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Institutional Constraints on Economic Nationalism in Latin America

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Institutional Constraints on Economic Nationalism in Latin America

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Dissertation

Presented to the Faculty of the Graduate School of

The University of Texas at Austin

in Partial Fulfillment

of the Requirements

for the Degree of

Doctor of Philosophy

The University of Texas at Austin

August 2015

Acknowledgements

First and foremost, I want to thank my advisor Kurt Weyland. His undergraduate class “Social Reforms and Revolutions” introduced me to political science, and turned my study abroad year at UT first into an MA in Latin American Studies and then into a PhD. Throughout all these years, Kurt has been incredibly supportive. His advice and feedback have deeply influenced my perspective on political science in general, and this research project in particular. I could not have finished (or even started!) this dissertation without his encouragement and mentorship.

My other committee members have been invaluable, as well. Terrence Chapman has been an amazing source of advice and support. Patrick McDonald challenged me about every time we met, but always offered ideas to keep me moving forward as well. Zachary Elkins gave fresh perspective at crucial times, and was especially helpful at the final stages of the project. Tse-min Lin’s door was always open to discuss research methods, from my very first semester in the program to the appendix of this dissertation.

Various other professors have played an important role in my graduate training. Especially, I am grateful to Henry Dietz who shared his passion for the study of Latin America and encouraged me to return to UT. Robert Luskin has been a constant source of advice both in matters of methods and the profession. Rachel Wellhausen offered her support during my final years in the program. Harrison Wagner, Gary Freeman, Wendy Hunter, and Daniel Brinks also guided me in important ways. Thanks also to Annette Park for helping me to navigate UT. The Government Department, the Lozano Long Institute for Latin American Studies, and the Graduate School provided the financial support that made this research possible. Beyond the department and UT, I am indebted

to Lawrence Sager, Andrew Kerner, Alison Post, and various conference discussants and fellow panelists for their time and interest in my project.

The field work was one the most exciting parts of the project for me, and I am greatly appreciative of everyone who made my stays in Venezuela and Bolivia so intellectually stimulating and enjoyable. For starters, I am deeply grateful to all my interviewees. The designers of the Venezuelan and Bolivian nationalization processes and the technocrats behind the implementation of these reforms were willing to meet me multiple times over the years and answered my questions patiently. In Bolivia, various members of the earlier governments were equally generous. I also want to acknowledge everyone who wished not to be named in this dissertation, especially my interviewees in the private sector: without them, crucial parts of the story would have been excluded.

I was privileged to receive institutional support in the field. In Venezuela, I joined IESA's *Centro Internacional de Energía y Ambiente* during my first research trip in 2011 and my longer stay in 2013, and my project benefitted from both visits immensely. Thanks to Francisco Monaldi and Pedro Luis Rodríguez Sosa for this opportunity, and Siegried Hagel and Amanda Beaujon for their help with the logistics. In Bolivia, I want to thank Cecilia Salazar at Cides-UMSA for her help. I also want to thank all the academics who were generous with their expertise in both countries, and journalists Sara Shahriari in La Paz, Marianna Párraga and William Neuman in Caracas, and Steven Bodzin for sharing their views and connections.

I also want to express my gratitude to everyone who made me feel at home in the field. In Bolivia, Sara, Jorge, and the rest of the Derpic family were incredibly hospitable and helped me to advance my research. Cesar was generous with his time, sharing his first-hand experiences with the nationalization process and engaging in various interesting conversations on the topic. Susana, Raul, Adriana, and Verónica broadened

my perspective on Bolivia when it came to non-hydrocarbon topics. In Venezuela, I was equally lucky to rely on a great group of friends. Alexandra Panzarelli was always willing to share her views and expertise, and her inside scoops kept me up-to-date on Venezuelan politics. Mercedes, Heli and Salvador, and family Navarro hosted me in the most welcoming manner. Cecilia aided my research in countless ways and made my stay all the more fun. Finally, thanks to my fellow fieldworkers Cecilia Medrano Caviedes and Mari Poikonen in Caracas, and Alissa Bernstein and Santiago Anria in La Paz. It was a pleasure to explore these cities together and learn about their research.

At UT, I have been surrounded by great friends and colleagues. I want to thank everyone who has been part of this adventure through course work, TAing, and dissertation writing. While I cannot possible name everybody who has helped me over the years, I want to extend special thanks to the group of Government Department Latin Americanists, especially Caitlin Andrews, Katherine Bersch, Eduardo Dargent, Paula Muñoz, Daniel Nogueira-Budny, and Randy Sunwin Uang. Thanks also to Kyle Endres, Regina Goodnow, Daniel McCormack, Rachel Navarre, Henry Pascoe, Mine Tafolar, and Allison White. Outside the department, Maria José Afanador Llach, Laura Gamboa, Laura Grönroos, and Carrie Kaplan were fantastic resources.

Finally, I am grateful to my *äiti* and *isä* for their constant support over the years, as well as my brothers for being there for me in their own ways. Dimitris has stood by my side through the ups and downs of graduate school. His support, patience, and love have made all the difference, and I dedicate this dissertation to him.

Institutional Constraints on Economic Nationalism in Latin America

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The University of Texas at Austin, 2015

Supervisor: Kurt Weyland

Economic nationalism has made an unexpected comeback in Latin America. This return is particularly surprising when one considers the institutional safeguards that the countries in the region adopted in the neoliberal 1980s and 1990s with the goal of *protecting* the property rights of private investors and *preventing* nationalization of multinational corporations in the future. My dissertation analyzes what role these safeguards, bilateral investment treaties (BITs), have – or have not – played in expropriation of foreign firms. A quantitative analysis of state takeovers in the region in 1985-2012 shows that the treaties have proven to be surprisingly toothless: they have not constrained nationalistic executives from attacking multinational investors. The second part of the dissertation explores the causal mechanisms behind the treaties' weak deterrent power. Case studies of Venezuelan and Bolivian hydrocarbon nationalization under Presidents Hugo Chávez and Evo Morales, respectively, show that the treaties are the weakest precisely when investors most need them. When a commodity boom increases profits in the sector, the host government is motivated to expropriate multinationals. Ironically, the price increase also enables governments to bear the treaties' costs by accepting international arbitration and paying any resulting compensation. While previous research argues that leaders' leftist ideology has driven oil and gas expropriation in Latin America, my research shows that the politicians' strategic

calculations, not their commitments to leftism, better explain the causes and the timing of the nationalization processes, and the way the presidents pursued their nationalistic plans.

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Chapter 1: Introduction

Thanks to the colorful political style of leaders like President Hugo Chávez of Venezuela (1999-2013) and Evo Morales of Bolivia (2006-present), Latin America has become known for the return of economic nationalism. The number of expropriations of foreign firms makes it clear that this comeback is not just rhetoric: while during the neoliberal 1980s and 1990s Latin American governments took over a mere 17 multinationals, the number has multiplied in the new millennium, with governments expropriating over 90 companies (Coyle, n.d.; Minor 1994; Hajzler 2012, author).

This resurgence of nationalization is surprising when one considers the international safeguards that were institutionalized in the 1990s to prevent such infringements of property rights. During the era of the Washington Consensus, Latin American countries joined the global, neoliberal investment regime by signing bilateral investment treaties (BITs), international treaties that guaranteed the property rights of foreign firms in the future. As a result, analysts and scholars expected governments to respect their contracts with foreign investors and refrain from taking over private property. Given this institutionalization of the neoliberal investment rules, the ability of Chávez and Morales to advance their nationalistic plans and expropriate foreign investment is puzzling. Have the presidents broken their legal commitments at whatever cost? Or has the investment regime simply failed to live up to the expectations of its proponents?

The recent electoral successes of the political left might explain part of the region's turn to economic nationalism. Chávez, for one, gained the reputation of a true leftist ideologue around 2005, when he proclaimed himself a socialist and started to advocate for "Socialism of the 21st century." The final step of his oil reforms, the expropriation of the remaining joint venture projects in the eastern part of the country in May 1, 2007, offered him yet another opportunity to strengthen this image: on a live TV broadcast, he first saluted Venezuelan workers and soldiers, clarified briefly what he meant by "Socialism of the 21st century," and accused the previous governments of selling out the country's ever-so-valuable oil (Ministerio del Poder Popular de Petróleo y Minería 2013, 153–178). He then proceeded to declare a "true" nationalization of the sector. With ferocious attacks on the Venezuelan bourgeoisie and the North American empire and calls for the "Bolivarian Revolution," the speech contained all the components that had by then made him the ideological leader of the new left in Latin America.

Chávez maintained his highly-charged, ideological rhetoric during the implementation of the oil nationalization – and, for that matter, during the rest of his time in office. Yet, behind closed doors, the events unfolded with much less drama and much more pragmatism. Nine of the eleven oil companies that were subjected to nationalization in 2007 found common ground with the government. Instead of having to render their facilities to the state, they either decided to sign new, renegotiated contracts or they accepted the government's payoff and left.[1] Only two firms, Exxon Mobil and ConocoPhillips, refused to accept either of these options and chose to invoke their BIT and seek compensation in international arbitration bodies.

However, Chávez did not lose his pragmatism even when faced with Exxon Mobil and ConocoPhillips's aggressive legal counterattack. In fact, he embraced the arbitration processes in an energetic manner: he assembled a highly professional legal team to defend the state. In the ensuing years, this team became known for its efficiency

[1] This part of the nationalization process involved the joint venture contracts in Orinoco (Eljuri and Tejera Pérez 2008, 484). Chapter 4 will present the details of the Venezuelan nationalization process.

and ability to deliver, as it mounted an elaborate and successful defense strategy (Guerrero-Rocca 2013). When the arbitration tribunals finally started to render their rulings against the state in 2009, the government complied, declaring that it had "always indicated that it is willing to compensate investors for decisions made in the strategic interest of the country" (Crooks and Rodriguez Pons 2012). In other words, rather than refusing to comply, as his ideological rhetoric would suggest, Chávez indemnified the companies and even assured the public that he had always intended to do so.

These events are puzzling in two respects. First, the resurgence of economic nationalism in Latin America is surprising, as noted above, given the proliferation of the bilateral investment treaties in the past decades. By providing foreign investors access to international arbitration in case of a dispute, BITs were assumed to protect foreign capital from property rights violation. Yet, Chávez and Morales were able to take over some of the world's biggest oil companies, seemingly undeterred by the treaties.

Second, Chávez's decision to comply with the international investment system during the implementation and aftermath of the nationalization process is intriguing. In light of his intensely ideological declarations on May 1, 2007 – and on numerous other occasions – his moderate behavior in the international legal arena was unexpected; rather than ignore the compensation demands and final rulings, he went along with the arbitration processes and respected the final outcomes.

These two puzzles motivate the present study: why have BITs, the institutional constraints of the neoliberal era, failed to deter expropriation? What factors have allowed leaders like Chávez and Morales to pursue their nationalistic goals, regardless of the treaties, and in what way have they pushed these processes through? The next section presents each research question in more detail.

THE RESEARCH QUESTIONS

This dissertation aims to uncover why BITs, the institutional safeguards of the neoliberal era, have not stopped economic nationalism in contemporary Latin America. Countries in the region adopted BITs in the 1990s, when they signed more treaties than any other part of the world (UNCTAD 2000). Certain European countries and international organizations, such as the United Nations Conference on Trade and Development, boosted this proliferation via active promotion (Elkins, Guzman, and Simmons 2006, 818). Moreover, BITs were often presented as an essential part of the pro-market policies of the Washington Consensus.

As Latin America embraced neoliberalism and the treaties, many analysts expected governments to shy away from nationalization. This presumed deterrent effect of the treaties rests on the compensation mechanism they specify: BITs sought to guarantee full, effective, prompt compensation and thus take away practically any economic benefit that a government would get from nationalization. This, in turn, was assumed to prevent leaders from violating the property rights of MNCs.

Various researchers have found that signing BITs leads to more FDI, suggesting that investors expect the treaties to deter nationalistic leaders (for example, see Kerner 2009). The return of economic nationalism indicates that this has not been the case, however, as many scholars have noted (Wells and Ahmad 2007, 4; Post 2008; Manzano and Monaldi 2010, 451; Simmons 2011, 30; Post 2014; Wellhausen 2015, 33–34). Yet, we lack both systematic empirical evidence for the treaties' ability to protect foreign investment (Salacuse and Sullivan 2005, 87) and a theoretical explanation for their weakness.

My first research question evaluates whether BITs restrain nationalistic leaders and prevent expropriation of foreign direct investment. Specifically, this dissertation asks: does the investors' right of recourse to international arbitration, stipulated in the treaties, pose enough of a threat for nationalistic politicians to prevent them from attacking foreign firms? Were Chávez and Morales exceptionally audacious in challenging the treaties and expropriating the oil multinationals the treaties protected, or have BITs failed to stop economic nationalism in Venezuela and Bolivia, and elsewhere in the region, as well?

After assessing the deterrent effect of the treaties, I move to examine the causal mechanisms behind the treaty failure, the second research question of this dissertation. Specifically, I analyze what has allowed Chávez and Morales to pursue their nationalistic goals and overstep the treaties in the process. Have they acted out of ideology, as commonly assumed, imposing their will on multinationals in an impetuous, impulsive manner? Or have they followed a strategic, calculating plan, considering the economic and legal consequences of their actions along the way?

The conventional wisdom explains expropriations under Chávez and Morales with their ideology; Madrid (2010, 590), for example, classifies these presidents as members of the Latin American "interventionist left" that aims to increase state control over the economy through nationalization. López Maya (2014, 73–74) calls Chávez's economic model "rentier socialism" that is based on nationalization of companies and confiscation of land, among other radical economic measures. Accounts such as these assume that when an ideological, leftist politician reaches power, his or her leftism will manifest itself through the economic policies implemented, including expropriation. Driven by their principles, ideological leaders will disregard the practical considerations and costs of their measures. In other words, they are willing to pay high political costs for reaching their goals (for this definition of ideology, see Pastor and Wise 1994, 475). In the case of Chávez and Morales, the ideological explanation proposes that the leaders were committed to leftism and pursued their goals in a forceful manner, regardless of the final consequences.

However, my brief assessment of the ideological argument in Chapter 2 and a more detailed analysis of the oil and gas nationalizations in Venezuela and Bolivia in Chapters 4 and 5 highlight the limitations of the ideological argument. For example, Chapter 4 will show that Chávez started to implement his nationalistic oil reforms only in 2004, and even then in a somewhat timid fashion. This was more than half a decade after his arrival in the presidential office. Were he acting ideologically, he would have nationalized much earlier. The fact that he waited for the global oil prices to increase before pursuing nationalization suggests that he behaved in a much more strategic manner than is often presumed. Additionally, both Chávez and Morales played along with the international arbitration process in the aftermath of nationalization. This again indicates that the ideological argument – which would have expected non-compliance – does not offer an accurate explanation of the events. In short, when one evaluates the Venezuelan and Bolivian nationalization processes in more detail, the shortcomings of the conventional, ideological explanation become evident.

THE ARGUMENT

I propose a novel argument based on the leaders' careful, strategic calculations, instead of their ideological commitments. The explanation starts from the common finding that an increase in world mineral prices motivates leaders to take over MNCs in the respective sector (Hajzler 2012; for the seminal work, see Vernon 1971). Surprisingly, mineral prices have another, equally important effect: in addition to motivating leaders to nationalize foreign investments, price booms increase the state's capacity to pay the legal process and compensation that BITs stipulate. This is because arbitration panels usually calculate the amount of compensation on the basis of the commodity price at the time of nationalization (Sabahi 2011, 102–133). If a government expects continuing price increases, it can calculate to pay the legal costs of BITs and the compensation, and still end up with a big gain in net revenue. In other words, by paying the economic costs of BITs along the way, leaders can nationalize without defying the formal rules of the international investment regime. In this way, the leaders are acting strategically: after careful policy planning and consideration, they adopt measures and allocate resources in a way that best leads them to realize their long-term policy goals, and they adjust their measures and resource allocation throughout the execution of their plan, if needed (Chandler 1962, 13). In the case of BITs, increasing oil prices allow leaders to make the strategic calculation that the treaties' costs will be affordable in the future.

Certain characteristics of the arbitration process further encourage leaders to prioritize the immediate benefits of nationalization over the possible costs. Many companies are unwilling to sue their hosts as this would hurt any future business in the country (Wells and Ahmad 2007, 72–73; Post 2014, 25).[2] Moreover, even if firms do resort to international arbitration, the final ruling is highly uncertain and the process takes years to finalize (Franck 2007, 49–50; Post 2008; Post 2014). Compared to the new revenue generated by nationalization, these uncertain costs of BITs do not constrain government officials when hydrocarbon prices boom. Consequently, the treaties fail to stop nationalistic leaders.

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[2] As Chapter 2 will discuss, the recent trends in international arbitration suggests that multinationals are more willing to choose arbitration than is commonly assumed. Nevertheless, firms that have other assets in the host country or that wish to return later are most likely hesitant to arbitrate and prefer one-on-one negotiations instead.

A few clarifications about the argument's scope are in order. First, after establishing that BITs do not deter nationalization, I aim to explain why, when, and in what way nationalistic leaders choose to pursue their underlying nationalistic goals and overstep the treaties. In other words, the strategic argument helps us answer three specific questions regarding the nationalization process: i) what causes politicians to act on their nationalistic goal? ii) when do they do so? and iii) in what way do they go about pursuing that goal? The project does not focus on leaders' underlying nationalistic motivations – rather, it uncovers how executives with such motivations are able to act on their motivations, despite the neoliberal constraints.

The project leaves leaders' motivations unexplored for the following reason: To understand and evaluate the effects of institutions, we need to focus on cases in which actors' underlying preferences do not align with the purposes of the institutions. If a politician was planning to respect investors' property rights to begin with, regardless of BITs, his actions would not shed any light on the treaties' effects. Only if a leader has nationalistic goals and plans to act on those goals can the treaties pose a constraint. Only in this latter case would we be able to evaluate the effect of BITs, by assessing whether the treaties force the nationalistic politician to alter his course of action by either cancelling nationalization altogether or by adjusting the process in some way.

Ideological variation in contemporary Latin America offers a real-life illustration. Rightist Presidents Álvaro Uribe and Juan Manuel Santos of Colombia both benefitted from the recent commodity boom, just as Chávez and Morales did. Yet, unlike their Venezuelan and Bolivian counterparts, the Colombian leaders did not expropriate foreign investors. This is because Uribe and Santos were not motivated to challenge multinationals to begin with. Therefore, the lack of nationalization in Colombia does not disprove my argument, nor does it prove that bilateral investment treaties work. These leaders simply shared the same respect for private property rights that is embedded in the treaties and, as a result, they did not act in ways that would have prompted the mechanisms stipulated in BITs to activate.

Finally, my theory is limited to the hydrocarbon sector. The logic of the argument should travel to all natural resources, given that dramatic price windfalls are commonplace in most extractive sectors. Yet, I do not extend the argument beyond hydrocarbons, since the qualitative evidence for my theory originates from this one sector. Importantly, however, the oil and gas sector is particularly relevant for the study of BITs. This is because the treaties were in many ways specifically designed to protect oil multinationals. Therefore, their failure to prevent nationalization in this sector can cast serious doubts on their overall effectiveness. The discussion below on case selection will return to this point in more detail.

THEORETICAL RELEVANCE

My argument has various broader implications for the study of political science. First, scholars have overestimated the deterrent power of BITs. Elkins, Guzman, and Simmons (2006, 15), among others, have suggested that the treaties allow states to credibly commit to the international investment regime by raising the costs of expropriation. However, my research shows that the treaties prove weak when they are most needed by investors; when commodity booms empower leaders to expropriate, BITs lose their deterrent power. This, in turn, suggests that BITs do not serve as a credible commitment mechanism. The argument conforms to Post's findings that the treaties have had little effect in contract renegotiations in the Argentine water utility sector (Post 2008, 323–324; see also Post 2014). It is also in line with the observation that property rights violations remain commonplace events, even in the presence of the treaties (Wells and

Ahmad 2007, 4; Manzano and Monaldi 2010, 451; Simmons 2011, 30; Wellhausen 2015, 33–34).

Second, political science may in general have overemphasized the importance of institutions. In the past few decades, comparativist scholars have turned their attention to formal institutions and attributed a multitude of important effects to them (for this "institutionalist turn," see Hall and Taylor 1996). Especially among scholars of Latin America, this theoretical re-focus was driven partly by real-world events: as the region democratized, newly empowered legislatures and other institutions offered plenty of new material for them to study (Weyland 2002, 61). By the early 2000s, studying institutions was so popular that Pierson and Skocpol (2002, 706) declared that "we are all institutionalists now."

While this attention to institutions has pushed the field forward on various fronts, many key issues remain unresolved. Most scholars have accepted by now that institutions depend on additional causal factors to produce outcomes (Thelen and Steinmo 1992, 3), our task, therefore, is to uncover and explain *how* institutions interact with other factors. As a field, we lack a systematic theory that would do so (Waldner 2002, 23).

My research offers one point of departure for such a theory, as it lays out how shifts in the underlying economic forces can remove the deterrent effect of BITs. On a theoretical level, the argument sides with Przeworski and others who have noted that political outcomes may be determined by the conditions on which institutions rest, not the institutions themselves (Przeworski 2004, 527–540; MacIntyre 1972, 11–12; see also Weyland 2002, 57–85; Kurtz 2004, 27). On a more concrete level, my theory offers a novel explanation for the weak deterrent power of BITs. Specifically, changes in the market value of commodities can explain BITs' lack of deterrence, as higher prices can motivate leaders to take over the sector and allow them to expect that the consequences of BITs will be affordable.[3]

A related literature in IR focuses on compliance with international institutions. Various authors have argued that countries might only sign treaties that require minimal changes in their behavior (for the seminal contribution, see Downs, Rocke, and Barsoom 1996).[4] The case of BITs suggests that signatory states may not know what their own optimal behavior in the future looks like and how the requirements specified in the agreements will affect that behavior. In other words, the structures that surround international agreements change.[5] My research highlights the role of such structural changes, stressing that state interests regarding FDI can change both from one government to another and from one economic situation to another.

My research also contributes to our understanding of the new left in Latin America. The region started to gear towards the left after the 1998 election of Chávez; by 2009 more than half of the countries and citizens of the region were governed by a leftist or leftist-populist government (Remmer 2012, 949). This electoral success – often dubbed as the "pink tide" – has received plenty of scholarly attention (see, for example, Weyland, Madrid, and Hunter 2010; Levitsky and Roberts 2011; Ellner 2014b). However, surprisingly few studies have focused on the economic policies of these new

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[3] Post offers an alternative theory for BITs' weakness: she considers that they are overridden by characteristics of the key actors – the firms' nationality and the level of diversification of their holdings, to be precise (Post 2008, 323–324). I argue that the answer lies in structure, not in agency.

[4] For an interesting discussion on this endogeneity, see the debate between Simmons and Von Stein over the effects of the Article VIII of the IMF (Simmons 2002; Stein 2005; Simmons and Hopkins 2005).

[5] Recent literature on escape clauses of international institutions considers these types of structural changes. Escape clauses are provisions that allow countries to abandon compliance with a treaty temporarily without violating the terms of the agreement (Rosendorff and Milner 2001, 830). However, in many of these studies the possibility of structural changes is known to the signatory states and, as a consequence, they can build flexibility provisions into the treaty (Kucik and Reinhardt 2008; Pelc 2009). This has not been the case with BITs.

governments.[6] The lack of research might reflect a more general trend among Latin Americanists, as political economy issues and topics seem to have fallen out of fashion (Luna, Murillo, and Schrank 2014, 5). My study responds to the recent calls for studies of political economy in the region (ibid., 6).

More specifically, this dissertation challenges the prevailing view on the Chávez and Morales governments. When it comes to the economic policy-making of these administrations, Venezuela and Bolivia specialists tend to highlight the importance of the leaders' ideology; as noted above, scholars often explain the recent hydrocarbon nationalization with Chávez's and Morales's leftism (Madrid 2010, 590; López Maya 2014, 73-74). I will challenge this conventional wisdom and show that Chávez and Morales pursued these nationalization processes in a much more strategic manner than they are usually given credit for.

Finally, the findings also have practical relevance. Given the weak deterrent effect of BITs, foreign investment is likely to remain relatively unprotected. Moreover, countries like Bolivia and Venezuela have cancelled some of their BITs and left the International Center for the Settlement of Investment Disputes (ICSID), the most widely used investment arbitration body. These measures indicate that governments retain considerable discretion over the politics of FDI. The most optimistic advocates of the treaties were thus wrong in expecting that these externally-imposed tools would automatically increase the respect for property rights. Moreover, the case of Chávez's Venezuela will illustrate that leaders' political moves can influence world prices, suggesting that politicians are still able to challenge multinational corporations.

[6] For notable exceptions, see Flores-Macias (2010), Weyland, Madrid, and Hunter (2010), and Flores-Macias (2012).

Yet, the international investment regime is not completely toothless either. As the decreased levels of FDI in Venezuela and Bolivia suggest, Chávez and Morales have actually paid a reputational price for their actions. Paradoxically, even if the leaders respected BITs by following through with the arbitration procedure specified in the treaties, they could not escape some of the costs of the treaty regime.[7] Consequently, we should not exaggerate the power of Latin American leaders to confront the international economic and legal systems, nor should we underestimate the power of the investment regime. The conclusion of the dissertation will return to this paradox in more detail and present some evidence for the reputational costs that Chávez and Morales have paid.

Since my study highlights the inability of BITs to weather commodity booms, the results can also be taken to suggest concrete changes in the international investment regime. While some scholars have encouraged developing countries to avoid signing BITs (Rodrik 2007, 20) and a few countries are moving in that direction, a return to a world without the treaties may be infeasible, given the treaty regime's high level of institutionalization. If one accepts the treaties as a part of the new international order of FDI, my research suggests that future treaties may need to address possible external, structural changes in their provisions. The conclusion of the dissertation will raise some of these concrete considerations but, overall, my focus is on the effectiveness of the current regime, not on its possible extensions or reforms.

