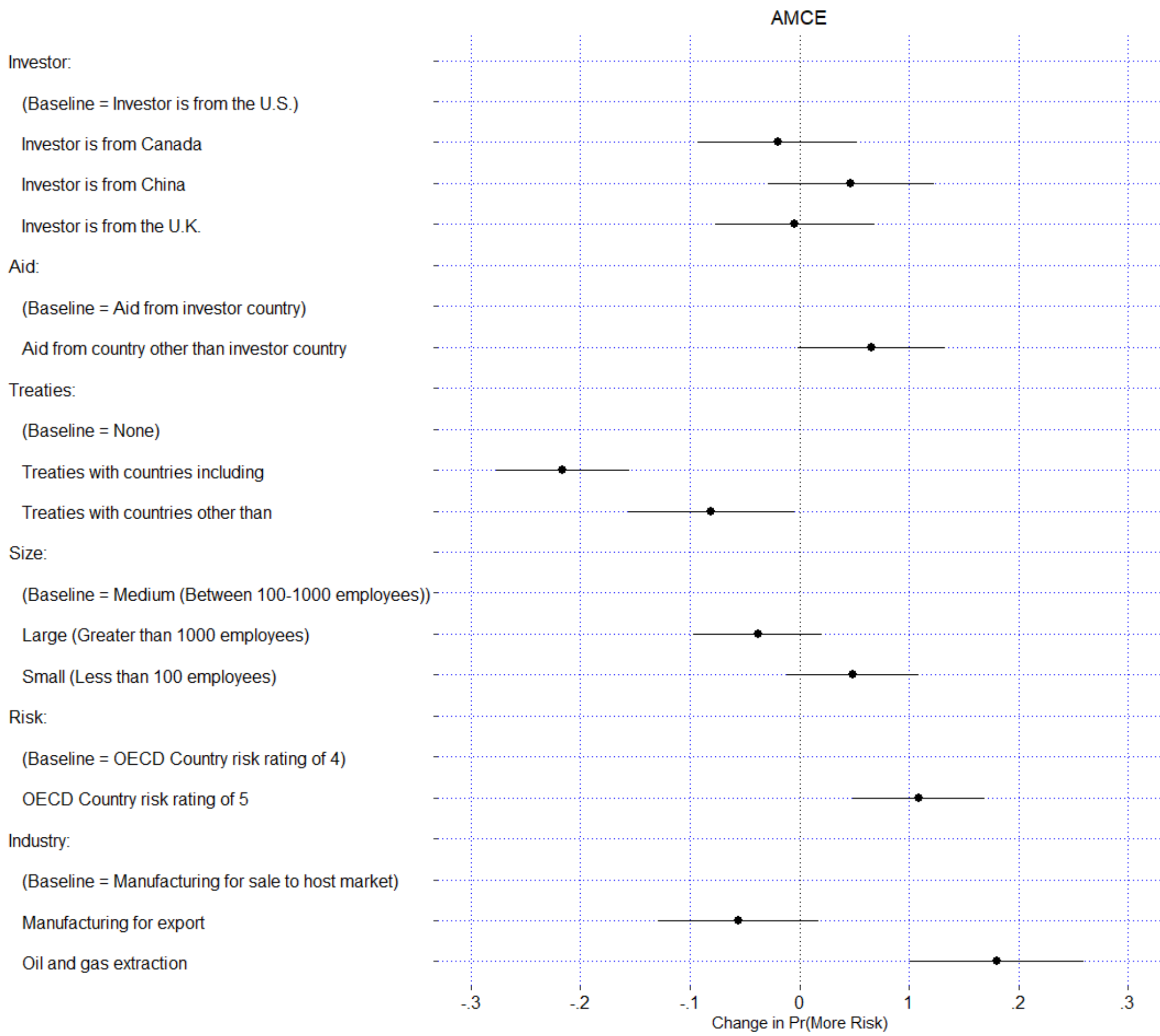

Figure 3: Average Marginal Component Effects

Appendix F: Robustness

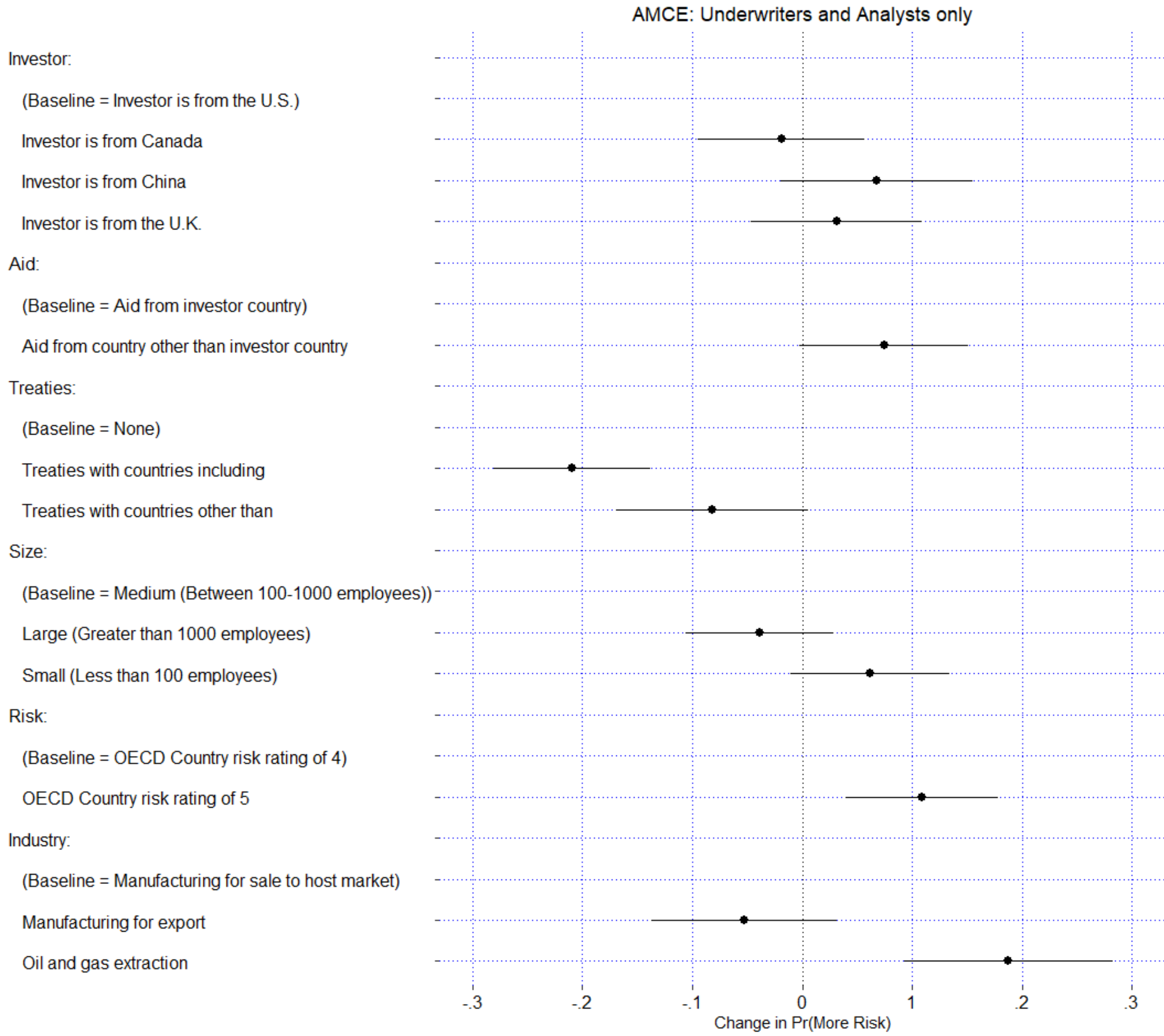

Figure 4: Average Marginal Component Effects among Underwriter and Analyst subsample