RESEARCH DESIGN

This dissertation uses both quantitative and qualitative methods to address the research questions. Specifically, I adopt Lieberman's "nested analysis" approach to embed in-depth case studies of two nationalization processes – the oil and gas takeovers

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[7] For a more detailed study of these reputational costs, see Allee and Peinhardt (2011).

in Venezuela and Bolivia – within a broader statistical analysis of FDI expropriation in Latin America. In this way, I can take advantage of the particular strengths of both quantitative and qualitative methods (Lieberman 2005, 436). The large-N, statistical analysis allows me to address the power of BITs in a broader context, whereas the qualitative case studies help me establish causal links to assess what role, if any, the treaties have in shaping nationalization processes.

According to Lieberman, case studies can be especially valuable when a large-N analysis refutes the original theory, or when we lack cross-country quantitative data to assess a hypothesis with statistical methods (Lieberman 2005, 443). Both are true here; the existing research on BITs has assumed that the treaties prevent expropriation – yet my statistical analysis in Chapter 3 suggests that this has not been the case. Therefore, to understand why the treaties have failed to deter nationalistic leaders, we need to examine the governmental decision-making processes in detail. Such processes are abundant with evidence that is not precisely measurable and validly quantifiable; as a consequence, they are better evaluated with qualitative research methods.[8] The particular method I use is process tracing, an evaluation of different pieces of evidence in a case in order to evaluate whether pre-established, theoretical causal claims hold (Collier 2011, 824).[9] That is, does the behavior of Venezuelan and Bolivian leaders conform to the expectations of the proposed argument, or do they act in ways that support the alternative, currently prevailing argument?

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[8] In fact, as discussed in Chapter 3, some characteristics of the quantitative data pose challenges for the statistical analysis. This further underscores the importance of qualitative research methods.

[9] Process tracing can be used for various different purposes, as well. Collier lists the following as its main objectives: "(a) identifying novel political and social phenomena and systematically describing them; (b) evaluating prior explanatory hypotheses, discovering new hypotheses, and assessing these new causal claims; (c) gaining insight into causal mechanisms; and (d) providing an alternative means—compared with conventional regression analysis and inference based on statistical models—of addressing challenging problems such as reciprocal causation, spuriousness, and selection bias" (Collier 2011, 824). For more on process tracing, see also George and Bennett (2005).

The process tracing of the events rests heavily on interview evidence that I collected in the field during the academic year 2012-2013 and two earlier, shorter research trips. I conducted 130 semi-structured elite interviews with many of the key decision-makers and participants in the nationalization, members of previous governments and opponents of the process, as well as outside observers. Most of the decision-makers are politicians who were in charge at the time: in Bolivia, I spoke with Vice President Álvaro García Linera, Ministers of Hydrocarbons Andrés Soliz Rada and Saúl Avalos Cortéz, and Ministers of Legal Defense Cecilia Rocabado and Pablo Menacho, for example. In Venezuela, I interviewed Minister of Energy and Mines Álvaro Silva Calderón, and a high-level government official and an advisor to President Chávez, both of whom wished to remain anonymous. I also interviewed various technocrats who were in charge of technical planning and execution of the nationalization. In Bolivia, this group includes the head of the governmental negotiation team Manuel Morales Olivera and various members of his team; Presidents of YPFB Jorge Alvarado, Juan Carlos Ortiz, Guillermo Aruquipa, and Santos Ramírez; as well as various analysts and experts in YPFB. Some of the Venezuelan technocrats interviewed are Bernard Mommer and Eulogio del Pino from PDVSA, the legal expert Hildegard Rondón de Sansó, and various analysts and advisors in the Venezuelan Central Bank. In both countries, I also met with diplomats and legal experts who had participated in the BIT negotiations in the 1990s. In Bolivia, I also conducted extensive research on the previous governments and their hydrocarbon policies. For example, I interviewed Presidents Carlos Mesa Gisbert and Eduardo Rodríguez Veltzé, most of their Ministers of Hydrocarbons, and other members of their administration.

To gain a comprehensive understanding of the events, I also met with representatives of various companies involved in the nationalization negotiations. In addition, I spoke with multiple private lawyers who have worked for the affected firms, and some who defended the state in international arbitration. Most of the private sector actors wished to remain anonymous and, consequently, the dissertation does not name them or their companies. I also interviewed various economists, analysts and technical experts, such as representatives of the Bolivian Hydrocarbons Chamber *Cámara Boliviana de Hidrocarburos y Energía* and the Venezuelan Hydrocarbon Association, *Asociación Venezolano de los Hidrocarburos*, and legal practitioners in various arbitration centers.

Additionally, I met with a wide array of actors who observed the processes closely. These interviewees include opposition politicians, embassy personnel, representatives of arbitration centers, academics, consultants, activists, members of NGOs, and journalists. Finally, I also collected primary and secondary literature in the field, including legislative debates and some unpublished governmental documents.

By nesting the process tracing of the two cases within the broader, statistical analysis, I can respond to a common critique of qualitative case studies, namely that of selection bias. Following the seminal works of Mill (2002), Przeworski and Teune (1970), and Lijphart (1971), among others, qualitative scholars have traditionally chosen their cases in a deliberate fashion. This is done in order to rule out or confirm what variables are either necessary or sufficient for the outcome of interest. As quantitative research methods have gained prominence, however, this traditional case study method has came under attack: quantitative researchers accused the users of qualitative methods of "choosing on their dependent variable" or, more concisely, of selection bias (King, Keohane, and Verba 1994; Geddes 1999). According to the critics, selecting cases with positive outcomes over-represents such cases in the broader population and, consequently, leads scholars to make mistaken causal inferences (for more, see Collier and Mahoney 1996).

Since my statistical analysis of Latin American countries suggests that BITs have failed to deter nationalization, we have to turn our focus to cases that can shed light to the reasons behind such deterrent failure. Hence my interest in Venezuela and Bolivia, where leaders have overstepped the treaties and attacked some of the biggest oil companies of the world with seeming ease. These cases will allow me to identify the key factors that allow politicians to bypass their international commitments. In other words, these cases hold particular promise for theory building *because* they are positive cases of nationalization.

The study focuses on the Venezuelan and Bolivian governments instead of other nationalizers in the region because of their strong ideological convictions. According to the conventional wisdom, as discussed above, economic nationalism in contemporary Latin America stems from leftist ideology; when politicians of the "interventionist left" (Madrid 2010, 590) gain power, they will translate their leftist beliefs into statist economic policies, including nationalization. As some of the most radical leftists in the region, Chávez and Morales should not be constrained by BITs.[10] In fact, such strong ideologues might take pride in overstepping the treaties, possibly viewing them as institutional relics of their nation's shameful, neoliberal past and, consequently, useful targets for public attacks.

In political science parlance, the Venezuelan and Bolivian cases are most likely cases for the ideological argument to hold (Bennett and Elman 2006, 462). Given Chávez's and Morales's strong leftist tendencies, they should attack multinationals in an

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[10] Experts classify Chávez and Morales as "radical" (Ellner 2014a, 2) or "contestatory" (Weyland 2010, 3), for example.

impetuous, impatient manner, and overlook the future costs of BITs in the process. Conversely, these leaders are least expected to pursue a strategic path. By choosing these cases, therefore, I am biasing the analysis against the strategic argument and in favor of the alternative, ideological theory.

The Venezuelan and Bolivian cases also offer some variation that helps to establish causality. The cases share the same final outcome – nationalization of BIT-protected investment – but they exemplify somewhat different paths to that outcome. Specifically, Chávez nationalized the oil sector gradually, intensifying his measures over time; Morales, in contrast, advanced radically in the beginning but accommodated investors later on. Process tracing of these two cases will illustrate that the economic conditions that the leaders faced at different points in time can explain both the similarities in the final outcome and the differences in the paths along the way. More specifically, given the variation in world oil prices over time, the cases help us establish the causal connections between the prices and the leaders' decisions to overstep BITs.

Additionally, the cases are substantively important for a few reasons. As Chapter 3 will discuss, Chávez and Morales represent the most active nationalizers in Latin America. As a consequence, analyzing their actions will help us to better understand the overall phenomenon of economic nationalism in today's globalized world. Moreover, Venezuela is an important player in oil, and Bolivia exports natural gas to Brazil and Argentina. The nationalization of these resources has had important implications in regional and global hydrocarbon markets, further highlighting the need for careful evaluations of the processes.

Finally, the qualitative cases focus on the nationalization of hydrocarbons because, to a great extent, BITs were designed with this particular sector in mind (Laffin, Kanargelidis, and Blyschak 2014). The political risks that foreign investors face are particularly high in oil and gas, where exploration requires heavy up-front investments but the less capital intensive extraction of the resources can last multiple decades. Once a multinational has made its initial investment, the government can renege relatively easily on its earlier promises and take over the facilities.[11] Given this well-known dynamic, BITs were expected to ensure that the host country would respect its original, long-term contracts. For this reason, the treaties and the oil and gas industry have "an important relationship" (ibid.). My qualitative case studies will illustrate how the treaties can lose their deterrent power in the very sector that they were designed to safeguard.

DEFINING NATIONALIZATION

The term "nationalization" refers to the involuntary transfer of property rights from the investor to the state. The literature on the topic sometimes distinguishes between nationalization and expropriation, classifying large-scale, industry-wide takings as the former and more property-specific takings as the latter (see, for example, Kobrin 1980, 68–69; UNCTAD 2012, 5–6). Following practitioners' recent trend to overlook these distinctions (UNCTAD 2012, 5–6), I will use the two terms interchangeably, together with "state takings" and "state takeovers."

While the definition of nationalization seems straightforward, governments may also implement expropriatory measures that do not constitute an outright nationalization in theory, but come close to one in practice. These acts – called "creeping expropriation," "indirect nationalization," or "*de facto* nationalization" – are regulatory changes that the host government imposes unilaterally to alter its agreed-upon contracts with investors (Kobrin 1980, 68; Hajzler 2012, 5). For instance, it can create new taxes, cancel permits, or limit profits in a way that the company perceives as confiscatory. While it is

[11] This is Vernon's (1971) famous "obsolescing bargain" dynamic. Chapter 2 will present it in more detail.

sometimes hard to distinguish between the direct and indirect forms of nationalization (Hajzler 2012, 5), the Venezuelan and Bolivian hydrocarbon reforms clearly constitute outright nationalization. This is because in both cases the state physically took over facilities of foreign firms after the parties failed to renegotiate new contracts.[12]

Finally, it is important to note that this dissertation focuses on nationalization of foreign direct investment (FDI), cross-border investment in which a company based in one country owns production in another country (Oatley 2011, 376).[13] Such investments are made by multinational corporations (MNCs), and I will use the terms "firm" and "company" interchangeably with "MNC", unless specified otherwise. I focus solely on takeovers of multinationals and not domestic firms, since BITs are signed between two governments to protect investment between the signatory countries. Consequently, domestic investors do not enjoy treaty protection and, therefore, they fall outside the scope of this study.

Organization of the Dissertation

The dissertation is organized as follows. Chapter 2 presents the existing research on BITs and uncovers its limitations to both evaluate the deterrent power of the treaties and to explain their weakness in Venezuela and Bolivia. I then develop my own explanation for the treaties' failure to stop Morales and Chávez. This explanation, outlined briefly above, rests on the booming market prices of the commodity in question and the politicians' rational calculations on the basis of those upward trending prices.

[12] There is little controversy over the Venezuelan case but the process in Bolivia is sometimes claimed not to have been a nationalization. This is partly because of Morales labeled the sector's takeover a "nationalization without expropriation". Even with the label, he did pursue to expropriate some of the companies, as will be described in more detail in Chapter 5. For an alternative view, see Kaup (2008, 1739).

[13] For controversy in defining and measuring FDI, see Kerner (2014).

Chapter 3 examines the deterrent power of the treaties in a broader context, using statistical research methods to analyze expropriation of multinationals in Latin America and the Caribbean between 1985 and 2012. The analysis reveals that the treaties do not constrain nationalistic leaders, as a BIT between two countries makes the host country *more* likely to take over investment from the treaty-partner country. The chapter offers a potential explanation for this surprising finding, suggesting that the regulatory changes that constitute an indirect expropriation might be more expensive for the host government in the presence of the treaties. Consequently, BITs may push politicians to nationalize when they contemplate between nationalization and less radical, regulatory measures. The chapter also evaluates the strategic theory in a preliminary fashion, finding evidence for the argument that the power of BITs in oil and other mineral sectors is contingent on commodity prices.

Chapters 4 and 5 present qualitative case studies of the Venezuelan and Bolivian nationalization cases in order to assess the ideological and strategic arguments. The theories can explain three different facets of the nationalization process: its cause, its timing, and the nationalistic leader's mode of action in various stages. The chapters describe first the events in the Venezuelan and Bolivian hydrocarbon sectors, and then move to address each of these three facets. I will demonstrate that the different paths that Chávez and Morales took to nationalization, and the leaders' behavior in the aftermath of the process, offer strong evidence for the strategic argument.

The concluding chapter presents the key theoretical contributions of the dissertation. It discusses the theoretical implications of the study, as well as raises some practical considerations. Finally, it presents the case of Kazakhstan to extend the theoretical scope of the argument.

Chapter 2: Theory

This dissertation examines whether institutional constraints of the neoliberal era have succeeded in protecting property rights of foreign investors in contemporary Latin America. The project answers two interrelated questions: First, how effectively do bilateral investment treaties (BITs), adopted in the 1990s to safeguard foreign investment, restrain nationalistic leaders in the region? Second, if a government chooses to nationalize investment protected by a BIT, what explains this apparent weakness of the treaty? In other words, what allows and induces nationalistic executives to overstep the institutions designed to tie their hands? This chapter analyzes the existing literature on the treaties, assessing whether it offers useful theoretical tools for understanding nationalization of BIT-protected investment. After discussing the extant work and identifying its limitations, the chapter develops a novel theory that can better account for the role of the treaties in the recent hydrocarbon expropriations in Latin America.

The chapter begins by assessing the studies that speak to the effectiveness of BITs. The arguments can be broadly classified as either institutional or economic. As the discussion will show, both types of arguments suffer from a significant flaw: they take compliance with the treaties as given. However, as the recent wave of nationalizations in Latin America proves, the treaties have *not* stopped nationalistic leaders from expropriating foreign investment, suggesting a good deal of incompliance with the treaty regime. Therefore, while the institutional and economic arguments can help us understand the positive impact of BITs on FDI flows, and the proliferation of the treaties in the 1990s, they cannot explain why governments continue to confiscate investment against the spirit of the treaties. The studies on compliance with international institutions are also unable to account for the expropriation of BIT-protected investment.

The second part of the chapter examines why nationalistic leaders nationalize FDI despite BITs. I introduce the prevailing explanation for the weak deterrent power of the treaties in Venezuela and Bolivia, based on executive ideology. As a closer examination of the events in Venezuela and Bolivia will reveal, the argument is insufficient to account for the nationalization processes. After uncovering the limitations of the prevailing argument, I develop a novel explanation for the weakness of the treaties, based on politicians' strategic calculations about the net gains of nationalization when world commodity prices increase.

According to the strategic argument, presented in the third and final section of the chapter, leaders carefully calculate the costs and benefits of expropriation by assessing the expected profits in a given sector. If politicians estimate the benefits of nationalization to outweigh the costs that BITs create, they take a conscious decision to proceed with nationalization and cover the future charges with the new wealth gained through the measure. Specifically, this can occur when mineral prices increase the expectations of future profits in the sector dramatically. Under such conditions, nationalistic politicians follow an economic rationale: they expect to shoulder the treaties' future costs with the revenue that nationalization itself generates. As a result, they do not disrespect BITs as the ideological argument predicts, but can afford to follow the letter of the treaties by submitting to arbitration and paying the eventual compensation.

A few additional factors help reassure leaders that the gains of nationalization will exceed the future costs of BITs. First, many firms prefer negotiations over legal measures, given the potential negative consequences of international arbitration on future business relations (Wells and Ahmad 2007, 72–23; Post 2014, 25). Second, negotiations between the parties allow governments to utilize sophisticated bargaining tactics that encourage firms to settle. Third, the international arbitration process is lengthy and its outcome is uncertain (Franck 2007, 49–50; Post 2008, 6; Post 2014, 7).[14] These factors boost host governments' confidence in their strategic calculations and allow them to proceed with their nationalistic plans, regardless of the treaties.

My argument highlights a paradox in the design of BITs: the treaties' effect is contingent on economic conditions. More specifically, their deterrent power rests on the economic penalty that they stipulate for nationalistic actions. This penalty can lose its significance when commodity prices boom, as leaders can expect the economic benefits of nationalization to outweigh the treaties' costs. Therefore, the treaties carry the least force precisely when they are most needed, namely when commodity booms create strong temptations for governments to nationalize.

TO WHAT EXTENT DO BITS DETER NATIONALIZATION?

Following BITs' proliferation in the 1990s, the treaties have attracted increasing scholarly attention. Most of the research has focused on either the impact the treaties have on inward FDI in signatory countries (for a recent contribution, see Kerner 2009), or the rapid adoption of the treaties across the globe during the 1990s (Guzman 1997; Elkins, Guzman, and Simmons 2006; Poulsen and Aisbett 2013). While these studies do not analyze the link between BITs and nationalization, the majority of them address the mechanism through which the treaties are expected to deter expropriations. These arguments highlight either institutional or economic factors. As I will argue, both types of

[14] It is important to note that firms' willingness to go to arbitration depends on factors like their level of diversification in the host country and their overall future plans in that market. Interestingly, the number of public investment disputes in arbitration has increased notably in the past few decades, and most of these cases stem from smaller regulatory changes, rather than from outright expropriation (Wellhausen 2015, 30–32). This suggests that many companies might, in fact, be quite willing to go to arbitration. Chapter 3 further discusses firms' propensity to opt for arbitration, though more research is needed to uncover what characteristics make companies more likely to arbitrate and under what conditions this route is more likely.

arguments fail to explain why we have observed a sharp increase in the takeovers of MNCs, despite the protection of BITs.

Institutional Arguments

Most scholars working on BITs have adopted an institutionalist perspective, as developed by theorists in International Relations (for the seminal contribution, see Keohane 1984). According to this view, the treaties are the outcome of conscious policy coordination between two utility-maximizing governments; on the one hand, the host government is willing to constrain itself domestically in order to attract multinational corporations and, on the other hand, the home government wants to protect these economically powerful corporations. In this way, BITs are the outcome of cooperation between the host and home governments.

The institutionalists attribute BITs' power to a particular article in the treaties, often considered their most important part (Franck 2006, 343): in case of a dispute between the host government and the investor, the article states, the investor can take the dispute to international arbitration. With this provision, the treaty allows foreign investors to avoid the legal institutions of the host country and sue the host government internationally. If the arbitration body rules against the state, the decision is enforceable immediately (International Centre for Settlement of Investment Disputes 2006a, 27).[15] In this way, the treaty is designed to make the concrete costs of expropriation prohibitive: while nationalistic leaders of the past could pressure domestic courts to rule in their favor, independent arbitrators now determine the compensation.[16] This external enforcement of compensation makes nationalization costly by ensuring investors

[15] Different arbitration bodies have different provisions for enforcement. The ICSID Convention is often considered the most binding arbitration body in terms of enforcement and annulment procedures.
[16] Franck examines 120 public awards between 1990 and 2006, finding that the average amount of damages awarded was 10.4 million (Franck 2007, 86).

effective indemnification in case of an expropriation. This “punishment”, in turn, should deter nationalistic measures by the host government.

This deterrence argument rests on the theory of credible commitment. Fearon (1997) identifies two distinctive mechanisms through which actors can convey their commitment to existing agreements in a credible manner: the *ex post* and *ex ante* costs. First, politicians can accept significant *ex post* costs for reneging on their agreements. In the case of foreign investment, for example, leaders can lock in their guarantees for private property by signing BITs. Since the treaties offer MNCs access to arbitration, they increase the costs that the government or its successor would face if it violated the existing contracts. In this way, the *ex post* costs of the treaties help governments to solve the problem of the “obsolescing bargain” (Vernon 1971), the tendency of host countries to break their contracts with foreign investors after the initial, immobile investments have been made. These nationalistic incentives disappear, once governments would have to shoulder the full costs for treaty violation.

In addition to the arbitration and compensation costs that BITs create, Elkins, Guzman, and Simmons (2006) identify two other *ex post* costs that the treaties impose on the host government. First, BITs clarify the terms of foreign investment to a much greater extent than customary international law, reducing the ambiguity of what constitutes a contract violation (ibid., 823). Second, since the treaties are signed between two governments, they involve the home country in host state-MNC relations. Consequently, a violation of the investors’ rights can harm the diplomatic relations the host country has with the investors’ home country (ibid.). Combined with the costs of arbitration and compensation, these factors raise the *ex post* costs of nationalization of BIT-protected investment and, in this way, they seal in the host government’s preference for private property rights.

Another institutionalist view on BITs adopts the logic of credible commitment but focuses on the *ex ante* costs, or sunk costs, of treaty signing (Fearon 1997). According to this variation of the institutionalist argument, host countries can signal their commitment to property rights to the home countries by assuming significant costs before any actual contract violation. In the context of BITs, this type of argument has been advanced by Kerner (2009, 79–80), who distinguishes two types of *ex ante* costs: first, the treaties shrink the policy-space of host politicians and state regulators – an unpopular reform to push through, as politicians usually oppose limits on their own power. Second, BITs benefit potential future investors and, consequently, they may draw opposition from the domestic private sector and existing foreign investors who, unlike their new competitors, do not benefit from the treaties (ibid.). According to the argument on *ex ante* costs, if a government is able to sign and ratify BITs despite the opposition from rival politicians, state regulators, and private investors, it sends a strong signal to potential investors, confirming the government's willingness to commit to property rights.

The vast majority of empirical work on BITs draws from these two mechanisms of credible commitment. Specifically, scholars have focused on the relationship between the number of BITs and FDI inflows, examining whether foreign investors are attracted to countries that sign BITs. A few early studies did not find evidence for such a relationship (UNCTAD 1998; Hallward-Driemeier 2003; Tobin and Rose-Ackerman 2005) but most of the recent studies argue that BITs are an effective mechanism of credible commitment, as new BITs in the host country increase the amount of FDI. Importantly, these studies find that both the *ex ante* and *ex post* costs of the treaties convince foreign investors. In other words, signing a new BIT increases investment from both the home country that signs the BIT, and from investors elsewhere who observe the new BIT but cannot invoke it (Neumayer and Spess 2005; Tobin and Rose-Ackerman

2006; Aisbett 2007; Kerner 2009; Busse, Königer, and Nunnenkamp 2010; for positive but more conditional findings, see Banga 2003; Ginsburg 2005, 117; Elkins, Guzman, and Simmons 2006; Gallagher and Birch 2006; Allee and Peinhardt 2010; Allee and Peinhardt 2011; Kerner and Lawrence 2014).[17] Overall, the empirical research thus supports optimistic arguments about BITs and their ability to establish and signal the hosts' commitment to foreign investors.[18]

However, this literature is unable to explain the comeback of economic nationalism and, specifically, the expropriation of BIT-protected investment in Latin America. As discussed in the introductory chapter, various leaders in the region have taken over companies safeguarded by a treaty. Yet, the studies surveyed so far suggest that investors perceive the treaties as effective mechanisms of credible commitment. But this confidence appears to be misplaced. In light of the confiscatory events, the *ex ante* and *ex post* costs that BITs create seem not to have been high enough to stop nationalistic leaders. The question about the deterrent effect of BITs is essentially an empirical one, and the following chapter evaluates the connection between treaty signing and nationalization in greater detail. The very fact that a number of nationalizations have occurred, however, suggests that the credible commitment interpretations of BITs have missed an important empirical phenomenon.

Another relevant body of institutionalist literature on BITs draws from the work on the "legalization" of world politics. This subfield analyzes states' decisions to "impose international legal constraints on governments" in different issue areas (Goldstein et al.

[17] Yackee (2007) makes an important empirical point when he shows that small methodological corrections change the findings of Neumayer and Spess (2005). However, the vast majority of the recent quantitative studies on BITs finds a positive correlation between the treaties and FDI inflows.

[18] It is important to note, however, that studies on political risk insurance providers and surveys on MNCs suggest that these actors do not take BITs into account when deciding about risk assessment or future investments (Yackee 2010; Poulsen 2010). These findings are puzzling, given the link between BITs and FDI established in the literature reviewed here.

2000, 386), such as monetary affairs (Simmons 2000), trade politics (Goldstein and Martin 2000), and human rights (Lutz and Sikkink 2000). As the proliferation of BITs illustrates, the politics of FDI has clearly undergone a similar legalization process at the international level. In fact, the legalization of state-MNC relations was one of the key goals of the International Centre for Settlement of Investment Disputes (ICSID), the arbitration body that the World Bank hosts and funds. The ICSID was established in 1966 specifically to "de-politicize" investment disputes (Shihata 1992, 4) and to rectify power imbalances between host states and their diplomatically more powerful counterparts (Puig 2013, 550).

Following the legalization literature in IR, various scholars have focused on the legal characteristics of BITs. Allee and Peinhardt (2010), for example, examine which dispute resolution center states have chosen in their BITs and what factors influence that choice. They find that host countries that depend more on global markets are more likely to accept ICSID, ceding to the demands of home states and investors who usually prefer ICSID over other arbitration bodies (ibid.). Blake (2013), in turn, analyzes why the national treatment commitments are stronger in some BITs than in others.[19] These studies investigate explicitly the variation in the legal obligations that BITs establish, contributing to our understanding of the treaties and the growing literature on the legalization of world politics.

Interestingly, a similar literature on the legalization of politics has boomed in the field of Comparative Politics. Comparativists often call the phenomenon the

[19] Blake argues that host governments with short time horizons are more willing to give greater concessions to investors in their BITs than governments with long time horizons, since the latter group of governments expects to remain in power and have to actually face the shrinking policy autonomy that BITs cause. The work of Haftel and Thompson (2013) can be also considered a study of the legalization of FDI, since they examine the factors that cause time delays between the signature and ratification of BITs. They find that the delays depend both on domestic constraints on the executive and relationships between the signatory states.

"judicialization" of politics, defining it as the entrance of courts and judges into public policy-making, replacing or at least complementing other previously dominant agencies (Tate and Vallinder 1995, 28).[20] Since the judicialization of politics can occur in different ways and have a multitude of different consequences, the work on the topic is expansive (Kapiszewski and Taylor 2008, 741). Perhaps most relevant to the study of BITs is the research on the mobilization of actors who have not traditionally used legal venues. For example, Smulovitz (2005, 165–169) describes how Argentinean political parties and unions used the courts to stall and remove the government-imposed restrictions on cash withdrawals in 2001. This activation of courts led the state to face complex political, social, and legal conflicts that would not have taken place without the unprecedented legal mobilization of the parties and unions (ibid.). A similar development has clearly taken place at the international level, where more companies are suing their host states for investment disputes than ever before (UNCTAD 2013). In other words, BITs have facilitated MNCs to pursue their demands against host states through new legal venues. The judicialization of politics literature could be useful in analyzing the consequences of such mobilization.

However, just like the credible commitment literature, the arguments on the legalization and judicialization of FDI politics are unable to explain the rise of nationalization in Latin America. The variation in BITs, the key focus of the legalization literature, is unlikely to explain the recent expropriations. This is because the treaties Latin American countries have in effect seem similar when it comes to the dispute settlement mechanisms (see Yackee 2007b, appendix). Despite this commonality, some governments have respected these treaties, whereas others have overstepped them with

[20] Others have noted that the process entails the introduction of a new venue into the political arena, rather than removing previous actors (Gauri and Brinks 2008).

apparent ease. Consequently, the causes of treaty violations are likely to lie elsewhere than in the treaties themselves. The judicialization of politics literature, however, could help us understand how the legal mobilization of MNCs shapes politics and policy outcomes in the host countries.[21] This, in turn, will uncover if MNCs use BITs to pressure and threaten nationalistic host governments. Nevertheless, the existing work on the legalization and judicialization of FDI politics has not addressed this deterrent effect of BITs.

In sum, the institutionalist work on BITs has mostly focused on analyzing whether the treaties attract more FDI to the host country. These studies have found evidence for both the *ex post* and *ex ante* mechanisms of BITs: the costs that the treaties would impose on governments before *and* after nationalization help host countries to commit credibly to property rights. Yet, this literature overlooks the question of treaty compliance: do the signatory states in fact follow through with their promise and protect the property rights of foreign investors? Scholars have assumed such compliance, connecting the lack of nationalization in the 1990s to the preceding proliferation of the treaties (Minor 1994, 10; see also Reisman and Sloane 2004, 115–50; Coyle n.d.; Vandevelde 2005, 184) but the treaties' effectiveness has not been tested empirically.[22] The recent wave of nationalizations in Latin America suggests that BITs can fail to protect foreign investment – an outcome that the credible commitment literature has overlooked. This unexpected return of economic nationalism calls into question the

[21] Simmons (2009) work on compliance with human rights treaties offers another potential venue for future research. Simmons argues that treaties' causal effects depend on the treaties' ability to empower actors in society who were not empowered before (ibid., 125). The conclusion of the dissertation will return to this point.

[22] To my knowledge, there are two studies that focus on the link between BITs and international arbitration. Simmons (2001, 29-30) finds that a higher number of BITs does not decrease the risk of arbitration, but increases it. Allee and Peinhardt (2011), argue that governments who end up in arbitration lose inward FDI. This suggests that BIT violations lead to concrete costs for nationalistic governments. My study asks whether those costs are high enough to deter nationalization altogether.

deterrent power of BITs and, at the very least, calls for a careful empirical evaluation of the treaties' effects.

The discussion has also uncovered the weakness of arguments based on the legalization and judicialization of politics. The legalization literature has a similar limitation as the credible commitment literature: it does not address the ability of the treaties to stop nationalistic governments. Work on the judicialization of politics in the field of Comparative Politics, on the other hand, could offer valuable tools for understanding the deterrent power of the treaties. Nevertheless, analysts of BITs have not examined the legal mobilization of MNCs and the consequences of such mobilization in detail. Given these shortcomings of the institutional arguments, the following section turns to alternative, economic arguments of BITs, assessing whether they can better explain the recent expropriations of treaty-protected investment in Latin America.

Economic Arguments

Similarly to institutionalists, the proponents of economic arguments conceive of BITs as conscious policy decisions by the host and the home country governments. Unlike the institutionalists, however, the scholars who highlight the role of economic factors emphasize the competitive nature of the global economy and the consequences of this competition for individual governments. Specifically, the economic accounts have been employed to explain why countries choose to adopt the treaties.

The proliferation of the treaties in Latin America is particularly puzzling, because governments' eager commitment to BITs in the 1990s marked a dramatic shift in the prevailing legal framework. Traditionally, Latin America had embraced the opposite stance: since the late 19th century, when an Argentine lawyer crafted the so-called Calvo Doctrine, nations had unilaterally removed the rights of foreign investors to appeal to any outside legal systems. Specifically, the Calvo Doctrine encompassed two principles: first, countries should not intervene in any way in the politics of sovereign states and, second, foreigners should not be entitled to any other rights or privileges than those of citizens of the host state (Shea 1955, 19–20). As the international community opposed the Calvo Doctrine, Latin American countries started to include its principles in their constitutions and legislation (Manning-Cabrol 1994, 1172). Consequently, for more than a century, contracts with foreign investors tended to include this Calvo Clause to ensure that foreigners would not receive any better treatment than nationals (ibid., 1172-1173).

The BIT regime was a clear departure from the Calvo Doctrine. The U.S. had rejected the Calvo Clause, defending international standards for foreign investment and the U.S. government's right to intervene on behalf of its nationals in case those standards were violated (Manning-Cabrol 1994, 1177). By de-politicizing investment disputes that involved multinationals and allowing them to challenge their host governments in third-party arbitration bodies, the BIT regime rested on international investment standards. By signing on to the treaty regime, Latin America seemed to leave its more nationalistic past behind.

The economic arguments explain this surprising willingness of Latin American governments to embrace BITs with policy convergence at the global level. The argument follows the general logic of the race-to-the-bottom literature on globalization (Oates 1972; Rodrik 1997), which suggests that the free movement of capital forces governments to compete for the same pool of investment. This competition pushes governments to deregulate various policy areas, such as environmental, labor, or social policies, as tighter regulation would lead investors to pull out their capital and move it to more capital-friendly countries. Consequently, policies will converge across countries to the lowest common denominator.

Various scholars have adopted the convergence perspective to explain the adoption of BITs. Perhaps the most influential work is Andrew Guzman's (1998) article, which examines why developing countries – which used to oppose the customary international law and its restrictions on nationalization – started to sign BITs that embody much tighter constraints than the customary international law.[23] For Guzman, the answer lies in the competition for foreign investment: by embracing the treaties, a developing country would offer multinationals a more attractive investment environment than the developing countries without such institutional guarantees (ibid., 670). In this competitive setting, host country politicians agreed to BITs out of fear of losing potential investors. Other scholars have made similar arguments, finding that the pressures of economic competition lead to the adoption of BITs (Pinto, Pinto, and Stier-Moses 2011; also Elkins, Guzman, and Simmons 2006) and to stronger dispute resolution clauses in the treaties (Allee and Peinhardt 2010).

However, while the argument could explain the rapid adoption of the treaties in previously skeptical Latin America, it faces a similar problem as the institutional arguments surveyed above: it does not problematize states' compliance with treaties. In fact, if the logic of convergence held after countries sign onto the international investment regime, we would not observe the current variation of FDI politics: why would some leaders nationalize treaty-protected investment whereas others seem to respect the treaties? According to a convergence argument, individual governments would comply with their BITs and avoid driving away investors with confiscatory measures. In other words, this approach cannot explain why some Latin American governments have complied with the treaties, whereas others have not.

[23] Specifically, the developing world opposed the Hull Rule of the customary international law. The Hull Rule required expropriations to be compensated with "prompt, adequate, and effective payment" (cited in Elkins, Guzman, and Simmons 2006, 813).

Scholars who draw from cognitive psychology and, especially, from theories on bounded rationality offer a slightly different convergence argument. Poulsen and Aisbett (2013) explain the proliferation of the treaties with treaty signers' biased judgments: as capital-exporting countries started to travel the world with their model BITs, politicians and technocrats in the capital-importing world agreed to the treaties without assessing the possible risks. In Pakistan, for example, the government assumed that the treaties were simply harmless pieces of paper; only the first cases of international arbitration revealed to the government that this was not the case (Poulsen and Aisbett 2013, 280–281). With its focus on the decision-making processes of governmental actors, this explanation of treaty adoption is clearly different from the mainstream economic explanation. Instead of economic competition, the argument emphasizes emulation: since some countries embraced globalization and its institutional innovations, the neighboring countries followed suit, without considering the future consequences.

The recent movement against the treaties by countries like Bolivia and Ecuador suggests that convergence due to bounded rationality may offer a realistic account of the initial proliferation of BITs. As countries that prematurely signed onto the investment regime come to realize the costs of their decision, they proceed to retract their earlier commitments. In other words, these states never planned to comply with the treaties – they simply did not understand the terms when adopting them. However, evidence suggests that the consequences of BITs were not a complete surprise for all politicians in the region. The Congress of Brazil, for example, refused to approve the 14 treaties that the executive signed between 1994 and 1999, primarily because it perceived the treaties as a threat to state sovereignty and a violation of the principle of equality among states (Wei 2012, 669–671). The treaties also faced vocal opposition in the Venezuelan legislature (for some of the opposing opinions, see Silva Calderón 2011). These examples illustrate that some Latin American governments understood the costs of the treaties. This, in turn, suggests that at least some countries were genuinely committed to treaty compliance, as well.

An alternative economic perspective would focus on the leverage of international organizations and home countries over signatory host states. Stallings (1992), for example, has studied economic policy shifts in developing countries in the 1980s, finding that the IMF and other foreign creditors can pressure governments to push through economic policies they would not have pursued without the external pressure. Similar external pressure is plausible in the case of BITs, as various European countries and international organizations, such as the United Nations Conference on Trade and Development (UNCTAD) actively promoted the treaties. In fact, Elkins et al. (2006, 840) find evidence for such pressure, given that countries that enter an IMF loan agreement also signed more BITs. Interview evidence with BIT negotiators offers more evidence for external pressures, as career diplomats in both Venezuela and Bolivia remember that some developed countries took a particularly aggressive position in the BIT negotiations (inverviews with Herrera Marcano 2013; Alvarado Aguilar 2012; for the perspective of U.S. BIT negotiators, see Pawlak 2011). These comments suggest that not all host countries were on an equal footing with the home countries in their BITs negotiations. Since some countries and international organizations may have pressured host countries to adopt the treaties, they could also force those countries to comply with the treaty regime.

Nevertheless, this argument seems unable to explain treaty compliance. If external economic pressures forced countries to respect the treaties, some of the most recent dramatic nationalization acts would not have taken place; Bolivia, for instance, received IMF funding the year before nationalization (Dreher 2006). Moreover, the expropriated companies in Bolivia were some of the biggest oil MNCs in the world. If the leverage of international actors determined BIT compliance, Bolivia should not have been able to confiscate property from Petrobras and Shell, for example. Domestic economic and political structures seem just as important – or even more important – for explaining policy choices and their outcomes compared to external pressures (Haggard and Kaufman 1992, 15–18; for a critical view of the effect of outside forces on economic stabilization, see Kahler 1992).

Finally, a few adherents of the economic approach have examined the treaties from the domestic perspective of the host country. Burke-White argues that the signing and ratification of BITs reflects a bargaining game between two sectors in the signatory state: the so-called "free traders" with interests in increasing investment flows through the treaties, and the "political protectionists" who prioritize state sovereignty and policy autonomy over BITs (Burke-White 2008; see also Vreeland 2003 on IMF agreements). Kerner (2009, 79-80) also distinguishes sectoral groups with divergent preferences over the treaties: domestic business and existing foreign investors in the signatory state will be at a disadvantage when compared to future investors from signatory countries, because only the latter group will be protected by the treaties.[24] With the exception of these two studies, surprisingly little attention has been paid to the domestic winners and losers of BITs.[25]

The influence of domestic interest groups may help explain treaty compliance. This is because the interest groups that advocated and opposed the treaties at the time of

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[24] Some BITs protect also investments done before the BIT ratification, while others do not (see, for example, Houthoff Buruma 2014; Sprenger and Boersma 2014).

[25] This is especially surprising since the sectoral approach is one of the key approaches in IPE. Scholars have analyzed the domestic winners and losers in a variety of research questions and topics, such as trade politics (Gourevitch 1986; Rogowski 1989; Hiscox 2001), and foreign policy and politics (Frieden 1988; Narizny 2003; Kirshner 1997).

their signing are likely to maintain their position after the treaties have been signed. The recent nationalizations of BIT-protected investment may thus have resulted from the entrance of treaty opponents into power. However, the political changes across Latin America do not seem to conform with this argument: the exit of free market advocates from governments in countries like Argentina and Peru has not led to multiple expropriations, whereas this has happened in Bolivia and Venezuela. Moreover, as will be discussed below, the opponents of the treaties in Venezuela have not proceeded to attack the treaties themselves, even after gaining power. The empirical evidence thus suggests that treaty compliance cannot be explained by focusing only on the shifts in political power at the domestic level.

To summarize, plenty of empirical research has approached BITs from an economic, rather than an institutional, perspective. The key finding of this strand of literature concerns the proliferation of the treaties: Guzman (1998) and others have shown that global competition among countries helps to explain why BITs spread so quickly in the 1990s. Some evidence also suggests that economic leverage from international institutions and signatory countries may have pressured Latin American nations to adopt the treaties.

Yet, when it comes to the effectiveness of the treaties, the economic arguments suffer from a similar weakness as the institutionalist arguments: the existing research has not assessed whether BITs actually deter nationalizations. In short, the economic literature on BITs does not evaluate states' compliance with the treaties once they are ratified. The following section discusses the compliance literature in IR, suggesting that the recent expropriations of BIT-protected investment may indicate a different type of compliance with international institutions than the existing work has identified.

Compliance with International Institutions

The recent takeovers of BIT-protected investment serve as examples of non-compliance with the international investment regime. The literature on cooperation in the international arena and compliance with international institutions could thus offer a helpful perspective to analyze the events. In his seminal work on international regimes, Keohane (1984) identified three key functions for such international regimes: they lower transaction costs among states and, consequently, they increase information and decrease uncertainty in the international arena. Downs, Rocke, and Barsoom (1996, 399) were among the first to raise the endogeneity problem that Keohane overlooked: cooperation could be considered successful only if states would have behaved differently in the absence of international institutions. Such "deep" cooperation, Downs et al. (ibid.) theorized, could be achieved only through enforcement, as countries facing concrete costs of non-compliance would be forced to alter their behavior.

Scholars have examined the connection between enforcement and compliance in various topic areas. McLaughlin Mitchell and Hensel (2007), for example, evaluate whether international institutions can increase compliance with agreements over territorial disputes. They find a positive correlation, arguing that more binding dispute settlement procedures increase compliance with agreements (ibid.). Hafner-Burton (2005) reaches a similar conclusion in the area of human rights: according to her, preferential trade agreements increase state compliance with human rights more than human rights agreements do because of the more effective enforcement mechanisms included in trade agreements. In other words, the ability of an international regime to impose concrete costs on violating governments is essential for changing the behavior of member states.[26]

[26] A related literature examines the effect of escape clauses on compliance. For example, Rosendorff and Milner (2001) argue that allowing states to overlook previously negotiated terms without punishing them

Following this literature, compliance with the BIT regime should be high. The final rulings of arbitration panels are highly enforceable, as companies can request national courts in third-party states to enforce the compensation demands. This is made possible through an extensive network of international treaties (Yackee 2007b, 22): most Latin American countries are members of both the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "ICSID Convention"). The New York Convention allows firms to request enforcement of final awards in third-party states, and the ICSID Convention requires courts of the signatory countries to enforce ICSID rulings as if they were given by the domestic court (ibid.). Given these strong enforcement mechanisms, the international investment regime should encourage compliance. Put differently, governments should not expropriate BIT-protected investment, since the final compensation rulings are highly enforceable. In light of this literature, therefore, the nationalization processes in Venezuela and Bolivia are puzzling, as they seem to be characterized with a low level of compliance with rules that are relatively highly enforceable.

WHY DO BITS FAIL?

The new wave of nationalizations during the past decade has unveiled limitations in the BITs literature. As discussed above, most of the existing work on the treaties has simply assumed treaty compliance. The literature on compliance with international institutions has shortcomings as well, since it would have predicted a high level of compliance with the treaties, given their relatively strong enforcement mechanisms. This

for treaty violation can help cooperation and compliance under uncertainty about the future. See also Kucik and Reinhardt (2008) and Koremenos (2005).

has not been the case, as evidenced by the expropriation of BIT-protected investment in Venezuela and Bolivia.

While various authors have noted that property rights violations persist in the era of BITs (Wells and Ahmad 2007, 4; Post 2008; Manzano and Monaldi 2010, 451; Simmons 2011, 30; Post 2014; Wellhausen 2015, 33–34), we lack a good theoretical understanding of the phenomenon. In her study of the water utility sector in Argentina, Post (2008) explains the negotiation failures between the Argentinean state and water multinationals with the increased tensions that BITs cause between the parties: unlike firms without BITs, treaty-protected MNCs can threaten to sue their host. Such threats make the conflict more public, escalating tensions between the parties; consequently, the likelihood of negotiation failure increases (Post 2008, 22).

Post's argument cannot explain the oil and gas nationalization in Venezuela and Bolivia, however. In Bolivia, various multinationals threatened, in both public and private, to sue the government if their contracts were violated (*Infobae* 2004; interviews with Rodríguez Veltzé 2012; Menacho 2012; Nogales 2012). Bolivia even had recent experience with international arbitration, since the water utility MNC Bechtel had sued the country for cancelling its contract after the so-called "Water War" in 2000. Given the oil companies' earlier threats and the public conflict with Bechtel, both international arbitration in general and disagreements between the state and natural gas multinationals in particular had plenty of issue salience. Yet the heightened tensions did not escalate the conflict, as Post's argument predicts. Instead, the companies agreed to Morales' new contract terms relatively smoothly. This suggests that there is no direct link between companies' willingness to remind the state of its BITs – or even to threaten to sue the government – and a negotiation breakdown.

This section assesses two plausible explanations for the treaties' failure to deter Chávez and Morales. The first, prevailing argument rests on leaders' ideology. According to this argument, politicians acting out their leftist ideology are likely to remain loyal to their nationalistic goals and push through their plans, ignoring any future arbitration and compensation costs. As the discussion will show, the argument cannot explain the events in Venezuela and Bolivia, however; Chávez and Morales did not overlook the heavy legal costs of their measures and disrespect BITs to demonstrate their nationalism, as the ideological argument would have expected. After assessing the ideological argument and its limitations, I proceed to develop a novel theory based on leaders' strategic calculations.

The Prevailing Explanation: Leaders' Leftist Ideology

Scholars and analysts often explain the expropriations in Venezuela and Bolivia with Chávez's and Morales's ideology, which these leaders have proclaimed loudly, both on the domestic and international stage (Madrid 2010, 590; López Maya 2014, 74; see also Corrales 2010, 39–40; Gray Molina 2010, 65–66). According to this explanation, the leaders' nationalistic measures are rooted in their leftist beliefs: after assuming power, the presidents have simply insisted on implementing policies that are in line with their interventionist, statist goals, such as nationalization. Following this line of argumentation, the executives' beliefs could cause the deterrent failure of BITs, as well: in violating BITs, Chávez and Morales might have acted out their leftist ideology regardless of economic costs and political consequences.

The ideological account expects the leader to execute the nationalization process in a manner that is consistent with his or her political convictions. A leftist politician would first take over foreign firms to increase the role of the state in the economy.

Having expropriated the firms, he would then refuse to pay the legal costs of international arbitration and the compensation claims that BITs guarantee. This rejection of the treaties would stem from the leader's leftist ideology, which paints BITs as neoliberal instruments of the Washington Consensus era. By overriding the treaties and ignoring their consequences, the executive would have maintained ideological consistency throughout the nationalization process, pursuing his leftist goals from the beginning stages of the process to the very end.

To evaluate the accuracy of this ideological explanation, we need to first define the concept of ideology. Pastor and Wise characterize ideology as willingness to incur high political costs for one's principle-driven actions (Pastor and Wise 1994, 475). Following this definition, a policy-maker who acts out his ideology is unconditionally committed to certain distinct principles and pursues them regardless of other, pragmatic considerations, and the overall consequences.[27] The Venezuelan and Bolivian presidents may well have conducted the nationalization process in this manner, pushing through their leftists goals and disregarding the repercussions, violating BITs in the process.

There are two specific political costs arising from the nationalization of BIT-protected investment. First, overstepping BITs violates the fundamental principle of international law that treaties are to be observed, *pacta sunt servanda* (Elkins, Guzman, and Simmons 2006, 823–824). Violating this principle sours relations with the investors' home country and can consequently harm the foreign policy goals of the host government (ibid.) Second, refusing to compensate the firms even after an arbitration ruling has high reputational costs. By disrespecting the authority of the third-party arbitrator, the host government signals to other states and investors its untrustworthiness in economic

[27] Weber calls the orientation behind such a mode of action "value-rational orientation," referring to politicians who are willing to act on their political convictions regardless of the future consequences (Weber 1978, 25; see also Gane 1997).

matters (ibid., 824). In short, by disrespecting BITs leaders damage their relations with investors' home countries and risk their overall reputation as a responsible actor in the international arena.

Argentina exemplifies the political costs of BIT violation. To tackle the crisis of 2000-2001, the Argentine government implemented economic measures that affected its contracts with foreign investors, especially in the utility sector. A few years later, dozens of these investors had invoked their BITs and sued Argentina in ICSID, calling the government's post-crisis measures expropriatory. While various arbitration panels sided with the investors, Argentina refused to pay many final awards. As a consequence, the U.S. suspended Argentina's preferential trade status in 2012 (Sidley Austin LLP 2012; Obama 2012). The U.S. also objected to Argentina's loan requests in international development banks, due to the government's failure to "fulfill its international obligations and lack of engagement with international institutions" (U.S. Department of the Treasury 2011, 5). According to legal experts, the U.S. took the measures to pressure Argentina to respect the ICSID rulings (Sidley Austin LLP 2012).[28] This illustrates how disrespecting BITs can hurt bilateral and multilateral relations with other countries, causing economic damage, as well.

A nationalistic politician acting out his ideology would most likely follow Argentina's example and ignore the costs of BITs. This is because his ideological preference to increase the state's role in the economy would override the potential negative consequences of BIT violation. The leader would thus act in an ideological mode through the nationalization process: he would proceed first with the takeovers and

[28] The U.S. pressure seems to have been effective, since the Argentine government started to compensate U.S. firms about a year later (Allen & Overy 2013).

then ignore both the companies' compensation demands and the ensuing arbitration rulings.[29]

In addition to ideological behavior during the process, the ideological explanation also expects a particular timing for nationalistic actions. Specifically, ideological executives should push the takeovers through when they reach power. This is because they should prioritize their ideological goals over practical considerations, such as the security of their office or the economic costs and benefits of their actions. Murillo (2009, 3-4), for example, has shown that Latin American countries have implemented pro-market policies in electricity and telecommunications when "true believers" in neoliberalism are in office. In a similar vein, nationalistic leaders acting in the ideological mode should be taking over foreign firms and ignoring BITs once they reach power.

To summarize, the ideological argument should explain three different aspects of the Venezuelan and Bolivian nationalization processes: the causes behind the leaders' decision to enact expropriation, the manner in which the process is pursued, and the timing of events. First, the ideological account argues that the executives' leftist beliefs will lead them to push the nationalization process forward. Therefore, were Chávez and Morales acting out their ideology, they should show little concern for violating BITs at the planning stage of the process; they would be fully committed to their nationalistic goals instead and overlook future costs of actions that aim to push those goals through. Second, they should continue with this mode of action throughout the nationalization process, overlooking the costs of the treaties in the implementation and aftermath of the plan, as well. In fact, once the nationalistic measures are taken, the leaders would refuse to compensate the companies and ignore the rulings of international arbitrators. Third,

[29] According to a common legal interpretation, a country consents to international arbitration automatically by signing a BIT. Therefore, states cannot altogether refuse to participate in the arbitration proceedings (see Paulsson 1995).

implementation of the expropriation should start soon after the nationalistic leader reaches government. As discussed above, ideologues want to realize their policy goals regardless of other, more practical considerations and, consequently, their leftism should start shining through from the moment they take office.

Plenty of existing literature embraces the ideological explanation. Most analysts of the contemporary Latin American left consider the Chávez and Morales governments as the most ideologically driven leftist governments in the region, characterizing them as "radical" (Ellner 2014a, 2) or "contestatory" (Weyland 2010, 3), for example. Expropriations of multinationals, especially in the oil and gas sector, are a key part of these leaders' economic models (Corrales 2010, 39–40; Gray Molina 2010, 2010). Given the strongly ideological, nationalistic nature of the Venezuelan and Bolivian governments, we could reasonably expect these presidents to have acted out their ideology when overstepping BITs. The broader political economy literature on Latin America offers additional support for the argument, as various recent studies have shown that ideology remains a significant predictor of policy choices in the region (Murillo 2009; Hart 2010; Martinez-Gallardo and Murillo 2011). These works suggest that Chávez and Morales may well have pursued their nationalistic goals in an ideological manner.