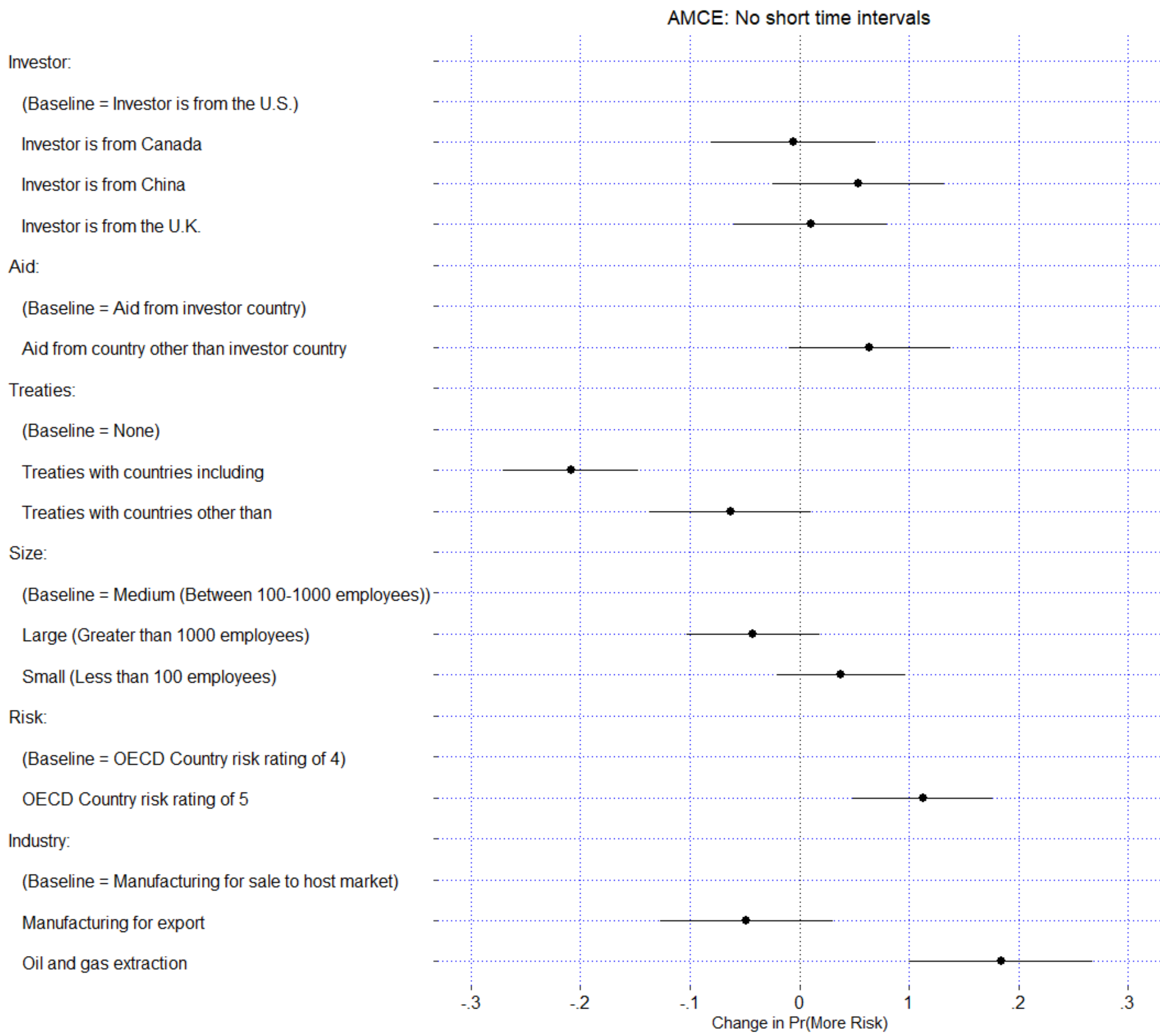

Figure 5: Average Marginal Component Effects among timed subsample

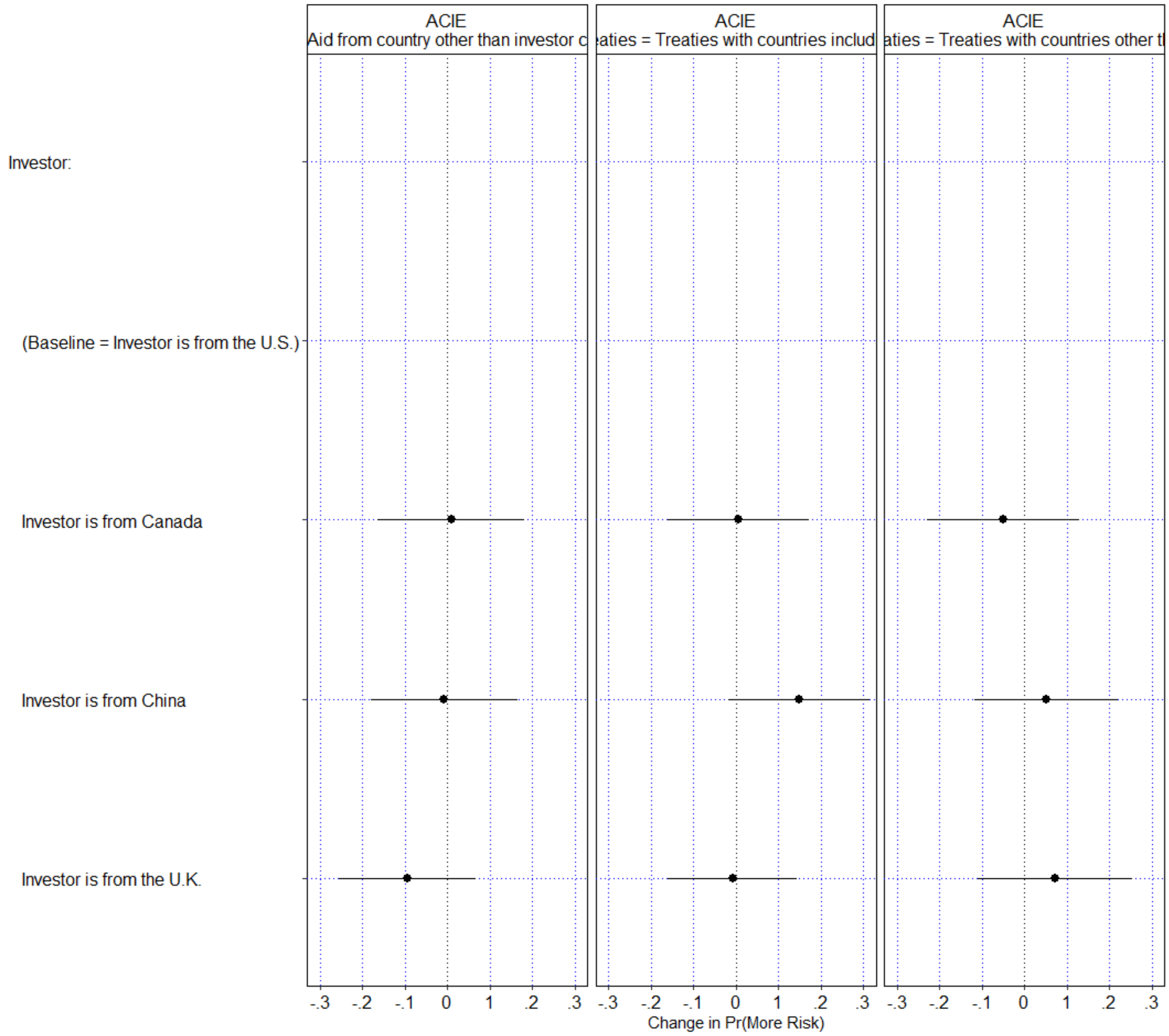

Figure 6: Average Component Interaction Effects: Origin and BITs, and Origin and Aid

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