The literature on expropriations of foreign investment also supports the ideological explanation. Various studies have highlighted the importance of ideology, finding that leftist leaders expropriate more foreign investment than their non-leftist counterparts (Jensen et al. 2012; see also Johnson 1965; Truitt 1974; Kobrin 1980, 72). Following these works, the recent nationalization acts in Latin America could be a direct consequence of the region's turn to the left; leftist executives could be enforcing the role of the state in the economy by nationalizing multinationals, and they could be breaking their predecessors' neoliberal commitment to the international investment regime by violating BITs.

Even though plenty of academic work suggests that Chávez and Morales may have acted out their ideology when implementing hydrocarbon nationalization, a closer examination of the events reveals problems with the argument. The presidents did not simply push through their ideological principles. Instead, they worked hard during the nationalization process to minimize the future legal costs of BITs. Moreover, rather than rejecting the legal consequences of their actions and facing the costs of such non-compliance, Venezuela and Bolivia chose to play along with the international investment system in the aftermath of nationalization and compensate the affected firms. In other words, Chávez and Morales were not willing to disregard economic penalties and pay the political price for their defiance. Furthermore, the timing of their nationalistic actions does not correspond to the expectations of the ideological argument. The following discussion examines the nationalization processes in more detail; the findings suggest that these leaders did not operate in the ideological mode.

The case of Venezuela illustrates particularly well how politicians complied with the BIT regime during the nationalization process. Having expropriated the facilities of ExxonMobil and Conoco-Phillips in mid-2007, the Chávez government faced multiple arbitration cases on the basis of these actions. So far, once the arbitration bodies have filed their final rulings, the government has complied and compensated the firms.[30] A lawyer specializing in international hydrocarbon contracts goes as far as to praise the government for "respecting the rules of the game… after the nationalization process" (interview with Lawyer 6 2013). Other lawyers and an embassy representative in Caracas

[30] The most recent decision, ICSID's ruling on the ExxonMobil vs. Venezuela case in October 2014, is currently not enforced after Venezuela's request for revision (Ulmer 2014).

affirm that the Chávez government has gained the reputation of being a compliant state among legal practitioners (interviews with Lawyer 6 2013; Lawyer 2 in Venezuela 2013; Representative of a foreign embassy in Venezuela 2013).

Proving even more accommodating than the Chávez government, Morales did not wait for the final rulings. Rather, he settled with the four companies that took their case to arbitration. This outcome suggests compliance with the investment regime, as well, since the government chose not to ignore the arbitration process and was willing to sit down with the firms to find a solution that would satisfy them. In this way, Morales's behavior diverges from an ideological mode of action; a president driven by ideology would nationalize the firms, refuse to compensate, and reject the ensuing arbitration rulings.

The timing of the nationalistic actions does not conform to the expectations of the ideological argument, either. This is especially clear in the Venezuelan case; Chávez started to implement the nationalization in a moderate, step-by-step manner. Since Chávez gained the presidency in late 1998, and began the nationalization in late 2004, it took him years to start to put his plan in action! This suggests that it was not his ideology but some alternative factors that determined the timing of the nationalization process.

To conclude, a closer examination of the Venezuelan and Bolivian nationalization processes challenges the ideological explanation. Chávez and Morales were concerned about – and prepared for – the treaties' consequences early on, suggesting that their ideological commitments did not lead them to enact the process. Moreover, they complied with the treaty regime in the aftermath of nationalization to a much greater extent than an argument based on the leaders' ideology would expect. Chávez also started to push for his controversial nationalistic measures years after reaching power, again against the expectations of the ideological argument. Therefore, the executive's ideology – the leader's insistence on pushing through his leftist principles even at high costs – does not offer a satisfactory account of the events in Venezuela and Bolivia. The following section proposes an alternative, more promising, explanation based on leaders' strategy.

A Novel Explanation: Leaders' Strategic Calculation

I argue that leaders' strategic calculations played a crucial role in the Venezuelan and Bolivian nationalization processes. Rather than acting out their leftism and ignoring future costs, the politicians assumed a strategic – not ideological – mode of action. Specifically, they calculated the economic consequences of their nationalistic plans and decided to enact them only when they had reason to expect net benefits. During the implementation period, they worked further to minimize the costs investors compensation demands created. Finally, in the aftermath of nationalization, they were willing to pay the final price arising from the arbitration proceedings that BITs stipulated. By settling these economic costs along the way, the leaders aimed to complete the nationalization process without having to incur the political and reputational costs of breaking with the international investment regime.

I define "strategy" following Chandler's (1962, 13) work in management theory. According to Chandler, strategy has two dimensions. First, it includes the choice of long-term goals, followed by the adoption of measures and the allocation of resources corresponding to these goals. Since I take leaders' nationalistic goals as given, my focus is on the latter part of this dimension: a strategic politician has an over-arching, realistic plan for the future and acts according to this plan. Second, strategic action allows for adjustments during the policy process, as the actor updates his understanding of the consequences along the way. Certain measures may at first sight look inconsistent with the politician's broader plan, yet observing them in the context of the process can reveal that they do, in fact, line up with the leader's ultimate goals. Strategic action thus includes both a comprehensive, *a priori* plan for reaching one's goals and *a posteriori* adjustments to that plan (ibid.).

When it comes to the politics of oil and other minerals, leaders' strategic calculations are, to a good extent, based on the world price of the natural resource in question. In fact, existing research has shown that shifts in the profitability of a natural resource sector – especially an increase in world market prices – can create special incentives for host leaders to nationalize the sector. This is because once the multinationals have done their expensive, immobile investments in the host country, those investments are physically sunk and cannot be liquidated easily. Therefore, the firms have little recourse against the host state if the government chooses to expropriate. A government aware of this dynamic change in the balance of power can thus start to demand more and more concessions once the initial investments are done – a dynamic Vernon (1971) called the "obsolescing bargain." Various scholars have demonstrated that this pattern prevails in oil and other minerals: Governments tend to attract investors with beneficial terms when commodity prices are low, but then break those contracts when prices increase (Truitt 1974; Hajzler 2012; Guriev, Kolotilin, and Sonin 2011; Duncan 2006). In short, increasing prices empower the host government against multinationals, prompting politicians to violate the original contract and take over the investment.

Curiously, rising mineral prices have another, equally important effect: in addition to incentivizing leaders to nationalize foreign investments, price booms increase the state's capacity to pay the legal process and compensation that BITs stipulate. This suggests that BITs are weakest when they are most needed: as high prices tempt politicians to expropriate, they also render the economic costs of BITs insignificant compared to the gains of nationalization.

As described above, the treaties are designed to reduce the expected benefits of expropriation by increasing the costs of the measure. Yet high prices swamp the cost of compensation and allow the government to pay it off with ease. This is because arbitration panels usually calculate the amount of compensation on the basis of the commodity price at the time of nationalization. In fact, most BITs specifically note that the compensation should be based on the value of the asset immediately before the expropriation (Nikièma 2013, 11).[31] Consequently, tribunals usually determine the compensation depending on the fair market value of the losses, on the date of expropriation (Sabahi 2011, 102–133).[32] If a government expects continuing price increases, it can calculate to pay the legal costs of BITs and the compensation they stipulate with the net revenue the nationalistic measure and the price boom create, and still end up with a big gain in net revenue. In other words, a predicted upward trend in the accumulation of profits in the sector causes the treaties to lose their deterrent force.

Thus, increasing mineral prices can undermine the deterrent effect of BITs. Given the additional revenues that commodity booms can create in the sector, and the incapacity of multinationals to prevent expropriatory acts from occurring in the first place, nationalistic leaders gain the capacity to take over foreign investment. To put it differently, the government's expectations about future profits in the sector determine whether it perceives the nationalistic measures as worth pursuing. If the government expects commodity prices to increase after the nationalistic measure, the gains arising from the nationalization can be drastically higher than the final amount of

[31] Most treaties also add that if the expropriation decreases the asset's value, the compensation should be based on the value on the date before the expropriation became known (ibid.).
[32] Fair market value, in turn, is usually calculated with a discounted cash flow method: the future value of the investment, discounted by inflation and risks.

compensation.[33] This strategic calculation contrasts with the ideological argument presented earlier, as a leader acting out his ideology would nationalize regardless of the future costs. But according to my theory, the policy-maker acts only if he perceives the future economic benefits to exceed the future costs of international arbitration and compensation. In this way, the executive can pay the economic costs of BITs and avoid the political costs that would follow from disregarding the treaties.

Figure 1 presents the argument graphically in a hypothetical illustration. At time t-1, multinationals pay a tax of one-third of the profits. Let us assume that economic conditions in the sector shift from time t-1 to t, causing a twofold increase in total revenue.[34] In absolute terms, the companies benefit from the change more than the government, as the first two bars in the graphs illustrate. The government observes this extra profit and considers two policy options: either respecting the existing contracts (left panel) or nationalizing the sector (right panel). If it chooses to respect the existing contracts and the profits in the sector continue to increase, the government, while continuing to receive one-third of company profits, foregoes even more revenue at times t+1 and t+2. To capture more of that future revenue than the existing contracts would permit, the government is motivated to nationalize at time t.

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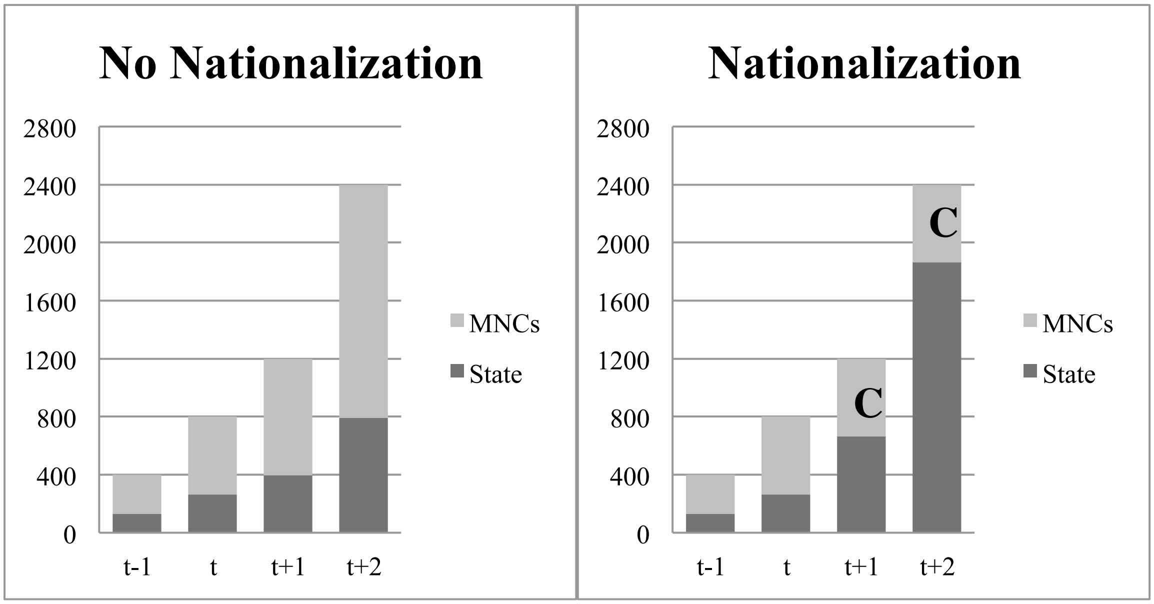
[33] When writing the dissertation, I became aware of the theory of efficient breach in the legal field. According to the theory, such a breach occurs when the state expects to be better off after breaking the contract and paying compensation than when respecting its contract obligations (Goetz and Scott 1977, 558). For the seminal contributions, see Birmingham (1969), Goetz and Scott (1977), and Macneil (1982). For efficient breach in international law, see Posner and Sykes (2011) and also Pelc and Urpelainen (2015). I contribute to the literature by showing that increasing commodity prices have induced and allowed the Venezuelan and Bolivian governments to behave in this way.

[34] This example assumes that production remains constant. In reality, the government has to consider technical factors such as the production cycle and the effects of nationalization on production. Additionally, the example depicts a complete takeover of the sector. As a consequence, the only revenue the companies receive after the nationalization is the compensation. The empirical cases will illustrate that the dynamic holds even if most of the companies choose to stay in the host country.

Figure 1: Expected distribution of profits between the state and MNCs



However, the government also has to consider its BITs with the MNCs' home governments. If the host government chooses to nationalize at time t, it may need to compensate the companies at time t+1. Interestingly, this cost does not effectively constrain the government. If international arbitrators rule at time t+1 that the government has to pay the companies the profits they were deprived of between time t and t+2 (lighter sections marked with "C" in time t+1 and t+2, right panel), the amount would be calculated on the basis of the price at time t.[35] Due to the price increase after nationalization, the state's new share exceeds the full compensation! Even if the state had to pay the full compensation immediately after the ruling at time t, it would have the resources required and end up with a net gain.[36] This means the government will have boosted its revenue at time t+2, despite the compensation. In other words, the government

[35] In this example, the contracts end in t+2. Since the state's gains clearly exceed the companies' compensation, the state could afford an even greater compensation.

[36] The payment does not always have to be immediate. For example, Argentina compensated Repsol for the April 2012 nationalization in 10-year bonds (W. Kennedy and Devereux 2013).

can pay the legal costs of BITs and compensate the companies relatively easily, thus avoiding the political costs of trampling on the international investment regime.

Certain characteristics of the international arbitration process further lower leaders' expectations about the economic costs of nationalization. First of all, many companies facing nationalization usually prefer to find an agreement with the government in order to stay in the country or negotiate their exit on amicable terms (Wells and Ahmad 2007, 72–73; Post 2008, 25). This is because arbitration harms any potential future business relations with the host government. As mentioned above, the recent trends in international arbitration suggest that multinationals may be more willing to sue than scholars have expected (for patterns in international arbitration, see Wellhausen 2015, 30–32). Nevertheless, given the costs of arbitration (Simmons 2014, 36–37) and the potential losses from an outright expropriation of facilities, many firms are likely to try to negotiate the terms of their exit from the host country when the government announces its plans to nationalize, rather than appeal to third-party arbitration bodies immediately. As a consequence, the government can expect to reach agreements with many of the companies, considerably lowering the future costs of compensation.

Even if a company begins arbitration proceedings, the negotiations with the host government continue, allowing the government to employ different negotiation tactics that can minimize firms' legal demands. Most BITs specify a so-called "cooling-off period", usually 6 months, during which the legal proceedings are halted and the parties have to try to reach a settlement. The government can use this period to persuade or pressure the companies to agree to the new terms. It can offer carrots to cooperative companies, such as access to valuable input factors or natural resources. Alternatively, it can pressure the companies by setting short timelines for the negotiations, for instance, forcing the firms to refrain from arbitration if they want to stay in the country. These positive and negative negotiation strategies aim to push investors to make concessions to the government; as a result, they decrease the government's expected costs of compensation.

Moreover, even if the international arbitration process moves to the final stage, the ruling is hard to predict in advance. The parties often disagree over the value of investments and, consequently, the arbitrators are likely to hear two drastically different accounts. Given this conflicting information, they can rule in unpredictable ways. In fact, host governments have historically won more cases than investors, possibly raising the expectations of contemporary nationalistic governments (Franck 2007, 49).

Finally, the arbitration process takes years to complete. The host government knows this from the outset and is therefore likely to undervalue the costs of the process (Post 2014; see also Post 2008). As political science research has shown, leaders discount future costs heavily: they prefer policy measures with immediate benefits and overlook long-term consequences (Nordhaus 1975). The time delay may even lead a nationalistic government to conclude that the majority of the arbitration fees will fall on the next government. This discrepancy between the immediate benefits of the nationalization and the possible future costs motivates governments to act opportunistically in the short term.

These features of the international arbitration process lower the expected costs of nationalization for the host government. A strategic politician can use this information when estimating the future costs of BITs in the planning stages of the nationalization process. He can also update his information during the process, especially when it comes to the companies' compensation demands and the state's likelihood of victory in arbitration. The leader can then negotiate a settlement with the companies, even against his early intentions. In fact, this is what occurred in Bolivia, where Morales moderated his stance against the multinationals over the course of the nationalization, after learning more about the arbitration process.

To summarize the strategic argument, a shift in the economic context can render BITs ineffective. When profits in the sector increase, leaders are tempted to bet that the future economic cost of BITs will be low compared to the benefits of nationalization. In addition, certain characteristics of international arbitration lead host governments to expect that they can afford the future costs of BITs. Only some companies are likely to pursue arbitration to begin with and the government can utilize bargaining strategies that further dissuade companies from suing. Even if the dispute proceeds to arbitration, the ruling might favor the host government and, in any case, the arbitrators give their final decision years after the event. All these factors lower the expected costs that BITs will impose on nationalistic governments and, consequently, cause the deterrent effect of the treaties to fail precisely when the economic gains of nationalization are high.

Shifts in global commodity prices and leaders' strategic calculations on the basis of those shifts can thus explain their decision to act on their nationalistic goals and overstep the treaties. The strategic argument also predicts that politicians will push the nationalization process through in a careful, calculating manner. Specifically, they keep BITs in mind when negotiating with the companies, aiming to minimize the future costs of the treaties. The following chapters will describe certain negotiation tactics that Chávez and Morales adopted in order to prevent the companies from suing them. This strategic mode of action should continue in the aftermath of the process: a strategic leader would be willing to comply with the investment regime and compensate the firms, understanding that a more ideological mode of action would simply increase the costs of nationalization, through international pressures and reputational losses, for example.

Finally, the strategic argument can also give us insights into the timing of the events. As described above, BITs lose their deterrent power when an executive expects the economic gains of nationalization to exceed the economic costs; in such a situation, the leader is willing to pay international arbitration and compensation in order to avoid the political costs that would ensue were he to ignore the treaties altogether. The core of the explanation rests on the executive's strategic calculations based on the rising price of oil and other hydrocarbons: when he is confident that higher future price increases the state revenue enough to shoulder the amount of compensation, calculated with the lower oil price at the time of nationalization, he will proceed with the nationalization plan. In other words, a politician is likely to put his nationalistic plan in action when the oil market price is trending upward and he is expecting the price increase to continue into the future. This clearly contrasts with the expectations of the ideological argument, according to which leaders expropriate soon after reaching power.

CONCLUSION

A survey of the BIT literature illustrates that extant studies have not examined the effectiveness of the treaties as a deterrent against nationalization. Institutionalist scholars have shown that the treaties can increase inward FDI. Scholars with an economic perspective have highlighted the effect that economic competition has on adoption of the treaties, explaining their proliferation in the 1990s with the competition for capital among developing countries. However, these studies do not offer tools to analyze the power of BITs once ratified. Alternatively, the work on compliance with international institutions has not focused on BITs. In fact, the compliance literature would predict the treaties to decrease the number of expropriation, since they include relatively strong enforcement mechanisms. The following chapter uses statistical methods to analyze whether the treaties have discouraged nationalistic leaders and, consequently, decreased the number of nationalization acts.

Since the experiences of contemporary Venezuelan and Bolivia suggest that the treaties do not bind nationalistic leaders, this chapter has also evaluated how well the prevailing argument based on leaders' ideology can account for the treaties' deterrent failure in those two countries. The discussion shows that the leaders' ideology does not offer a satisfactory explanation for the events in Venezuela and Bolivia. Specifically, Chávez and Morales did not disregard the costs of BITs as they launched their nationalization plan, nor did they overlook the costs at the implementation and aftermath stages of the process. Moreover, Chávez embarked on his nationalistic reforms only years after reaching power, also challenging the ideological explanation.

The chapter therefore presented an alternative explanation for the treaties' deterrent failure. According to my novel theory, leaders make strategic calculations about the costs and benefits of nationalization. If the immediate economic benefits of nationalization seem to exceed the future costs of BITs, a situation possible when oil and gas prices boom, politicians can reasonably expect to pay the future legal fees and compensation with the new revenue that the nationalization act creates. This, in turn, allows them to avoid the political costs of violating BITs.

The argument uncovers a surprising characteristic of the treaties: they carry the least force precisely when they are most needed. Global commodity booms are known to motivate politicians to nationalize foreign investment. This same price increase, however, also enables the government to bear the BITs' costs by accepting international arbitration and paying any resulting compensation, washing out the deterrent and punitive effects of the treaties. As a consequence, the international investment regime is much weaker than expected. After analyzing the effectiveness of the treaties in the next chapter, this dissertation moves to assess whether the hydrocarbon nationalization processes in Venezuela and Bolivia conform with the theory.

Chapter 3: Evaluating the Deterrent Effect of BITs

Given the proliferation of bilateral investment treaties in the 1980s and 1990s, the recent rise of economic nationalism in Latin America is puzzling. The treaties were designed to protect foreign investors from their host government. As discussed in the previous chapter, analysts expected the third-party arbitration mechanism specified in the treaties to *prevent* government takeovers of treaty-protected firms. This dissertation aims to uncover the power of the treaties by answering two questions. First, do BITs deter nationalization as hoped by their designers and feared by their opponents? Second, what has allowed Hugo Chávez and Evo Morales to pursue their nationalistic plans, despite the treaties?

This chapter will use statistical methods to study expropriation in Latin America between 1985 and 2012. The analysis begins by tackling the first research question and evaluates whether the existence of a treaty between two states, a Latin American host country and a home country of FDI, makes the host government less likely to expropriate investment from the home country. The results suggest that the treaties do not decrease the likelihood of expropriation. On the contrary, the statistical tests find that the effect of the treaties on host governments' propensity to nationalize is positive; that is, politicians are more likely to take over a treaty-protected firm than a multinational that does not have the backing of a BIT. After presenting the statistical results and controlling for the possible endogeneity between the treaties and nationalization, this chapter offers a potential explanation for this surprising finding.

In short, I propose that the positive effect of BITs on the probability of nationalization could stem from unintended consequences of the treaty regime.[37] When a

[37] I thank Lawrence Sager for this idea.

host government wishes to gain more control over foreign investors, it can implement a wide variety of measures, ranging from minor regulatory changes to outright expropriation. BITs allow firms to challenge all governmental measures along this spectrum, not just full nationalization. Consequently, since policymakers can face serious legal costs of arbitration and compensation even after implementing relatively small regulatory changes, BITs might push them to nationalize when, in the absence of the treaties, they would have opted for less invasive, regulatory measures.

After analyzing the deterrent effect of BITs, this chapter also evaluates my theory of why the deterrence fails. Specifically, the chapter will examine whether the argument presented in the previous chapter holds in the broader dataset: are BITs particularly weak deterrents in natural resource sectors when commodity prices increase, as leaders make the calculation that the future costs of compensation will be affordable? The analysis finds preliminary support for the argument, uncovering that the treaties' surprising, positive effect on the likelihood of nationalization strengthens during commodity price booms.

It is important to note, however, that the characteristics of the data pose multiple challenges for the statistical analysis. First of all, expropriation is an extremely rare event; in fact, many of the countries in the sample did not witness any takeovers during the time under study.[38] Moreover, the few nationalizations cluster heavily to Chávez's Venezuela and Morales's Bolivia, further complicating the analysis. These and other issues – as well as my responses to them – will be discussed in more detail below. Given these challenges, and Chávez's and Morales's status as the most active nationalizers in contemporary Latin America, Chapters 4 and 5 will zoom in on the hydrocarbon

[38] This kind of rarity of positive cases leads to underestimation of event probabilities (King and Zeng 2001), and even the inability to assess the effects of some variables (King 2001, 502–503).

takeovers in Venezuela and Bolivia and use qualitative research methods to evaluate the treaties' deterrent power in those two, crucial cases.

The chapter begins with a discussion of how the dependent variable – *expropriation* – and the key independent variable – *BIT* – are defined and measured, and what the overall patterns of both expropriation and BITs are in Latin America. The second section presents the research design, the data, and the methods. The third section focuses on the treaties' deterrent effect, conducting the first statistical tests and discussing the key findings, including the surprising positive effect of BITs and plausible explanations for this effect. The fourth section narrows down to the natural resource nationalizations and evaluates whether the effect of BITs on the likelihood of expropriation is conditional on the commodity prices at the time. The chapter concludes with some broader implications of the quantitative analysis and highlights the importance of detailed, qualitative case studies to understand the apparent weakness of BITs.

THE KEY VARIABLES: EXPROPRIATION AND BITS

The dependent variable in the statistical analysis is *expropriation* of foreign investment. The takeovers are codified following Kobrin's seminal definition of an "act of forced divestment," with a minor modification. In Kobrin's data, the act of expropriation consists of involuntary expropriation of any number of firms in a single industry (Kobrin 1980, 72). He thus collapses the takeovers of multiple firms in one sector in a given year into one single case of nationalization. For the purposes of my research question, I consider the takeover of each firm a separate event of expropriation. This is because BITs are signed between investors' host and home countries. To evaluate whether a treaty prevents the host government from taking over a multinational, we need to be able to distinguish between the different home countries of investors, even if the firms are a part of the same nationalization act as defined by Kobrin. However, if the host government took over multiple firms from one home country in a given year, the takeovers are recorded only once in the data. This is because a BIT between two countries should deter any expropriation in that dyad.[39]

The analysis focuses on the transfer of ownership from private hands to the government. Cases of indirect expropriation in which the state gains greater control over an investment by increasing taxes, cancelling permits, or other similar measures are thus not included in the statistical analysis. While such measures can result in *de facto* nationalization, they are oftentimes hard to detect and are usually excluded from nationalization databases (Hajzler 2012, 5).

Due to data availability, the sample is limited to 19 countries in Latin America and the Caribbean between 1985 and 2012.[40] The expropriation cases in 1985-1992 are identified by Minor (1994), in 1993-2002 by Coyle (n.d.), in 2002-2006 by Hajzler (2012), and in 2007-2012 by the author. I complemented the existing data sets by tracking down the home country of each affected firm; the home countries are identified on the basis of existing literature and media reports. The complete list of nationalizations and the affected firms is included in the appendix.

The unit of observation in the statistical analysis is a dyad-year. The dyads are directed: the observations record an investor's host state in Latin America and a home

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[39] In nine cases, the host government took over various firms from the same home country. These cases are: Bolivia in 2012 (two Spanish electricity companies), Mexico in 2001 (two U.S. sugar mills), Peru in 1985 (two U.S. oil companies), Venezuela in 2002 (two U.S. mining companies), Venezuela in 2007 (two U.S. oil companies and U.S. investments in electricity), Venezuela in 2009 (two Swiss companies, in cement manufacturing and an airport), Venezuela 2009 (U.S. investments in a rice mill, bottling plant, gas project, and a hotel), Venezuela in 2010 (two U.S. firms in oil and mining), and Venezuela in 2010 (two Dutch firms, in bottling and petrochemicals).

[40] The countries are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay, and Venezuela.

state anywhere in the world each year under study. Only investment relevant dyads are included, in order to ensure that country pairs in which the home state does not send any investment to the Latin American host state to begin with are excluded. The descriptive statistics presented here adopt the same unit of analysis; rather than evaluating the acts of nationalization, as Kobrin (1987) defined, my focus is on the firms and their home countries.

In total, nationalization occurred in 72 dyads in the time under study. Eight different host countries took over foreign investment: 40 takeovers occurred in Venezuela (56% of all cases), 19 in Bolivia (26%), four in Mexico (6%), three in Peru and in Argentina (4% each), and one in the Dominican Republic, Honduras and Ecuador (1% each). The governments nationalized firms from a heterogeneous group of countries: there are a total of 20 different home nations in the group of affected companies. The U.S. was the most common host country, as a total of 13 expropriations involved an American firm (18% of all cases). The remaining cases involved investors from the following countries: nine affected MNCs had their headquarters in Spain (13%), six in Canada, the UK and Switzerland (8% each), five in France (7%), four in Barbados and Argentina (6% each), three in Mexico and the Netherlands (4% each), two in Colombia and Germany (3% each) and one in Panama, Peru, Brazil, Chile, Ireland, Luxembourg, Italy and Japan (1% each). In total, 17 of the expropriations involved a Latin American company (24%). These patterns follow the overall trends of FDI in the region: during the 1990s and 2000s, the U.S., Spain, the U.K., Switzerland, and other Latin American nations have all been among the most common sources for FDI in the region (ECLAC 2013, 31; OECD 2001, 105–106).

Most of the nationalizations happened in the post-neoliberal era: 66 events (92%) took place in the new millennium, whereas the first half of the 1980s and the 1990s witnessed only three takeovers (4%) each. The timing of the events thus resembles the global trend, as Hajzler (2012) reports that the number of state takings has increased world-wide since the mid-1990s.

The sectoral characteristics of expropriation are also similar to those elsewhere in the world: investment in the oil and mining sectors continues to be most vulnerable to takeovers globally (Hajzler 2012), which seems to be the case in Latin America, as well. In total, 19 of the expropriations under analysis here involved a firm in oil and gas (26%).[41] Of the remaining acts, 17 occurred in manufacturing (24% of the total), 15 in mining (21%), nine in services (13%), seven in utilities (10%), and five in agriculture and finance (7% each).[42]

Overall, the pattern of expropriation in Latin America echoes those at the international level, and the same holds also for *BIT*, the key independent variable in the following analysis. In their study, Elkins et al. (2006, 815) show that BITs spread across the globe most dramatically during the 1990s. Latin America was on the front line of this trend: governments in the region signed more treaties in the 1990s than in any other part of the world (UNCTAD 2000). Figure 2 illustrates this proliferation of the treaties by graphing the number of ratified BITs both in the region and in the world. The number of the approved treaties decreased in Latin America in the late 1990s temporarily, while their adoption at the global level peaked. Except for this difference, the Latin American experience with the treaties resembles that of the rest of the world.

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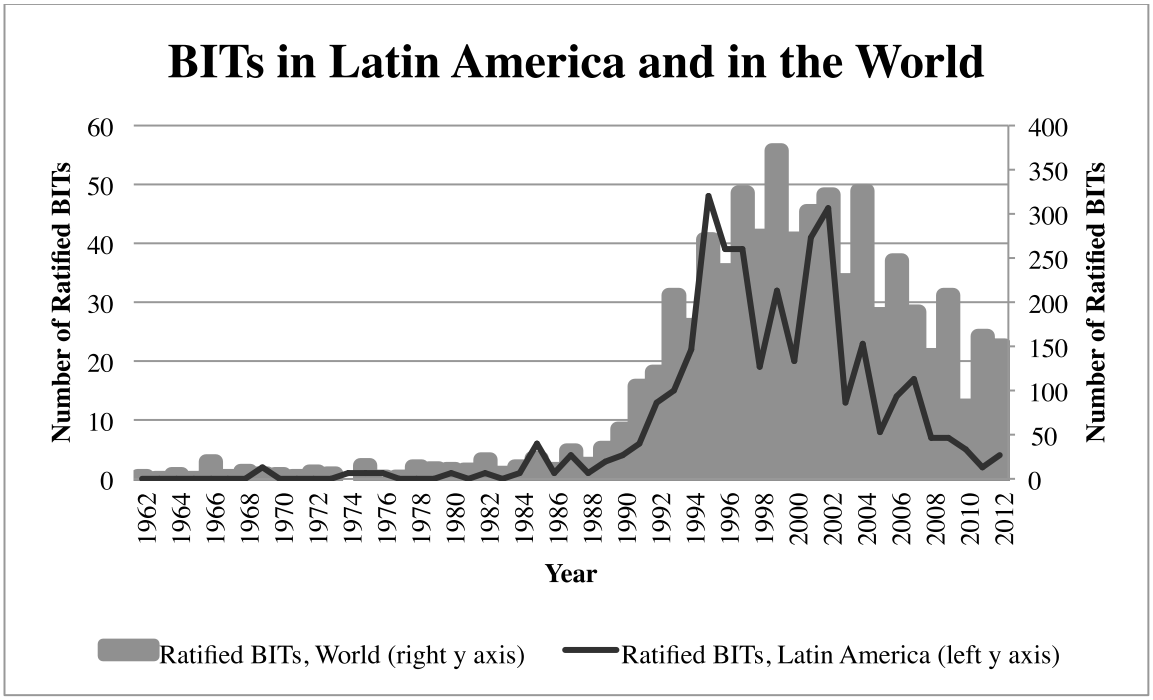
[41] Of the oil and gas nationalizations, eight took place in Bolivia, eight in Venezuela, two in Peru and one in Ecuador and Argentina.

[42] As the list of expropriations shows, a few dyad-years include nationalizations in various sectors. Hence, the percentages presented here exceed 100%.

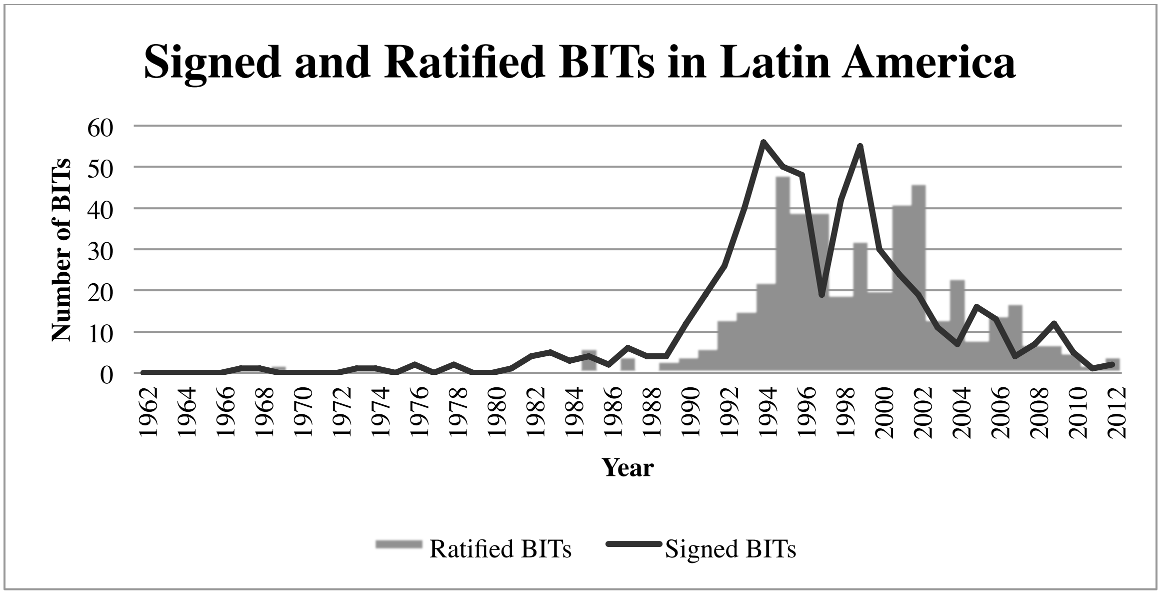
Figure 2: Number of ratified bilateral investment treaties



Source: UNCTAD (2015b)

Figure 3 focuses on the Latin American experience and presents the number of signed and approved treaties in the region. The graph confirms that the treaties were essentially a phenomenon linked to the Washington Consensus reforms: most of them were signed during the neoliberal 1990s, and their ratification in national legislatures followed in a few years time.

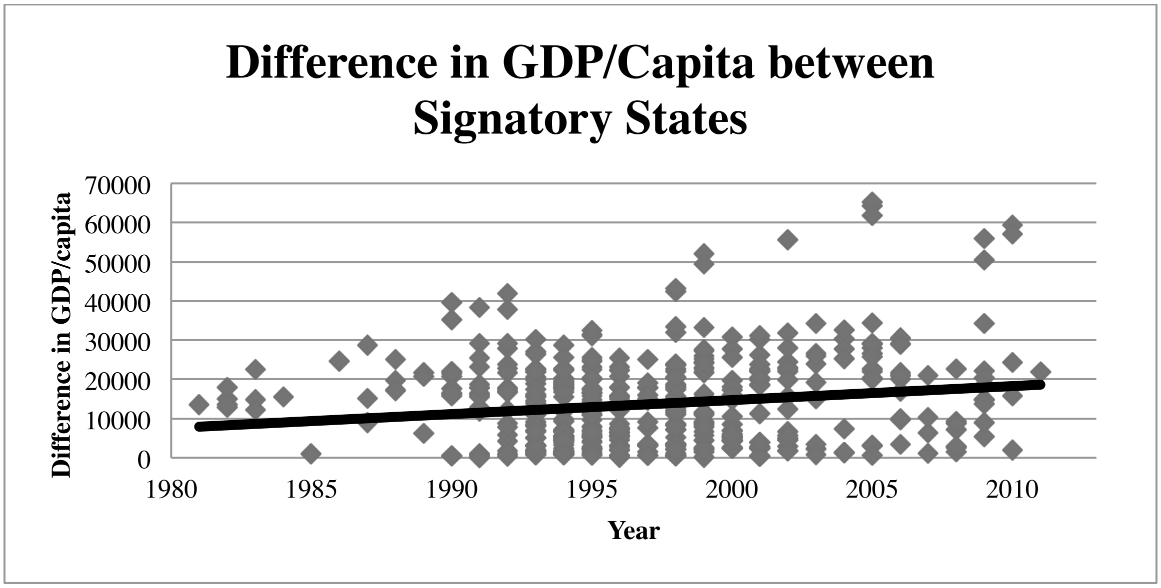
Figure 3: Number of signed and ratified bilateral investment treaties in Latin America



Source: UNCTAD (2015b)

Elkins et al. (2006) also find that the signatory countries have begun to resemble each other more over time, both economically and politically. When it comes to the economic differences between BIT partners, however, the Latin American experience diverges from this global trend. Figure 4 below illustrates that the GDP/capita gap between the signatory states has in fact increased – not decreased – slightly over time.

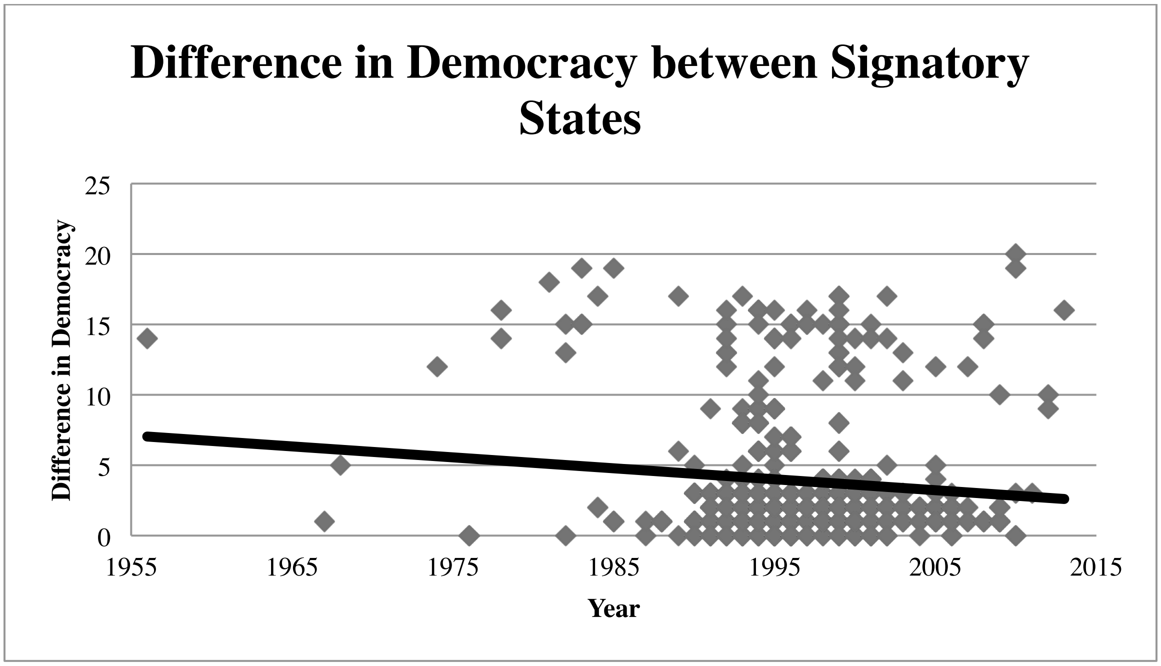
Figure 4: Difference in GDP per capita between Latin American countries and their treaty partners anywhere in the world



Source: World Bank (2013)

Politically, however, the Latin American treaty signers and their partner countries have grown more alike. Figure 5 presents the difference in the level of democracy between the countries in the dyad, as measured by the polity2 composite index of Polity (Marshall and Jaggers 2012). Elkins et al. (2006, 812) show that a similar convergence between the political institutions in the treaty-partner countries has taken place world-wide.

Figure 5: Difference in the level of democracy between Latin American countries and their treaty partners anywhere in the world



Source: Marshall and Jaggers (2012)

We can also examine the relationships between these patterns of nationalization and treaty signing in a preliminary fashion. Out of the 72 expropriations in the data, 48 (67%) occurred in the presence of a treaty. Conversely, 24 (33%) expropriations involved an investor that did not enjoy treaty protection. A simple chi-square test suggests that there is a statistically significant relationship between the decision to take over a foreign firm and having a treaty in effect with the firm's home.[43] That is, unlike expected, this first look at the data suggests that a BIT between the two countries does not discourage – but rather encourages – the host state government to proceed with its nationalistic plans. The rest of this chapter focuses on examining this relationship with more sophisticated statistical tools. While the treaties were assumed to tie the hands of nationalistic leaders,

[43] Chi-square with one degree of freedom=794.2, p=0.000.

the high number of nationalizations of BIT-protected companies hints that this may not, in fact, be the case.

Research Design, Data, and Methods

The data comprises all investment-relevant dyads between a Latin American host country and a home country of FDI anywhere in the world. The unit of analysis is therefore a dyad-year. I focus only on investment-relevant dyads since a host government can only expropriate firms from a country that is sending investment to the target country. [44] Given the lack of detailed data on the sources of FDI in the region, the dyads are identified on the basis of COW's International Trade data (Barbieri and Keshk 2012; Barbieri, Keshk, and Pollins 2009).[45] A dyad is included in the analysis if the countries traded in 1985, the beginning of the data set, or any ensuing year. In total, the data set consists of 2404 dyads.[46]

The dependent variable, *expropriation*, is a binary variable that takes on a value of 1 if the host government expropriated FDI from the home country in a given year; and 0 otherwise. As discussed above, I consider a takeover of each firm an individual act of expropriation in order to identify the home country of each affected investor. Takeovers of various companies from one country in a given year, however, are collapsed into one case. The summary statistics of *expropriation*, and the other key variables introduced below, are presented in the appendix.

[44] Focusing on certain dyads is a common practice in conflict studies, where statistical analyses are often conducted on samples of politically-relevant dyads. See, for example, Lemke and Reed (2001).

[45] I constructed the data set with the help of EUGene (D. S. Bennett and Stam 2000).

[46] The data suffers from aggregation bias, as the amount of firms varies from dyad to dyad. Since data on the number of firms from a certain country in each Latin American nation is not available, an additional statistical model aims to control for this variation within dyads by including the inflow of trade from the home country to the host county as a proxy for FDI inflows.

The key independent variable, *BIT*, will uncover the effect of the treaties on the probability of expropriation. The variable is binary: it takes on a value of 1 if the dyad has a treaty in effect in a given year; 0 otherwise (UNCTAD 2015b). If the treaties deter property rights violations, the likelihood of expropriation in the dyad should decrease after the host country ratifies a BIT with the home country of an investor. It is important to note, however, that the existence of a BIT might be endogenous to the probability of nationalization: countries that are more likely to take over foreign firms might also be more likely to sign BITs in order to attract otherwise hesitant investors.[47] I will evaluate this possibility with an additional statistical model.

The control variables were chosen on the basis of existing research on nationalization. Starting with the domestic political factors, the model includes the independent variable *democracy*, measured with Polity IV's composite indicator of democracy and autocracy that ranges from 10 (democracy) to -10 (autocracy) (Marshall and Jaggers 2012).[48] The variable is included because previous studies have shown that leaders of democratic countries expropriate less than their autocratic counterparts. Since a higher value of *democracy* indicates a more democratic system, an increase in the variable should decrease the likelihood of expropriation.[49]

The model also includes various domestic economic variables. Jodice (1980) and subsequent studies have found that economic development of the host country tends to decrease the likelihood of expropriation. While this pattern does not seem to hold in Latin

[47] For the argument that multinationals have pushed for BITs, see Salacuse and Sullivan (2005, 71).
[48] The indicator includes competitiveness, participation, the openness and competitiveness of executive recruitment, and constraints on the chief executive in the system.
[49] Henisz (2000) and others have emphasized that the constraining effect of democratic polities really lies in the number of veto points executives face. An alternative model is run by replacing democracy with a seven-category variable *executive constraints* (Marshall and Jaggers 2012) that captures the formal restrictions the system sets on the head of state. Its effect is also expected to be negative: the more veto players in the system, the less likely the leader is to nationalize. The results of this model are included in the appendix.

America (ibid., 199), the model controls for the level of development: the variable *GDP per capita* is the natural logarithm of the real gross domestic product per capita (World Bank 2013). The model also includes a measure of economic growth, *GDP growth*, which captures the annual GDP growth rate in percentages (ibid.). Another economic variable, *FDI,* controls for the importance of foreign investment for the host country, measured as the percentage of total FDI stock of GDP (ibid.). A similar variable, *trade*, the percentage of total trade in GDP (ibid.), captures the host country's integration into the global markets. These variables are standard in the expropriation literature, and their effect on the likelihood of nationalization should be negative: a government highly dependent on foreign investment and trade should be more cautious to attack foreign investors than a less dependent government.

Additionally, the analysis includes a domestic economic variable that is less common in the existing nationalization literature: the host country's exchange rate arrangement or, more specifically, its past decision to adopt the US dollar as the sole currency. Overall, Latin America presents great variation in the prevailing exchange rate regimes: while most nations allow the market to determine the value of their money, Panama, Ecuador, and El Salvador have given up their own currency altogether and use the U.S. dollar as their only legal tender. Existing work has connected this "dollarization" of the economy to various macroeconomic outcomes, starting with an increased fiscal discipline that, in turn, leads to higher investment and economic growth, better access to international capital, and more stable capital flows, for example.[50]

Since Rafael Correa of Ecuador and Mauricio Funes of El Salvador, two executives in the sample, represent both dollarized countries and the new Latin American

[50] For a concise summary of the logic that connects dollarization to these outcomes, see Lucas (2009, 5). Various scholars have also examined how exchange rate stability affects foreign direct investment (see, for example, Stevens 1998; Froot and Stein 1991; Klein and Marion 1997).

left, I test whether the constraining effects of dollarization also extends to the politics of FDI. To this end, the analysis includes a binary variable, *dollarization*, that distinguishes between economies with a national currency (0), and dollarized economies (1) (Reinhart and Rogoff 2002). Given the disciplining effects of the dollar, its effect on the likelihood of nationalization should be negative: as a country ties itself to the U.S. dollar, its leader is less likely to challenge the existing contracts with foreign investors, making nationalization of FDI rare.[51]

To control for the international economic constraints the host government faces, the model includes a variable that captures the level of world energy prices. The variable *energy price* is the World Bank's annual price index of crude oil, natural gas, and coal (World Bank 2014). While not all Latin American countries produce these commodities, nearly every country in the region produces metals or non-oil minerals. The price of metals and minerals, in turn, is highly correlated with energy prices, making the latter an appropriate proxy for the overall global economic constraints in the region.[52] On the basis of the existing nationalization literature, the effect of this variable on the likelihood of expropriation should be positive, as higher natural resource prices tend to motivate leaders to break the existing contracts.[53]

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[51] The specific mechanism that connects dollarization to lack of nationalization might rest on the domestic winners of the measure and their continuing leverage over politics. In El Salvador, for example, the banking sector and entrepreneurs promoted dollarization and, in turn, had direct access to power through the ruling party (Towers and Borzutzky 2004). Evidence suggests that these groups have also been the main beneficiaries of dollarization (Quispe-Agnoli and Whisler 2006, 68; Lucas 2009, 34). Dollarization could have further consolidated the political capital of these groups and, given their preference for private property rights, they could remain powerful veto players when it comes to preventing nationalistic policies later on. Pandya (2007, 152) makes this kind of argument based on the domestic distributional effects of FDI: she finds that regulation of FDI is higher in sectors in which FDI is simply used to compete in local markets rather than in sectors where FDI is used to lower production costs.

[52] The correlation between the World Bank's energy price index and the metal and minerals index is 0.87 (World Bank 2014).

[53] The last section of this chapter focuses solely on expropriations in the natural resource sector.

Since private investors can also gain protection from private or public insurance agencies, the model includes a variable that aims to capture some of the additional institutional safeguards that multinationals hold. The variable *MIGA member* stands for the home country's and host country's membership in the World Bank's Multilateral Investment Guarantee Agency (MIGA). The agency offers political risk insurance for firms from the member nations who wish to invest in developing member countries (Multilateral Investment Guarantee Agency 2012, 5). If both countries in the dyad are members of MIGA, the likelihood of its nationalization should increase, as the nationalizing government may expect an insured firm to object to expropriatory measures with less intensity than an uninsured company (Multilateral Investment Guarantee Agency 2015).[54] The variable takes on a value of 1 if the home government was a member in a given year, and 0 otherwise.

Finally, one of the key variables aims to control for leaders' nationalistic goals. As discussed in the introduction of this dissertation, BITs are expected to deter politicians with nationalistic tendencies. If, on the contrary, an actor is not motivated to challenge the property rights of multinationals to begin with, the treaties should remain dormant. The analysis aims to capture leaders' tendency to nationalize with a dummy variable, *left government*, classified as 1 if the executive comes from a leftist party, and 0 otherwise. Leftist ideology of the ruling party is chosen as a proxy for these nationalistic motivations because the left in the region is known for its demands for nationalization (Castañeda 1993).

[54] Industrialized home countries often have their own similar insurance programs: the U.S.' Overseas Private Investment Corporation (OPIC) is perhaps the best known of these. Due to lack of data, I only include MIGA in the model. For a similar decision, see Yackee (2007, 182–183).

This variable is based on Coppedge's seminal classification of Latin American parties (1997) and the coding of Huber et al. (2008).[55] Importantly, the variable distinguishes left and right on the basis of parties' pre-electoral agendas. This minimizes the risk that leaders' ideology is assigned according to the policy measures they take once in office (Pop-Eleches 2009, 59), ensuring that nationalistic leaders are not coded as leftist automatically. For the purposes of my research question this is especially important, as we need to make sure that the group of governments coded as leftists includes all potential nationalizers that may have been deterred by BITs and cancelled their nationalistic plans – not simply leftists that nationalized and were not deterred, for one reason or another.

The analysis consists of two different statistical models. First, I conducted a simple probit regression in which the possible expropriation in a given dyad is regressed on the independent variables discussed above. Second, in order to control for the possible endogeneity of BITs, I computed a recursive bivariate probit model, estimated also by maximum likelihood (MLE).[56] The recursive bivariate probit model is discussed after the simple probit model.

Both the simple probit and the recursive probit model required a few additional corrections. First, there is considerable temporal dependence in the data, since a host

[55] Measuring ideology is difficult in Latin America, where many political actors and movements do not fall naturally on the traditional left-right continuum. In fact, some authors classify Chávez as a populist, rather than a leftist, in his first years in office (Huber et al. 2008). In this analysis, I consider Chávez and Morales leftist from the beginning of their terms. This is because I use Coppedge's variable to identify leaders with nationalistic tendencies. As Chapter 4 will show, Chávez's early actions to strengthen OPEC suggest that he was planning to reform the sector already before proclaiming himself a socialist in public. Morales, in turn, was open about his nationalistic goals well before his presidency, as Chapter 5 will discuss.

[56] A simpler instrumental variable MLE probit is not appropriate for the question at hand, since the endogenous variable, existence of a BIT in the dyad, is binary (Greene, 2000, 249-252). Heckman selection model is another common approach to the study of treaty compliance in the field of IR. See, for example, Von Stein (2005). Such a model is not appropriate here, since the outcome of interest, nationalization, is not restricted for the selection group; expropriations occur both in dyads with and without a BIT.

government's decision to expropriate in a given year depends on the history of expropriation in the dyad (see, for example, Beck, Katz, and Tucker 1998). To correct for this dependence, I followed the recommendation of Carter and Signorino (2010) and included three time variables in the models: the time since the last expropriation in the dyad, and its square and cube. In the case of the recursive bivariate probit model, the duration variables are also included in the equation for BITs, since the nationalization history in a dyad is also likely to affect the signing of a BIT between the countries (for a similar approach, see Tiernay 2014). Second, to address some of the possible reverse causality, the control variables were lagged by one year.[57]

Third, the data present considerable left-censoring, since many of the investment-relevant dyads were formed before the beginning of the data set in 1985. To correct for this, I followed the recommendation of Carter and Signorino (2013), and set the duration variables in 1985 to reflect the number of years passed since the previous expropriation in the dyad. There are 52 such expropriations between 1960, the beginning of Kobrin's (1980) expropriation data set, and 1985. For the remaining cases, I used 1948 as an estimation for the date of the dyad's formation (Carter and Signorino 2013). This is a crude estimation on the basis of the third privatization cycle in Latin America that Chua (1995) identifies.[58]

Since we can assume the observations within a country to be correlated, the standard errors should be clustered on the home country. However, expropriation is often a takeover of a single firm, rather than an industry-wide nationalization of multiple

[57] The simple probit model is a random-effects model, given the bias of unconditional fixed effects estimates (see Greene 2002). The issue is addressed in a model that includes country dummies, presented in the appendix.
[58] More specifically, Chua identifies the following privatization cycles that precede the beginning of Kobrin's data in 1960: Post-Revolutionary Privatization in Mexico in 1940-1958 (232), return to privatization in Chile beginning in 1958 and beginning in 1948 in Peru (238-239), and the liberal internationalism in Brazil in 1945-1950 (240-241).

firms.[59] Executives contemplating expropriation might thus consider the expected response from certain companies and their home countries. To control for this kind of correlation at the dyad-level, I present the results of an alternative model in the appendix, with the errors clustered on each country-dyad.

Finally, it is important to note that the rarity of expropriation poses additional challenges for examining the data with statistical methods. The unit of analysis is dyad-year, and the sample includes all investment-relevant dyads between investors' Latin American hosts and home states anywhere in the world, bringing the number of observations up to 112.143. Within those observations, there are only 72 nationalizations (0.06% of the observations). As King and Zeng (2001) note, such infrequent outcomes are difficult to explain with traditional estimators. Consequently, they developed a rare events logit estimator that can offer less biased and more accurate estimates than the traditional logic model (ibid. 711-712). This chapter uses the traditional probit estimator in order to build on the model when addressing the endogeneity between BITs and nationalization. However, the results remain unchanged with the rare events estimator, as reported in the appendix.

STATISTICAL TESTS AND RESULTS

Table 1 presents the results of the simple probit model. The first model includes only the control variables. The second model introduces the variable *BIT* in the dyad. Surprisingly, the effect of BITs on the likelihood of nationalization is positive; that is, a government is more likely to expropriate investment that is protected by a treaty than unprotected investment. However, the countries that are more likely to nationalize might

[59] 71% of the nationalization acts in Latin America since 1985 involve only one firm at a time (Minor, 1994; Coyle, n.d.; Hajzler, 2012; author).

also be more likely to sign BITs, causing the positive correlation between BITs and nationalization. This possibility is examined in more detail below.

Table 1: Determinants of expropriation, simple probit

	Model 1	Model 2	Model 3
BIT		0.991*** (0.119)	1.106*** (0.124)
Democracy	-0.141*** (0.033)	-0.139*** (0.034)	-0.194*** (0.034)
Left government	0.321 (0.214)	0.365* (0.204)	
Energy price	0.016*** (0.003)	0.015*** (0.003)	0.016*** (0.005)
GDP per capita	-0.067 (0.220)	-0.087 (0.226)	-0.127 (0.216)
GDP growth	0.040** (0.019)	0.041** (0.017)	0.067*** (0.015)
FDI	-3.97e-5 (3.98e-5)	-4.36e-5 (4.93e-5)	-3.35e-5 (3.71e-5)
Trade	1.89e-5*** (6.39e-6)	2.16e-5*** (7.75e-6)	6.83e-5*** (1.42e-5)
Dollarization	-0.847*** (0.269)	-0.959*** (0.292)	-0.691** (0.270)
MIGA member	0.771** (0.353)	0.336 (0.317)	0.327 (0.344)
Time variables	included	included	included
N	64524	64524	22551
Wald chi^2	7742.91	7979.80	10059.93
Prob > chi^2	0.0000	0.0000	0.0000

Notes: Standard errors in parenthesis.
* significant at 10%; **significant at 5%; *** significant at 1% level.

To reiterate, the variable *left government* aims to capture the leader's underlying nationalistic goals, not the mode in which he chooses to express these goals. Since we can expect only nationalistically motivated leaders to challenge BITs to begin with and expropriate, as discussed in the introduction, Model 3 runs the main model on a sample that includes only the governments with nationalistic tendencies, proxied with their leftist ideology. The results suggest that even when we focus on the leaders that are most likely to have an underlying wish to take over private investment, BITs fail to deter; the coefficient for BIT remains statistically significant and positive on this smaller sample.

When it comes to the control variables, the coefficients are either as expected or they fail to achieve statistical significance. Democratic institutions decrease the likelihood of nationalization, as stated in the existing work, and this finding is consistent across different model specifications (see Model 1, Table 5 in the appendix for the coefficients of executive constraints). The effect of exchange rate is also statistically significant and as expected: leaders of dollarized countries are less likely to nationalize than their colleagues elsewhere. While *GDP growth* and *trade* seem to make expropriation more likely, the coefficients for the related variables *GDP per capita* and *FDI* are not statistically significant, warranting some caution about definite conclusions. Similarly, the coefficient for *MIGA membership* fails to meet the significance tests at conventional levels of confidence.

Finally, the causes of nationalization – the focus of the statistical analysis – are clearly closely connected to the factors that explain the weak deterrent effect of BITs. In fact, one of the control variables, *energy price*, speaks to the causal mechanisms behind the treaties' deterrent failure, albeit in a preliminary fashion. The analysis shows that higher energy prices motivate executives to expropriate. A similar economic rationale might also drive politicians to overstep BITs, since increasing energy prices can cause the benefits of nationalization to outweigh the costs of BITs. In this way, the statistical analysis offers tentative support for the strategic argument. The last section of this chapter will evaluate this possibility in more detail.

The findings do not help us assess the alternative, ideological argument, however. This is because in Latin America, leftist ideology is closely connected to economic nationalism. For this reason, I used Coppedge's (1997) standard classification of governmental ideology in the region to capture leaders' underlying wish to nationalize. The results support the rather obvious claim that leaders with nationalistic tendencies are more likely to nationalize than non-nationalistic politicians, but the analysis does not speak to the possible ideological explanation of BITs' weakness. Chapters 4 and 5 will assess this alternative argument for the lack of treaties' deterrent power.

As the multiple alternative models presented in the appendix suggest, the positive effect of BITs on nationalization is robust.[60] Additional control variables, such as *amount of trade* from the home country to the host country (Appendix, Model 2 in Table 9), or *economic crisis* (Appendix, Model 3 in Table 9), do not affect the role of BITs. The results are similar when the dependent variable entails only *expropriation in natural resource sectors* (Appendix, Model 4 in Table 9). The coefficient for *BIT* also remains relatively constant when each independent variable is excluded from the model one at a time and when the model includes *country dummies* (Appendix, Model 5 in Table 9).[61] The appendix also presents the results with errors clustered on the dyad (Model 6 in Table 9). Overall, then, the finding about the treaties' deterrent failure is robust across different model specifications.[62]

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[60] In the presented iterations, Chávez and Morales are considered leftist from the beginning of their term. In other words, I assume that the leaders always had the underlying motivation to take over FDI.

[61] The inclusion of fixed effects aims to address the heavy clustering of the events to Chávez's Venezuela and Morales's Bolivia. When these two governments are excluded from the sample altogether, the statistical significance of many key variables disappears. This, together with the rarity of expropriation, calls for case studies of specific expropriations. Importantly, however, when the country controls are included in the model, the effect of BITs remains positive and statistically significant.

[62] As mentioned above, the appendix also includes a similar analysis conducted with the rare events estimator (Appendix, Table 10).

Since my analysis focuses on evaluating whether BITs have any effect on the likelihood of nationalization, the discussion on the substantive effects of the predictors is kept short. Table 2 presents the average marginal effects of each independent variable when the variable changes by one unit and the other variables are held constant. This helps us to see how much the probability of expropriation increases or decreases when the value of each independent variable changes.[63]

Table 2: Average Marginal Effects, simple probit

BIT	0.0045**
Democracy	-0.00031**
Left government	0.00077**
Energy price	0.000033**
GDP per capita	-0.00019
GDP growth	0.000091*
FDI	$-9.7e^{-8}$
Trade	$4.8e^{-8}$*
Exchange rate	-0.00010**
MIGA member	0.00060

Notes: * significant at 10%; **significant at 5%; *** significant at 1% level.

The table suggests that BITs have a small, positive effect on the likelihood of nationalization: when two countries sign a treaty, the probability that the host country takes over investment from the treaty partner country increases by 0.045 percentage points. Overall, the likelihood of nationalization in a dyad in any given year is low:

[63] For the binary variables, the change is from 0 to 1. For the continuous variables, it is instantaneous or infinitely small. For more, see Long and Freese (2014, 239–253)

0.1%.[64] The final section of this chapter will present some of these substantive effects in more detail. For now, it suffices to say that BITs appear to have a concrete, positive effect on the propensity of expropriation.

Do Nationalizers Sign More BITs?

The surprising positive impact of BITs on nationalization may be caused by an endogenous relationship between leaders' decision to sign a treaty and their successors' decision to take over foreign firms. More specifically, a president of a country with a nationalistic history may need to work harder than his counterparts – sign multiple BITs – to convince potential investors of his respect for property rights. The next president may well return the country to its nationalistic path, despite his predecessor's attempts to embrace the global investment regime. In this scenario, BITs do not cause the increase in the probability of nationalization; rather some other, unidentified factors make countries more likely to both adopt treaties and expropriate multinational corporations.

To consider this possible endogeneity of BITs, I computed a recursive bivariate probit model.[65] The model is specified as follows (notation adopted from Greene 2000; for a similar application, see Tiernay 2014, 10):

$$y_1^* = \beta 1_1' x_1 + \gamma y_2 + \varepsilon_{1,} \quad y_1 = 1 \quad \text{if } y_1^* > 0, 0 \text{ otherwise},$$

$$y_2^* = \beta_2' x_2 + \delta \text{instrument} + \varepsilon_{2,} \quad y_2 = 1 \quad \text{if } y_2^* > 0, 0 \text{ otherwise},$$

$$E[\varepsilon_1 | x_1, x_2] = E[\varepsilon_2 | x_1, x_2] = 0,$$

$$\text{Var}[\varepsilon_1 | \beta_1, \beta_2] = \text{Var}[\varepsilon_2 | \beta_1, \beta_2] = 1,$$

$$\text{Cov}[\varepsilon_1, \varepsilon_2 | x_1, x_2] = \rho.$$

[64] Significant at 1% level.

[65] A simpler instrumental variable MLE probit is not appropriate for the question at hand, since the endogenous variable, existence of a BIT in the dyad, is binary (Greene, 2000, 249-252). Heckman selection model is another common approach to the study of treaty compliance in the field of IR. See, for example, Von Stein (2005). Such a model is not appropriate here, since the outcome of interest, nationalization, is not restricted for the selection group; expropriations occur both in dyads with and without a BIT.

The dependent variables are y_1, whether the host expropriates investment from the home country in a given year, and y_2, whether the dyad has a BIT in effect that year. The vectors x_1 and x_2 share the independent variables discussed above, with the exception of an instrumental variable, included only in the latter equation. With the help of the instrumental variable, the model first estimates the likelihood that the host country has a treaty in effect with the host country (the equation for y_2^*) and then uses the predicted probabilities of this equation to estimate the likelihood of nationalization in the dyad (the equation for y_1^*).

Following Kerner (2009), I used the percentage of the host country's neighbors that have a BIT in effect with the same home country as the instrumental variable, *neighbor's BIT*.[66] For an instrumental variable to tease out the true effects of the endogenous regressor, it must be uncorrelated with the outcome of interest but correlated with the endogenous independent variable.[67] The following discussion assesses these two characteristics of the instrument – its exogeneity and its relevance (Greene 2008: 316) – aiming to establish that the host country's neighbors' BITs are unrelated to the dependent variable, the host country's decision to nationalize, but that they are indeed connected to the host's BITs, the independent variable.

The first criteria for a valid instrument, the exogeneity restriction, can be evaluated both theoretically and empirically. Theoretically, the treaties of a neighboring country should not affect a leader's decision to take over FDI. For example, if Argentina chooses to sign a BIT with Germany, the executive of Bolivia is unlikely to consider the

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[66] The dependent variable in Kerner's study is *FDI*. As will be discussed in the following, the ratified treaties in the neighboring countries should not be connected to nationalization of foreign firms, a specific type of restriction on FDI, either. Countries are considered neighbors if they share a land border or are separated by less than 12 miles of water, as coded by the Correlates of War data set (Stinnett et al. 2002).
[67] For instrumental variables in general, see Greene (2000, 316).

treaty when contemplating expropriation of German investment. This is because the costs of BITs are exclusive to a specific treaty and, for this reason, they apply to the signatory countries only. Therefore, the patterns of treaty adoption by neighboring country governments should not influence the propensity to nationalize.[68] Given this lack of evident theoretical connection between one's neighbors' treaties and nationalization, to my knowledge, the literature on expropriation has not connected these two variables. Moreover, empirically, I find that the correlation between the instrumental variable and expropriation is small: 0.031.[69] We have thus reasonable grounds to expect that the chosen instrument is exogenous to expropriation.[70]

The second key criteria for a valid instrument concerns the instrument's relevance. That is, does the instrument predict the endogenous independent variable, *BIT*, to a reasonable extent? The existing work on BITs has established a competitive dynamic that leads to the treaties' adoption: economic competition in the global markets increases the rate at which a country signs BITs (Elkins, Guzman, and Simmons, 2006; see also Guzman 1998). Moreover, especially towards the late 1990s, the United Nations Conference on Trade and Development (UNCTAD) and various Western countries

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[68] Given the competitive regional dynamics of FDI, countries might be more likely to sign BITs if their neighbor nationalizes, aiming to take advantage of the neighbor's bad investment climate. I addressed this possibility by running the model with the same instrumental variable lagged by one year, given that the neighbor's decision to nationalize should not affect the adoption of treaties in the region the year before. The results are similar in terms of the key independent variables to those presented in Table 3.

[69] Sovey and Green (2011, 194–195) warn about trusting these kind of empirical tests when assessing the instrument's validity. Here, the empirical tests are combined with a strong theoretical justification.

[70] A common criteria for checking the instrument's validity is to see whether the F-test of the excluded instrumental variable exceeds 10 (Sovey and Green 2011, 198). According to Nichols (2011, 34), however, the commonly-used critical values do not offer an appropriate criteria for regression with a binary dependent variable. To evaluate my instrument's strength in some more detail, I regressed nationalization on the instrument and the independent variables specified in the main model as a linear model using ivreg2 (Baum, Schaffer, and Stillman 2003) in Stata (StataCorp 2009). These diagnostics cast some skepticism on my instrument: for example, the Sargan–Hansen test of overidentifying restrictions suggests that the instrument is, in fact, *not* exogenous. Overall, political scientists seem not to have converged on a specific evaluation of instruments in a bivariate recursive probit model. For example, Tiernay (2014, 143-145), who employs a similar research design, relies on the F-test and a theoretical justification.

started to promote the treaties in multilateral meetings and conferences, in which the participants signed treaties amongst themselves (Elkins, Guzman, and Simmons 2006, 818). Given the competition among the potential host governments and the promotion of BITs by the home governments, we can expect a neighboring country's decision to sign a BIT with a certain treaty partner to affect the willingness of a country to sign a treaty with that same partner. Kerner (2009, 88) adds another theoretical explanation for the instrument's independence: signing BITs can be considered an international norm, given their popularity, and hence the fact that your neighbor signs a treaty with a country will make you more likely to follow suit.

Empirically, I find confirmation for the argument that links the neighbor's decision to sign a treaty to one's own decision to sign a treaty. This can be seen in Table 3, which shows that the instrument is a statistically significant, positive predictor of the treaties.

Table 3 presents the results of the recursive bivariate probit model. The right-hand side of the table shows the coefficients for the predictors of a BIT. As discussed above, the coefficient for the instrumental variable, *neighbor's BIT*, is statistically significant and positive, indicating that the higher the percentage of one's neighbors that have a treaty in effect with a certain partner country, the more likely the country is to have a treaty with the same partner country, as well. The left-hand side of the table presents the covariates for the decision to nationalize. Curiously, the effect of BITs on the likelihood of nationalization remains positive after controlling for the endogenous nature of BITs; this conforms to the finding that the treaties increase rather than decrease the likelihood of expropriation.

Table 3: Determinants of expropriation, recursive bivariate probit

Variables	Expropriation equation	BIT equation
Neighbor's BIT		0.031*** (0.002)
BIT	1.092*** (0.324)	
Democracy	-0.134*** (0.015)	-0.066*** (0.200)
Left government	0.381** (0.169)	-0.160 (0.199)
GDP per capita	-0.007 (0.263)	1.32e-4*** (4.01e-5)
GDP growth	0.040*** (0.013)	-0.006 (0.005)
FDI	-5.77e-7 (5.2e-5)	-1.17e-5 (1.76e-5)
Trade	2.24e-5*** (8.28e-6)	-4.23e-5 (4.64e-5)
Energy price	0.014*** (0.003)	0.002 (0.002)
Dollarization	-0.998*** (0.290)	-0.015** (0.118)
MIGA member	-0.307 (0.292)	0.708*** (0.184)
Time variables	included	included
Athrho	-0.066 (0.161)	
N	60884	

Notes: Standard errors in parenthesis.
* significant at 10%; **significant at 5%; *** significant at 1% level.

Importantly, however, this model suggests that the decision to sign a treaty and the decision to nationalize are not connected. The rho statistic reported below the independent variables is the correlation between the errors in the two equations (Greene 2000, 854). In other words, it measures how correlated the existence of a treaty and the decision to nationalize are in the dyad, controlling for the other factors included in the analysis. Since the rho is not statistically different from zero, we can conclude that the decisions are not correlated.[71] In other words, a government's choice to sign a BIT and its choice to nationalize FDI are not related.

This finding is in line with some of the literature on the treaties presented in Chapter 2. Specifically, Poulsen and Aisbett (2013) have argued that the treaties spread in the third world out of diffusion, rather than rational policy-making. According to this view, in competing for new FDI, executives from capital-poor countries worked hard to convince potential investors of their respect for property rights, regardless of whether their country had a legacy of expropriation or not. Consequently, the next government's future decision to nationalize is not tied to its predecessor's decision to sign a treaty. The patterns of expropriation and BITs, presented earlier in the chapter, further increase the argument's plausibility: while most of the treaties were adopted in a wave in the neoliberal 1990s, nationalizations have peaked in the new millennium, under the electoral dominance of the new left. This suggests that the treaties have been challenged by a new generation of executives who have different preferences over FDI than their predecessors.

Are BITs Associated with More Nationalizations?

The analysis so far suggests that BITs are in fact linked to an increased probability of nationalization. This section offers a potential explanation for that surprising finding. To understand why a BIT-protected firm might be a more likely target for a nationalistic government than a non-protected firm, we need to consider the relative costs of nationalization for the host government and how the treaties impact those costs.

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[71] More specifically, we cannot reject the null hypothesis that the error terms of the estimated equations are not correlated. As a robustness check, I ran the bivariate model with various different combinations of the independent variables and also without the covariates. The statistic for rho remained statistically insignificant.

A nationalistic leader has a range of tools he can utilize to increase his control over foreign firms. At one end of the spectrum are regulatory changes that force investors to make minor adjustments; these can include new environmental or health regulations, for example. At the other end of the spectrum lies outright nationalization. In between these two extremes, there are multiple measures that infringe on investors' rights but are more moderate than direct expropriation. For example, a government can impose new taxes on multinationals, introduce currency and exchange rate restrictions, or limit the repatriation of the companies' profits (see, for example, Hill 1998) – measures that are regarded as indirect or creeping expropriation.

According to the existing literature, countries decide between the less invasive regulatory measures and outright expropriation on the basis of their technological, managerial, and administrative capabilities (Kobrin 1980, 68). That is, countries will nationalize only if they have the means to take over the investment and continue its operations. In the presence of BITs, however, the government also has to consider the legal consequences of its measures. As discussed in Chapter 2, the treaties impose significant new costs on nationalistic leaders in the form of legal fees of arbitration and compensation. Importantly, these costs are not limited to governments that implement outright nationalization: the vast majority of BITs specify that investors also have the right to appeal to third-party arbitration bodies for indirect measures that are "tantamount to expropriation or nationalization" (Reisman and Sloane 2004, 118–119).[72] In other words, BITs increase the costs of different types of regulatory measures, not just those of outright expropriation.

[72] The direct quote is from the US-Russia BIT. Its substance is included in virtually every BIT (Reisman and Sloane 2004, 118–119).

These new costs that BITs stipulate for regulatory measures explain why a nationalistic government would treat multinationals differently, depending on whether or not they are protected by a treaty. If a company does not have the protection of a BIT, the host government can impose regulatory changes without fear of legal retaliation. This is because the company's home country is unlikely to run to its defense for tax increases or environmental regulations, for example, as such measures clearly fall within the rights of a sovereign state. However, the home government may raise objections to actions such as an outright nationalization, and utilize diplomatic pressure or sanctions to defend its investors. For this reason, the relative cost of nationalizing a non-protected firm is high compared to the costs of other, less drastic regulatory measures: the host government can face serious economic consequences for nationalizing companies without a BIT, but less dramatic regulatory changes that affect those same firms are likely to go unpunished.

When it comes to firms with BITs, the expected costs of regulatory measures are much higher. This is because BIT-protected companies can use their treaty to challenge the host government in international arbitration even for smaller, regulatory changes. Whereas a company without a BIT cannot claim expropriation on the basis of regulatory measures, MNCs with a BIT can do so and take their case into arbitration. In other words, BITs allow companies to hold their host government accountable for regulatory changes that would remain unchallenged without a BIT.[73]

For the host government, the treaties thus increase the costs of regulatory measures compared to the costs of nationalization. A nationalistic politician should plan his measures accordingly: if a company does not have a BIT, the costs of regulatory measures are low when compared to those of outright nationalization. As a consequence,

[73] Real-world patterns of international arbitration support this argument, as most of the recent arbitration cases have been raised on the basis of smaller regulatory changes rather than expropriation (Wellhausen 2014, 32).

regulatory measures are a safer bet for the host government. In contrast, if the firm does enjoy treaty protection, even minor regulatory changes may lead to arbitration. This possibility can push the government to choose the more radical path and nationalize – after all, the company may sue it anyways for damages such as lost investments.

The decrease in the relative costs of nationalization that BITs cause could explain the positive effect that the treaties have on the likelihood of nationalization. The treaties may be driving host governments to expropriate firms that they would have regulated with less invasive measures in the earlier, pre-BIT era. Realizing that any nationalistic action they take may lead into international arbitration, full expropriation suddenly appears more attractive for the host government.

This explanation assumes that BIT-protected firms are willing to sue their host, even when facing less dramatic regulatory changes. As noted in Chapter 2, however, companies might not be that eager to litigate if they are hoping to remain on good terms with the host government. This is often the case if they have additional investments in the country (Wells and Ahmad 2007, 72–23; Post 2014, 25) or if they wish to tap into the host country's markets or natural resources in the future. In contrast, if the company's assets are not diversified, or it does not expect to re-enter the country after the dispute, we can expect it to fight for its rights and invoke its BIT without much hesitation. When the key goal is to win back as much of one's investments as possible, rather than maintain good business relations for the future, international arbitration poses an attractive option.

Recent trends in international arbitration suggest that companies have been eager to sue their hosts for regulatory takings. This development, in turn, makes it plausible that host governments have learned about the new costs of BITs and adjusted their behavior accordingly. After the proliferation of BITs in the 1990s, the number of public investment disputes in arbitration has increased dramatically (Wellhausen 2015, 30–

31).[74] The majority of these cases have been raised on the basis of smaller regulatory changes, not outright expropriation (ibid., 32). By the early 2000s, at the outset of the global commodity boom, leaders may have learned from their early experiences with arbitration and started to prefer more dramatic measures. Whereas without BITs they would have implemented less controversial regulatory changes, the looming arbitration processes for such actions might have pushed them to nationalize.

To conclude, the curious positive effect of BITs on the likelihood of expropriation and its possible causes aside, the evidence against the deterrent power of the treaties is strong. Controlling for the variables established in the existing nationalization literature, BITs do not constrain nationalistic leaders. This finding goes against the expectations of many: while neoliberals championed the treaties in the 1980s and 1990s as safeguards for foreign investment and nationalists combated them for that very same reason, my analysis shows that they have not prevented takeovers of private investment.

Testing the Theory: Do BITs Weaken when Prices Boom?

As discussed in the previous chapter, this dissertation has two goals: first, to evaluate the possible deterrence power of BITs and, second, to explain why Chávez and Morales have been able to overstep the treaties without major obstacles. This chapter has focused on evaluating the treaties' power to prevent possibly nationalistic leaders from acting on their goals. As the tests and the discussion above suggest, the treaties have not proven as strong as their advocates in the 1990s had hoped.

When it comes to assessing the proposed theory for the treaties' weaknesses, statistical research methods are less appropriate. This is because my theory focuses on the oil and gas sector, in which there have only been 19 expropriations in Latin America

[74] As Wellhausen (2015, 30) notes, most BITs allow for both private and public resolution processes and, consequently, the overall number of cases in international arbitration is even higher.

since 1985; this makes the occurrence of nationalization in the data even more rare. However, the logic of the theory should travel to other mineral resources, as these sectors also witness dramatic price fluctuations, the key component of my theory. By expanding the dependent variable to expropriation of FDI in all mineral sectors, the number of positive cases increases to 34.[75] Most of these natural resource expropriations took place in Venezuela and Bolivia: Venezuela nationalized mineral multinationals in 19 dyads (accounting for 56% of all natural gas nationalizations) and Bolivia took over firms in the sector in 10 dyads (29%).[76] Given the clustering of the events in these two host countries, detailed case studies offer a more promising method of analysis. Consequently, I present the following statistical test as tentative evidence for my theory, and Chapters 4 and 5 will assess the argument in more detail with the help of qualitative research tools.

To evaluate the theory with statistical tools, I conducted a simple probit analysis on the sample specified above, with a few modifications.[77] First, the dependent variable is *nationalization in any mineral sector*: the variable is coded 1 if the Latin American host took over oil or mining multinationals from the home country in question in a give year, 0 otherwise. Second, the model includes an additional independent variable, namely an interaction variable constructed on the basis of the independent variables *BIT* and *energy price* (of crude oil, natural gas, and coal) (World Bank 2014). According to my theory, the treaties lose their force when the prices of the commodity in question boom. Since

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[75] The cases are presented in the appendix (Table 7).
[76] The remaining nationalizations, as shown in the appendix, occurred in Dominican Republic, Ecuador, Peru, and Argentina.
[77] The sample includes only the governments with nationalistic tendencies, as identified above. Importantly, all countries in the region, with the exception of El Salvador and Panama, have produced some minerals each year between 1985 and 2011 (British Geological Survey 2011). El Salvador did not report any mineral products in 1987, nor did Panama in 1994. Given that these years seem to be aberrations in these two countries, they are included in the sample. It is important to note that the sample is inflated with more non-relevant investment dyads than the main analysis, since fewer countries are sources of outward FDI in mineral sectors.

prices of other minerals correlate heavily with those of oil, gas, and coal, as discussed above, the variable is constructed by multiplying the variable *BIT* with the World Bank's energy price index. The remaining regressors are included as above in the main model.

Table 4. presents the results of the main model (Model 1) and the results with the interaction variable included (Model 2). The effects of the other independent variables remain unchanged. The coefficient for the new interaction variable is statistically significant, suggesting that the commodity prices condition the effect of the treaties.

Table 4: Determinants of expropriation in mineral sectors, simple probit

	Model 1	Model 2
BIT	1.107*** (0.124)	0.449*** (0.173)
Energy price	0.016*** (0.005)	0.015*** (0.003)
BIT*Energy price		0.004* (0.002)
Democracy	-0.194*** (0.034)	-0.178*** (0.049)
GDP per capita	-0.127 (0.216)	-0.055 (0.230)
GDP growth	0.067*** (0.015)	0.071*** (0.016)
FDI	-3.35e-5 (3.71e-5)	-1.6e-5 (2.08e-5)
Trade	6.83e-5*** (1.42e-5)	5.29e-5*** (8.19e-6)
Dollarization	-0.692** (0.270)	-0.347 (0.320)
MIGA member	0.327 (0.344)	(omitted)
Time variables	included	included
N	22551	16413
Wald chi2	10059.93	6195.70
Prob > chi2	0.0000	0.0000

Notes: Standard errors in parenthesis.
* significant at 10%; **significant at 5%; *** significant at 1% level.

To evaluate the substantive effect that oil prices have on the power of BITs, I present two graphs. First, Figure 6 showcases the marginal effect of BITs at every ten-unit increase in the energy index from 0 to 130. As the graph shows, the positive effect of the treaties on the likelihood of nationalization increases together with energy prices. This is perhaps clearest through an example; the energy index is set to 100 in 2010, when the annual crude oil price averaged at $79 dollars (World Bank 2014). When Chávez took power in 1999, in contrast, the oil price was at a yearly average of $18 and the energy index was at 25 (ibid.). During the low energy prices of 1999, the probability of nationalization in an average dyad without a BIT was 0.01%, whereas with a BIT that probability was 0.04%.[78] During the high prices of 2010, in turn, the likelihood of expropriation was 0.1% in dyads without a BIT but 0.9% with a treaty![79] This example illustrates how dramatically energy prices strengthen the positive effect that BITs have on the likelihood of nationalization in oil and other mineral sectors.

Figure 6: Marginal effect of BITs

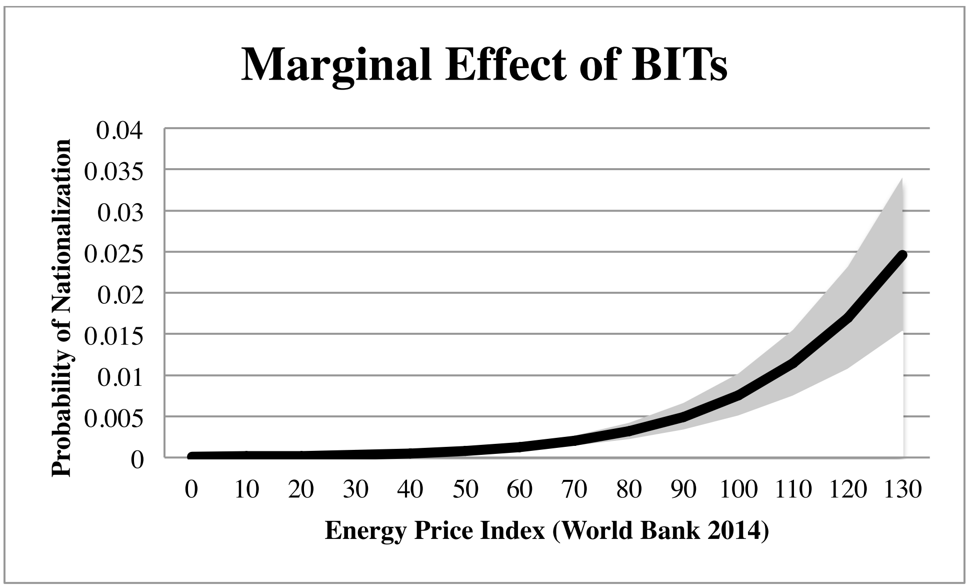
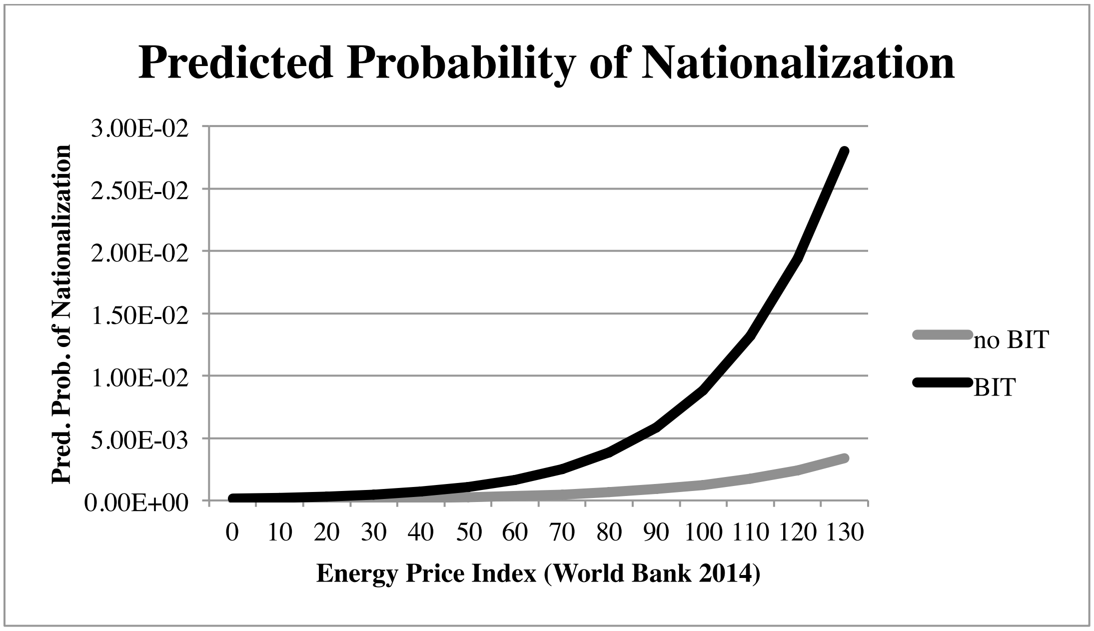


Figure 7 illustrates the predicted probability of nationalization at different values of the energy index, for both BIT-protected and non-BIT-protected firms. This figure also suggests that the treaties' positive effect on the likelihood of nationalization is significantly stronger when commodity prices boom. When it comes to companies without a treaty, the prices have a much more moderate effect. Overall, therefore, the

78 Average marginal effect, significant at 1% level.
79 Average marginal effect, significant at 10% level.

results suggest that BITs are particularly weak in protecting investment in oil and other mineral sectors at times of high energy prices.

Figure 7: Predicted probability of nationalization at values of energy price index



The preliminary statistical tests offer support for the argument that BITs' effects are conditional on oil prices. In fact, the results are consistent with the proposed explanation for the surprising, positive effect of the treaties: Expectations of high profits motivate leaders to breach their natural resource contracts at times of high commodity prices. At this point, if a multinational in the sector does not have a BIT, the costs of outright expropriation remain relatively high for the host, compared to the costs of smaller, regulatory changes that are likely to go unchallenged in international arbitration, such as moderate tax increases. Consequently, the high prices encourage politicians to regulate rather than expropriate. In contrast, if the company has a BIT in effect, this calculation is different: the potential gains of nationalization, amplified by the price increase, make outright nationalization more profitable relative to the more moderate, regulatory measures, as both policy options are likely to lead into arbitration. For this reason, the treaties increase the likelihood of nationalization especially when oil prices boom.

CONCLUSION

This chapter examined whether BITs restrain nationalistic leaders and prevent expropriation of FDI. The results suggest that the treaties have not prevented Latin American host governments from taking over foreign investment, unlike many treaty advocates and critics expected. The finding has important implications for the study of international institutions, as it indicates that the neoliberal investment regime has not succeeded in altering state behavior towards FDI. This, in turn, suggests that it may be hard to establish and enforce property rights through externally imposed institutions. The conclusion of the dissertation will discuss this topic further.

The statistical analysis highlights an intriguing puzzle: against all expectations, BITs appear to *increase* the likelihood of nationalization. The treaties' effect remains positive even when one controls for the possibility that more nationalistic countries sign more treaties to begin with. This chapter has proposed a novel explanation for the outcome: since the treaties penalize governments for regulatory actions that are not expropriations *per se*, leaders may be driven to take more drastic measures against those firms that enjoy the protection of the treaties and nationalize, as they realize that less dramatic regulatory changes are just as likely to lead into arbitration.

The final section of the chapter evaluated whether the power of BITs is conditional on oil price, as my theory posits. While the data poses some limitations to the statistical analysis and cautions against definitive conclusions, the results offer preliminary evidence for the theory. The tests indicate that oil prices amplify the treaties' effects in all mineral sectors: when global prices are high, leaders are more likely to take over firms that enjoy treaty protection than companies without a BIT. This offers support for the argument that nationalistic leaders act strategically: when a multinational has a BIT in effect, the host is likely to calculate that high commodity prices will allow him to simply take over the investment and pay the costs of international arbitration. When the company does not have a treaty, in contrast, the host knows that the company has no remedy against smaller contract breaches. In this case, the government is likely to opt for measures that do not constitute an outright nationalization. In short, the treaties are particularly weak when oil prices are high.

While this chapter has shown that BITs fail to deter expropriation at the regional level, it is important to keep in mind that Chávez and Morales have conducted most of the recent state takings. Consequently, to truly understand what role the treaties play when a nationalistic leader wants to challenge the multinationals, we need to turn our focus to these two cases. The following empirical chapters use qualitative research methods to address the second research question of this dissertation: what has allowed leaders like Chávez and Morales to ignore the treaties? Have they acted ideologically and disregarded the neoliberal constraints of the past? Or, have they pursued nationalization in a strategic, calculative manner, as my theory posits?

Chapter 4: Strategic Nationalization in Venezuela

> Privatization of oil in Venezuela is over; it was, after all we have done, the last area we needed to recover. This is the true nationalization of oil. The oil belongs to all Venezuelans.
>
> Hugo Chávez on February 26, 2007

Hugo Chávez declared the nationalization of Venezuelan oil on his live television show *Aló Presidente* in February 2007. Specifically, the state would take over majority control of oil projects in the Orinoco Belt, which holds the largest proven petroleum reserves on earth. The announcement marked the final stage of Chávez's oil reforms: the renegotiation of the Orinoco contracts was the last step in his mission to dismantle the old legal framework in the sector (Eljuri and Tejera Pérez 2008, 484–485). The ensuing negotiations with the multinationals a few months later did not go smoothly, however. Some of the companies refused to accept Chávez's new terms and threatened to invoke their bilateral investment treaties instead. After unsuccessful negotiations, the government took over the facilities of ExxonMobil and ConocoPhillips, two key players in the sector. The companies responded by commencing arbitration proceedings against the state in various venues. The deterrent effect of BITs had failed.

This chapter assesses whether the strategic argument offers a convincing explanation for the nationalization process in Venezuela. Specifically, the chapter will address three questions regarding the process: First, was Chávez's decision to act on his nationalistic goals and overstep BITs caused by his strategic, pragmatic calculations or, alternatively, by his leftist ideology? Second, after choosing to act on his nationalistic motivations, in what way did he pursue the expropriation? Did he proceed impulsively and impetuously, as the ideological argument would predict, or did he follow a more calculating, strategic mode of action? Third, was the timing of the nationalization related to Chávez's arrival in the presidential office or an increase in global oil prices? The analysis concludes that the theory based on leaders' strategic, economic calculations offers a more compelling account for the events in Venezuela than the competing, ideological argument.

VENEZUELAN OIL POLICY: FROM NATIONALIZATION TO "*APERTURA*"

In the decades before the Chávez government, Venezuela's political economy went through two important changes. First, the oil sector experienced a profound institutional transformation, starting with nationalization in 1976 and ending with the re-opening of the sector to foreign investors in the 1990s.[80] Second, more or less simultaneously, the country embraced the rules of the international investment regime, including BITs. Since both developments would later shape Chávez's oil reforms, this section introduces them briefly, before proceeding to assess the potential theoretical explanations for the treaties' inability to stop Chávez.

A key actor pushing for the changes in the oil sector, and one that would later clash with Chávez in a dramatic manner, was the state-owned oil company Petroleos de Venezuela (PDVSA). Established as a holding company after nationalization in 1976, PDVSA was in charge of ensuring that its subsidiaries executed the policies of the Ministry of Energy and Mines (Mendoza Pottellá 2012, 141–142). Only a few years into its existence, however, the company was already at loggerheads with the Ministry. This battle between the two institutions would shape the politics of Venezuelan oil both before and during the Chávez government.

[80] The opening of the sector and its consequences are highly contested in Venezuela. The following analysis draws both from more and less critical works on the topic. For critical accounts, see Mommer (2003) and Silva Calderón (2011, 90–100) For an alternative, more supportive view, see Wainberg (n.d.).

The newly established PDVSA began to distance itself from the government and seek autonomy over oil policy in the early 1980s. In concrete terms, PDVSA accomplished this by funneling money to new investments abroad: in 1983, PDVSA entered into a joint venture with an oil refinery Veba Oel in Germany, and various similar arrangements followed. According to the critics of this internationalization strategy, the company invested overseas to avoid its fiscal responsibilities at home (Mommer 2003, 5-6). The proponents of internationalization, in contrast, justified it as a reasonable measure to increase the company's global market share and to reach consumers directly (Baena 1999). Both opponents and proponents agree that the firm and the government were already in conflict at the time: PDVSA aimed to insulate itself and its resources from political pressures, whereas politicians wanted the exact opposite, aiming to maximize the state's fiscal revenue from oil.

By the early 1990s, two key developments had taken place. First, the internationalization process and the high level of technical expertise required in the sector had allowed PDVSA to shield itself from political pressures. While the Ministry of Energy and Mines still retained some veto power, PDVSA and its technocrats were now the key actors driving Venezuela's oil policy. Second, the overall economic outlook of the sector was precarious: after various price booms and busts in the 1970s and 1980s, PDVSA was in desperate need of new investment and capital. With its newly found autonomy, the company started to address the serious economic situation in a way that would soon conflict with the preferences of many politicians. (Wainberg n.d., 4-5)

Over the course of the 1990s, PDVSA invited oil multinationals back into the country in a process known as *apertura*, or the opening of the sector. While the Ministry of Energy and Mines was deeply antagonistic towards foreign investment, it was in charge of the sector only in theory. Consequently, PDVSA was able to introduce gradual changes that ended up thoroughly reshaping the sector's institutional framework. Since the presidents who implemented these changes – Carlos Andrés Pérez (1989-93), Ramón José Velásquez (1993-94), and Rafael Caldera (1994-99) – lacked a majority in the Congress, they invited the companies in with new types of contracts that did not require legislative approval, namely operating agreements, association agreements, and risk exploration agreements. To further complicate matters, the contracts were signed in multiple auction rounds.[81] Consequently, the resulting institutional framework created during *apertura* was complicated and fragmented. (Manzano and Monaldi 2010, 437)

As the new contractual framework for oil was shaping up, another important development took place in the legal arena. Over the course of the 1980s, Venezuela left behind its earlier commitment to the Calvo Doctrine and started to incorporate itself into the international investment regime (Betancourt 2013, 87–89).[82] The embrace of the global investment rules intensified in the early 1990s when the government of Andrés Pérez, as a part of its attempt to liberalize the economy, began to negotiate BITs (Tejera Pérez 2012, 38). The first BIT he signed, the Venezuela-Italy BIT of 1991, faced strong opposition in the lower house of the legislature and, as a result, it was never ratified.[83] Nevertheless, legal experts consider the treaty an important milestone, since it paved the way for a multitude of other BITs that the legislators subsequently approved (ibid., 40).

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[81] There were three round of auctions for the operating agreements, or operations service agreements, in 1991, 1992, and 1997. The extra-heavy oil association agreements (AAs) in the Orinoco Belt were signed between 1993 and 1997, and the risk exploration (REs) agreements in 1996. For a more detailed technical description of the sector, see Manzano and Monaldi (2010).

[82] Specifically, Venezuela started to sign international agreements over arbitration, such as the Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards, and Inter-American Convention on International Commercial Arbitration, both in 1985 (Betancourt 2013, 87).

[83] Among the most vocal treaty opponents were future Ministers of Oil and Energy Alvaro Silva Calderón and Alí Rodríguez Araque. For their positions in the debate, see Tejera Pérez 2012 (43–65).

By the end of the decade, Venezuela had twenty more treaties in effect and one waiting for ratification (ibid, 461-462).[84]

As this chapter will show, these BITs would later shape Chávez's oil reforms. In particular, they would force him to restructure the sector in a gradual manner. While the oil prices remained low – and the potential costs of BITs high – he would implement only minor reforms. When high oil prices made the costs of BITs affordable, in turn, he would proceed to his more radical, nationalistic measures. The BITs would also lead him to adjust his bargaining tactics during the negotiations, as he would need to give in to some of the companies in order to avoid arbitration. At the time of treaty signing, however, legislators seemed not to understand the importance of the treaties and their potential implications for future politics in the oil sector (interview with Mommer 2013). For example, legislative consideration of Venezuela's first ratified treaty, the Venezuela-Netherlands treaty, did not pay attention to the fact that Shell is a Dutch company (ibid.). As one of the largest petroleum multinationals of the world, Shell had a long trajectory in Venezuela (see, for example, Tinker Salas 2005). Consequently, one could have expected the company to come up in the discussions over a BIT with its home country. The lack of such discussion suggests that the legislators failed to understand the treaties' potential effects on future policies and reforms in the oil sector.

In reforming both the investment framework and the oil sector, the governments aimed to attract new foreign capital to Venezuela. Mommer takes the argument further and suggests that the reorganization of the investment structure and the reforms in the oil sector were actually driven by oil-importing states: in his view, the developed countries used BITs to embed the governance of oil into the overall investment regime at the global

[84] Venezuela also started BIT negotiations with 25 other countries but these negotiations have not been concluded (Tejera Pérez 2012, 37).

level (Mommer 2002, 79–80). In this way, Mommer argues, the oil importers diminished the bargaining power of individual oil exporting countries and limited their sovereignty over natural resources in the future (ibid.).[85] Even if one does not consider these two developments as closely related as Mommer does, it is undisputable that the Venezuelan *apertura* coincided with a rapid transformation in the international investment structure of the country, namely the adoption of BITs. The BITs, in turn, would influence greatly Chávez's nationalization process, as the following analysis will show.

As the millennium drew to its close and Chávez stepped into power, two key developments had taken place: the oil sector had gone through a major reorganization and the country had embraced the global legal investment regime. While Chávez would later invite some of the politicians and technocrats who had opposed BITs in the early 1990s into his government, the administration would not take any drastic steps to challenge the treaty regime. As this chapter will show, Chávez chose to comply with the system and, in fact, he signed four new treaties himself.[86] In other words, the dramatic shift from the Calvo Doctrine to the adoption of the global, neoliberal investment system in the 1990s would have long-term consequences for the future oil policies of the country, even if these far-reaching effects did not seem obvious to the politicians at the time. The remainder of this chapter will focus on evaluating what role BITs played in Chávez's nationalization process, and what allowed him to overstep them only about a decade after their adoption.

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[85] In the oil sector, the importer countries began to push for new types of contracts that would replace the old concessions and, importantly, these contracts included arbitration clauses (Mommer 2002, 79-80). This was the case with the contracts signed in Venezuela under *apertura*.

[86] These treaties were with countries that have not been traditionally important sources of FDI, namely Iran, Belarus, Russia, and Vietnam (Tejera Pérez 2012, 462–463). Moreover, Chávez decreed a new law in 1999 to protect and promote investment that offered both national and international firms access to international arbitration. Starting around 2005, this law became the subject of intense controversy due to its apparent embrace of international arbitration and it was later interpreted by the Supreme Court to deny foreigners the right to international arbitration (Tejera Pérez, 221-225).

Chávez Takes Power: The Imposition of "*Plena Soberanía Petrolera*"

When Chávez took office in 1999, the public had little information about his plans for the oil sector. Known to the masses for his failed coup attempt in 1992, Chávez was a true political outsider: he was a former military officer without any ties to the traditional, dominant parties. He campaigned on dramatic political changes, such as the eradication of the traditional parties and a new constitution (McCoy 1999, 65–66), but his economic proposals remained ambiguous throughout the campaign (Ellner 2001, 11; Corrales and Penfold-Becerra 2011, 50).

The first years of Chávez's government saw very little change in the economic sphere. After the election, Chávez expressed his commitment to the existing economic order by promising to maintain the IMF adjustment program and by carrying over the finance minister from the previous government (Corrales and Penfold-Becerra 2011, 51). Instead of economic reforms, he focused on reconfiguring political institutions, decreeing a referendum for a constituent assembly for April 1999. The resulting new constitution, adopted in December of the same year, changed the political landscape drastically, extending the presidential term from five to six years and increasing the executive's appointment power, for example. Despite the shake-up of political institutions, Chávez's economic policies remained moderate.

The new government seemed not to pursue change in the oil sector, either. However, Chávez's early foreign policy measures suggested an understanding of the importance of the natural resource for the country's economy. One of his first diplomatic initiatives was to embark on a string of visits to the member states of the Organization of Petroleum Exporting Countries (OPEC). During these visits, he called for the unification of OPEC and invited his fellow executives to a summit in Caracas, with the goal of strengthening the organization and driving up global petroleum prices. The meeting took place in September 2000 and it was a success: it led the oil producing countries to lower the production quotas and, consequently, engineer higher global prices (Hughes 2006). While analysts at the time did not seem alarmed by the changes, these visits to the OPEC nations and the summit seem to have marked a new direction for Venezuelan oil policy.

Despite his active role in reviving OPEC at the international level, Chávez did not implement any domestic oil reforms. He enacted the first change in the sector in November 2001, a little over a year after the OPEC summit, when he used presidential decree powers to pass the New Organic Hydrocarbon Law. The law established 51% state ownership in all hydrocarbon companies and it increased the government's tax take of all projects to 30%. Importantly, however, these changes were to apply only to new contracts (interview with Lameda Montero 2013). In other words, the measure did not violate the companies' rights. To reaffirm its good will and respect for the existing contracts, the government even granted the MNCs some formal and informal access to the preparation of the law (interview with Lawyer 1 in Venezuela 2013). The companies viewed the opportunity as a sign of moderation, even cooperation, on the part of the government and participated in the process quite actively (ibid.).[87]

Oil started to play a crucial role in the political conflict of the country soon after the issuance of the New Organic Hydrocarbon Law. In February 2002, PDVSA refused to accept a new board of directors that Chávez had appointed, considering the move an attack on the autonomy the firm had gained during the previous decades. The incumbent directors called a strike, followed by a coup in April 2002 and then a longer strike, *paro petrolero*, starting in December 2002. The strike failed after two months, leading Chávez

[87] According to the same lawyer, however, the companies later realized their participation had very little effect on the final law. Government representatives confirmed to this author that the law was well-developed before the process was opened up for consultation (interviews with Silva Calderón 2013; Lameda Montero 2013).

to fire PDVSA's top managers along with 18,000 other employees. This marked Chávez's victory over the PDVSA elite: by replacing opponents with allies, he took control of the centerpiece of the Venezuelan economy (Corrales and Penfold-Becerra 2011, 54).

Even though Chávez's actions early on in his term had not suggested dramatic changes in the sector, political conflicts between 2001 and 2003 transformed the relationship between PDVSA and the government in a profound manner. In about a year's time, the institutional insulation that PDVSA had obtained during the 1980s and 1990s was gone. As the government stacked the company with its own supporters, PDVSA returned to the hands of politicians. It was now the government, not PDVSA technocrats, who drove oil policy in the country.

While the conflict between the government and PDVSA played out between 2001 and 2003, the MNCs started to prepare for future challenges and changes in the sector. They notified the authorities of their discontent with the New Organic Hydrocarbon Law and pressured the government through their home country embassies (interview with Silva Calderón 2013). Since the government did not attack the companies or their existing contracts directly, however, there was not much more they could do.

Chávez shifted into higher gear in October 2004 when he announced his new oil program called *Plena Soberanía Petrolera*. He first raised the royalties on the extra-heavy oil projects from 1% to 16.67%.[88] While this was not a radical change, as the contracts already included a royalty increase in a few years time (Manzano and Monaldi 2010, 442), the companies nevertheless notified the government of their discontent (Boué 2013, 28). Additionally, two important multinationals operating in the country,

[88] For the public announcement of the measure on live television, see Gobierno Bolivariano de Venezuela and Ministerio del Poder Popular para la Comunicación y la Información (2007).

ExxonMobil and ConocoPhillips registered their projects in the Netherlands to gain the protection of the Netherlands-Venezuela BIT (ibid). Other firms followed suit, registering their projects in third-party countries to ensure legal protection (interview with Lawyer in the Ministry of Energy and Mines 2014).

As the companies prepared for future legal battles with their host, the government continued to dismantle the institutional framework its predecessors created during *apertura*. Between April 2006 and October 2007, the Chávez-dominated legislature first terminated the operating agreements and then forced the association agreements and risk exploration agreements in the Orinoco Belt into joint ventures. With the renegotiation of the contracts in the Orinoco region, which Chávez announced in February 2007 and finalized a few months later in June, the neoliberal reforms of the 1990s were reversed (Eljuri and Tejera Pérez 2008, 484–485). Most of the companies operating in the country found common ground with the state and decided to stay under the new contracts. However, ExxonMobil and ConocoPhillips did not agree with the government's demands and, consequently, they appealed to international arbitration bodies.[89]

By late 2007, the government had succeeded in overturning the institutional framework of *apertura*. Yet, in doing so, it had activated the arbitration mechanism of the global investment regime: two of the affected companies chose to pursue arbitration. What explains the government's behavior over the course of the nationalization process? Did Chávez take the expropriatory measures with a strategic mindset, planning and implementing the process in a calculating, rational manner? Or did he pursue state ownership over the sector out of ideology and radicalism, overlooking the costs of BITs?

[89] Italian oil firm Eni Dación also filed a case in ICSID over the renegotiation of its operational service agreement in early 2006. The company withdrew its case soon after, as will be discussed below. According to Cárdenas García (2011, 241), Total began arbitration proceedings as well, but settled the dispute quickly.

THE EMPIRICAL IMPLICATIONS OF THE ARGUMENTS

To assess the arguments in a systematic manner, I divide the nationalization process into three distinct stages. First, in the planning stage, the government focuses on evaluating its future measures and their consequences. At this point, the nationalizer's exact intentions are unknown to the public; while politicians may take some concrete measures in preparation of the upcoming nationalization, the companies and observers consider these measures non-expropriatory. In this planning stage of the process, BITs are usually not discussed in public, since the government has not yet violated the firms' property rights.

The second stage, the negotiation stage, begins when the government announces nationalization. At this stage, the state starts to implement the takeover, the companies respond to the state's measures, and the parties enter into negotiations about the multinationals' future in the country. If the negotiations proceed smoothly, the parties either agree on new contracts and the companies stay in the country, or the companies leave the country satisfied with the compensation offered for their losses. However, if the firms consider the government to have violated their property rights without appropriate compensation, they can invoke their BITs and begin international arbitration proceedings against the host. BITs usually become public knowledge at this point in time, as the press learns about the cases registered in different arbitration bodies.

During the third stage of the process, in the aftermath of nationalization, the parties proceed with arbitration and settle their disagreements. This stage is oftentimes the lengthiest part of the process: on average, arbitration takes 3.6 years (Sinclair, Fisher, and Macrory 2009, 1). The process begins when a company notifies the government of its intentions to invoke a BIT in a so-called "trigger letter." The letter starts a cooling-off period during which no arbitration proceedings take place and the parties are expected to find an amicable solution. The aftermath stage ends early if the government indemnifies the companies either during the cooling-off period or while the legal proceedings in the international arena are ongoing. If the parties do not reach such an early settlement, the process comes to an end when the tribunals publish their decisions and the government indemnifies the firms.[90]

As discussed in Chapter 2, the strategic theory and the competing, ideological argument offer different accounts of three aspects of nationalization: the causes behind the leader's decision to enact the expropriation, his mode of action throughout the process, and the timing of the events. By examining the government's behavior at each stage of the nationalization process – the planning, the implementation, and the aftermath stages – we can evaluate which argument does a better job in explaining these aspects of the Venezuelan hydrocarbon nationalization.

First, to evaluate the causes of nationalization, we have to focus on the planning stage of the process. Specifically, if the decision to nationalize was taken out of strategic considerations, the government would have spent plenty of time and energy to estimate future oil prices before acting. If and only if its projections suggested a significant continuing increase in prices, it would expect the gains of nationalization to overweigh the costs of BITs. As a consequence, BITs would not pose a threat to the nationalistic plans and the government would be motivated to overstep them. In essence, therefore, the increasing oil prices and the government's calculations on the basis of those prices trigger the nationalization of BIT-protected investment.

According to the competing argument, the government's leftist ideology would cause the nationalization. In this view, politicians are compelled to act out their ideology

[90] If a tribunal holds the government liable but the government refuses to comply, the company can seek to enforce the ruling in any signatory state of the New York Convention. If the government still declines to pay, and it has few commercial assets abroad, the firm has no further legal options available.

regardless of the consequences. This ideological commitment overrides the threat of expensive arbitration processes and causes the leaders to ignore the potential costs of BITs. Consequently, an ideologically acting government would not be concerned about the treaties and their future consequences at the planning stage of the process. Instead, the leader's nationalistic goals would induce him to disregard the costs of the treaties.

Second, the two arguments expect the government to pursue nationalization in different ways, once it has announced its plans and the negotiation phase of the process begins. The strategic argument expects the government to work actively to minimize the costs of BITs. In particular, it should employ different bargaining tools to convince the companies to agree to the new contract terms or to the government-proposed compensation. This is because a strategic leader understands the price of a lengthy arbitration process and the ensuing costs of indemnification. To bring down the number of contested cases and, consequently, the overall costs of the nationalization process to the state, a strategically acting executive would be willing to sit down and negotiate with the companies. This stage of the process should thus be characterized by intense negotiations in which the government tries to discourage the firms' legal appeals by offering them incentives to agree to the offered compensation.

Moreover, in the aftermath of nationalization, a calculating, strategic government should follow through with the final compensation to the multinationals. Indemnification can take place either immediately after the nationalistic measures or following an international arbitration process, as discussed above. If a third-party arbitration body ordered the compensation, a strategic politician would not be surprised by the outcome. In fact, state officials and technocrats may have included an estimation of these final expenditures in their initial nationalization plan to begin with. Consequently, they would be eager to end the process, honor the arbitration rulings, and pay the compensation amounts stipulated.

The ideological argument would predict different behavior both during the negotiations and in the aftermath of the process. At the negotiation stage, an ideological government would not express such concern for BITs. Instead of compromising with the companies and pressuring them to avoid lengthy arbitrations, an ideologically acting government would push through its nationalistic reforms unhindered, regardless of the future costs of arbitration. In fact, the government might not be willing to negotiate its terms at all. Like the planning stage, this stage would thus be marked by the government's disregard of the global investment regime and its rules.

In the aftermath, an ideological politician would ignore the arbitration process and the ensuing rulings. First, an ideologically acting nationalizer would not spend considerable time and effort on its legal defense. In fact, the arbitration processes might offer the leader an opportunity for some rhetorical fireworks by trying to persuade the domestic and international audience of the injustices of the neoliberal investment system. Second, when the tribunals publish their decisions, the nationalizer would not fear the long-term costs of noncompliance. Instead, he would retain his intransigent position and disregard the final awards, refusing to pay up.

Finally, power struggles within the government during the different stages can offer evidence for either of the arguments. Since the government is still deliberating on its exact course of action, some politicians might oppose a certain mode of action and advocate for the alternative route instead. If such internal debates become public, they can shed light on the governmental decision-making process and allow us to determine the leader's preferred mode of action. However, given the highly centralized decision-making procedure in the Chávez government (López Maya 2014, 68), we are unlikely to find much evidence for such infighting in Venezuela. The Bolivian case discussed in Chapter 5 will analyze these inter-governmental conflicts in detail.

Third, the arguments also expect leaders to time their nationalistic actions differently. As the discussion above on the causes of nationalization suggests, a strategic executive follows global commodity prices: he or she will act when projections indicate that a continuing future price increase will make the costs of BITs affordable. An ideological president, in contrast, would not be equally concerned about the international market conditions. Rather, he would be more likely to push the takeovers through right after gaining office. This is because an ideological president should prioritize his ideological goals over practical considerations, such as the security of his office or the economic costs and benefits of his actions.

The following section assesses how well the arguments explain the causes behind Chávez's decision to pursue nationalization, his mode of action throughout the process, and, finally, his timing. The analysis of each aspect begins with a discussion of the ideological argument and continues with an examination of the evidence for the strategic argument. The discussion concludes that the strategic theory does a better job in explaining the events in Venezuela than the competing, ideological theory.

ASSESSING THE ARGUMENTS: WHAT CAUSES LEADERS TO PROCEED WITH NATIONALIZATION?

The government's level of preparation for BITs in the planning stage of the process helps us evaluate whether the causes of nationalization lay in Chávez's ideology or strategy. As described above, ideologically operating politicians would neglect the consequences of the treaties in the early stages, as their future costs would be irrelevant compared to the nationalistic goals. Against these predictions, the planning stage in Venezuela was marked by notable preparation and readiness for the treaties on the part of the government. In fact, Chávez started to anticipate future law suits already in 2004 (Guerrero-Rocca 2013, 89), and his technocrats received advice from American experts on international arbitration early on in the process (interview with Lawyer 2 in Venezuela 2013, 2). This suggests that Chávez acknowledged the importance of the treaties from the very beginning and prepared for their consequences in a rigorous manner.

Since the behavior of the Venezuelan government does not conform to the expectations of the ideological argument, the strategic argument may offer a more satisfactory account. To evaluate the accuracy of my theory, we need to first establish the government's expectations of future oil prices at the onset of the nationalization process. According to my theory, leaders overstep BITs when they consider the treaties' future costs as small compared to the gains of nationalization. More specifically, nationalizing politicians trust that an increasing oil price will multiply state revenue and make any future compensation affordable. Since Chávez took his first expropriatory measure in the sector in October 2004, we should find evidence that the government projected an upward trend in oil prices earlier that year, before he announced his nationalistic measures.

While little public information exists on governmental estimates of oil prices in Venezuela, the government budget sheds some light on these expectations. According to the constitution, the executive branch is in charge of the oil price projections in the budget proposal, which it submits to the legislature in June of the previous year (Puente et al. 2006, 21).[91] Table 5 presents these oil price estimates since 1999. In June 2004 Chávez predicted the price to increase 24% from 18.5 $/barrel in 2004 to 23 $/barrel in

[91] It is important to note that the oil price estimations in the budget are often manipulated for political purposes (Puente et al. 2006, 13–14, 23). In particular, the government has strong incentives to underestimate the price because this can maximize the amount of funds available for discretionary government spending the ensuing year.

2005. The predicted increase is quite dramatic, considering that the year before the government had projected the price to increase less than 3%. This confirms that the government clearly had an optimistic outlook for the sector in mid-2004, expecting a notable increase in the oil price. Since these projections were made only a few months before the beginning of the nationalization process in October 2004, they offer support for the strategic argument: Chávez started to implement the expropriatory measures with the expectation that oil prices would increase in the near future.

Table 5: Estimated oil prices in the government budget in Venezuela

Year	**Estimated price per oil barrel (US$/B)**	**Percentage increase in estimated price**
2000	15	
2001	20	33.3
2002	18.5	-7.5
2003	18	-2.7
2004	18.5	2.7
2005	23	24.3
2006	26	13.0
2007	29	11.5
2008	35	20.7
2009	60	71.4
2010	40	-33.3

Source: Medrano Caviedes (2015, 162)

Importantly, the government's price projections remained high until the end of the negotiation stage of nationalization. In the 2006 budget proposal, the government estimated a 13% price increase, and for 2007, the final year of the reforms, the expected increase was 11.5%. The budgets for the two years following nationalization included positive price trends as well, as Table 5 illustrates. This indicates that the government expected oil prices to increase after each nationalistic measure it took. If the government's expectations were to come true, expropriation would end up being profitable: the potential compensation for the affected firms would be calculated on the basis of a relatively low oil price when compared to the profits the government would be cashing in thanks to the nationalization.[92]

Examining real oil prices over time is, of course, less telling, since the nationalizers took their decisions without the information at the time. A *post hoc* analysis of price developments certainly makes an optimistic outlook in late 2004 plausible: the crude oil price increased dramatically starting in mid-2004. By the end of the year, the value of a barrel had almost doubled from the value of the year before (U.S. Energy Information Administration 2006). Figure 8 presents the development of the world crude price and the government's expectations of the price as documented in the budget. The clear upward trend both in the price and the estimations since 2003 suggests that the government started to implement its measures at an opportune economic moment.[93]

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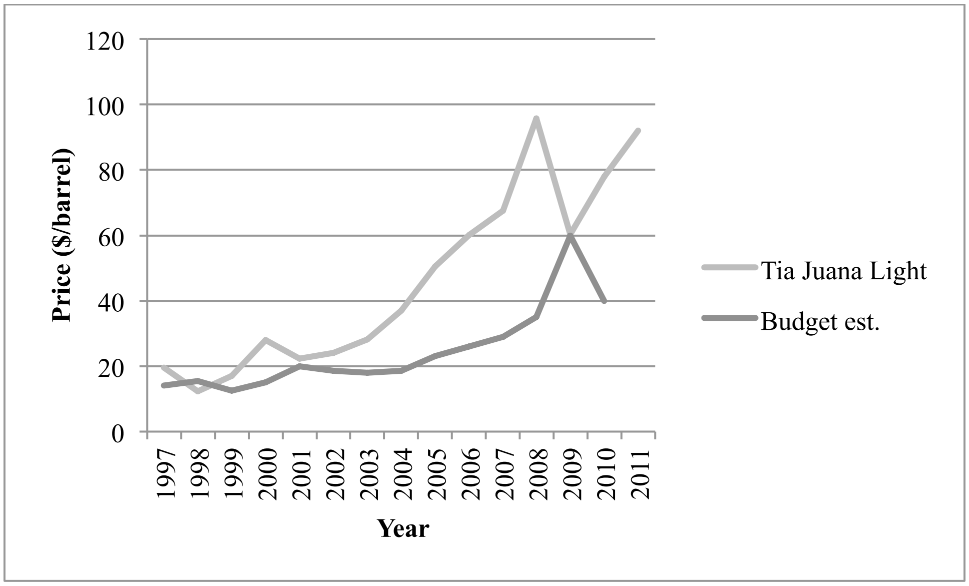
[92] In 2001, in contrast, the price increase was most likely deemed as a one-time peak rather than a longer-term development, since the price projections were negative in the two ensuing years. Usually, the global commodity boom is considered to have begun around 2002 (see, for example, Conceição and Marone 2008, 5), well after the Chávez government's estimates for 2001.

[93] The graph also highlights how the Venezuelan government tends to deliberately underestimate oil price in budget to have more revenue for discretionary spending (see footnote 74, and Puente et al. 2006, 13–14, 23).

Figure 8: Average spot price for Venezuelan Tia Juana Light crude and its estimations in the Venezuelan budget



Sources: Energy Information Administration (2011), Medrano Caviedes (2015, 162)

It is important to note that the government was not only the passive benefactor of global market forces, but actively manipulated the world price in its favor. As discussed above, Chávez started to tour the OPEC member states soon after taking office, meeting with the executives of OPEC countries in the Middle East and promoting a stronger, more disciplined organization. With a renewed OPEC in mind, he invited the heads of state to Caracas in September 2000. This meeting – the first of its kind since 1975 – succeeded in decreasing the production quotas and, consequently, increasing global prices (Hughes 2006).

Chávez's purposeful actions to increase the oil price offer support for the strategic argument. In a sense, Chávez paved the way for higher oil prices by leading the OPEC members to lower their production quotas. Understanding the importance of an increasing price for the profitability of the nationalization process, he did what he could to set the prices on an up-ward trend.

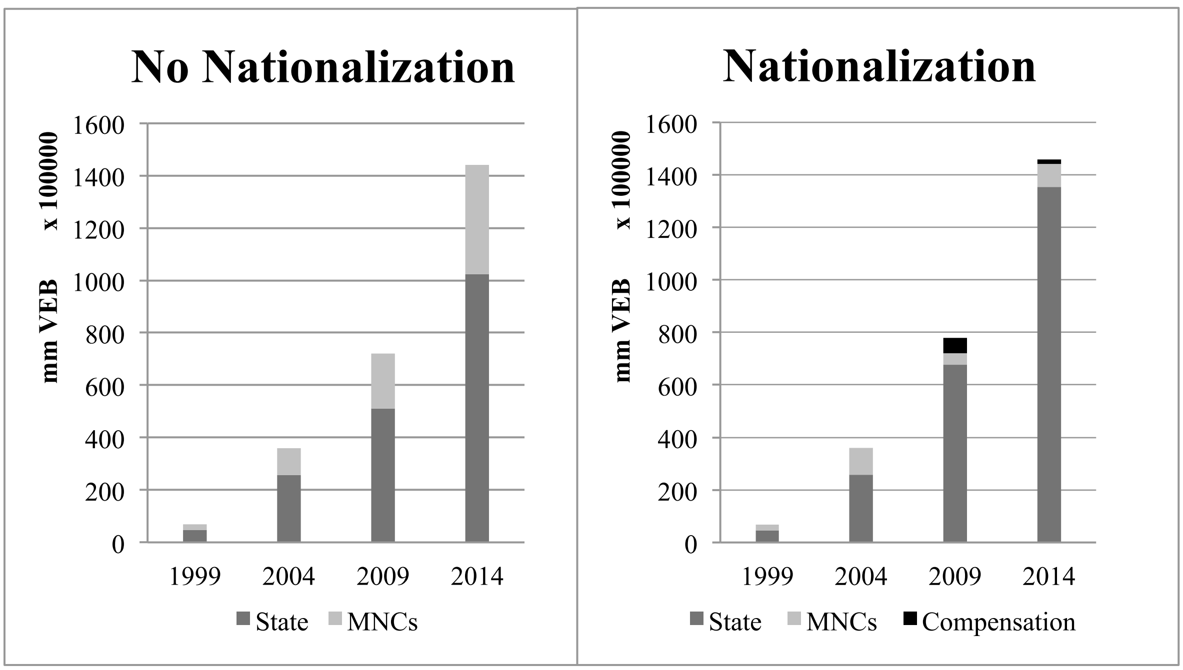
The significance of a more disciplined OPEC – and Chávez's role in steering the organization in that direction – only becomes clear after the government started the nationalization process. In 2004, the year Chávez took the first expropriatory measures, oil minister Alí Rodríguez Araque told *Le Monde diplomatique* that the OPEC quotas and stabilization of oil prices had been a central focus for Chávez already in 1999 (Rodríguez Araque 2004, 32). Rodríguez Araque gave his testimony to the press well before the economic success of Chávez's nationalistic measures had become evident. It is thus quite likely that he offered more of an honest account of the events rather than trying to claim credit for the successes *post-hoc*. This offers yet another piece of evidence for Chávez's strategic mode of action in the early stages of the nationalization process. In particular, it suggests that Chávez had not simply waited for opportune conditions to nationalize. Instead, as his active promotion for a more disciplined OPEC indicates, he worked hard to create a favorable setting for the future nationalization process. This attempt to influence the world oil price offers additional evidence for the argument that Chávez acted in a strategic, calculating manner, rather than ideologically, when planning expropriation.

Figure 9 reconstructs the economic calculation that explains the government's nationalistic measures starting in October 2004. The government knew that under a steady price increase, even if some companies would be awarded full compensation for their losses in 2009,[94] the price increase between the nationalistic measures and compensation in 2009 would cover the expenditures; the state's share of oil income in 2009 (colored in darker gray), is greater than the companies' share in 2003, the year before the measures (colored in lighter gray). If the price continued to increase, the gains

[94] As noted the above, the average length of ICSID arbitration is 3.6 years, excluding the cooling-off period. (Sinclair, Fisher, and Macrory 2009, 1) Given the complexity of the hydrocarbon sector, an estimation of five years is more appropriate.

of nationalization by 2014 would make up for the compensation paid in 2009, as exemplified by the last bar in the graph. If the arbitration panels determined that the government had to indemnify the firms, the compensation would amount to the profits the firms would have gained in 2004. This compensation, colored in black, is clearly less than what the companies would have received without nationalization. The government's decision to nationalize thus reflects a rational expectation about high economic gains of nationalization versus the cost of BITs.[95]

Figure 9: Expected distribution of net oil income between the Venezuelan state and MNCs



Sources: Rodríguez Sosa and Rodríguez Pardo (2012), Ministerio del Poder Popular del Petróleo y Minería (2012), author's own calculations[96]

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[95] Manzano and Monaldi (2010, 444–451) examine the economic situation of the sector post-reform, concluding also that the legal costs seem not to have been high enough to prevent contract breach.

[96] The values for 1999 and 2004 are calculated by Rodríguez Sosa and Rodríguez Pardo (2012, 104) on the basis of *Petróleo Y Otros Datos Estadísticos* (Caracas: Ministerio del Poder Popular del Petróleo y Minería, various years). The expected net profit in 2009 is twice the observed profit in 2004, and the expected profit in 2014 is twice the expected profit in 2009. This is a reasonable assumption about the government's expectations, given that net profits had increased more than five-fold between 1999 and 2004. The

Interviews with key technocrats support the interpretation that the dramatic price increase allowed the government to take nationalistic measures and overstep the treaties. Álvaro Silva Calderón, the main designer of the New Organic Hydrocarbon Law, acknowledges that the law was moderate compared to the changes starting in 2004 (interview with Silva Calderón 2013). According to him, major changes were not feasible earlier because of low oil prices and the intense domestic political conflict (ibid.). Bernard Mommer, who was in charge of the contract negotiations with the companies, offers a similar assessment, confirming that reforms were only possible after the oil price started increasing in 2004 (interview with Mommer 2013).

Finally, for the strategic argument to explain the decision to pursue nationalistic goals, we also need to establish that the government was aware of BITs and prepared for the treaties' consequences before initiating nationalistic measures. This would imply that the government took the decision to expropriate with the full knowledge of the future compensation that BITs may stipulate.

The Venezuelan technocratic team was, in fact, very knowledgeable about the treaties. The first oil minister Rodríguez Araque and his successor Silva Calderón had opposed the treaties already in the 1990s. At the time, when the treaties were signed and ratified, Silva Calderón chaired the international treaties subcommittee in Congress. In this position, he helped to cancel Venezuela's first BIT, the Venezuela-Italy BIT. He argued that the treaty favored foreign over domestic investors and it could force the state into arbitration in the future. For these reasons, he recommended the foreign relations committee reconsider the Venezuela-Italy agreement, signed by the executive in 1990.

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government's share of the profits after the nationalization is set to 94%, following the example of the 1976 oil nationalization. While Chávez's reforms did not lead to an equally high government take, they came close in 2007 with a government take of 93% (Rodríguez Sosa and Rodríguez Pardo 2012, 104). As shown in Chapter 2, the logic holds also when the government plans to take over the entire sector.

The committee did so and, eventually, the Congress declined to ratify the treaty (Tejera Pérez 2012, 38–53).[97] Silva Calderón objected to the ensuing BITs as well, on the basis of the same arguments, but could not stop the ratification process (interview with Silva Calderón 2013).

The team's expertise did not rest solely on Silva Calderón's knowledge of BITs; Mommer had also opposed the treaties since the 1990s. His opposition is recorded in his academic work, in which he argues that the "bilateral and multilateral 'investment' treaties represent the negation of 'permanent sovereignty of natural resources' and, more specifically, of OPEC's basic principles" (Mommer 2002, 150). Overall, then, people who knew the treaties and their consequences well planned the Venezuelan nationalization process. It is reasonable to assume that these politicians and technocrats used their expertise and took the treaties into account when crafting nationalistic measures.

The government also received legal counsel from experts of international arbitration in the planning stage, again implying that the treaties were considered well before the enactment of expropriation. In 2004, Chávez had already formed a legal team to defend the state against the companies (Guerrero-Rocca 2013, 89). To prepare for future claims, the team hired a U.S. law firm that specializes in investment arbitration (interview with Lawyer 2 in Venezuela 2013, 2). This precaution suggests that the technocrats understood the future consequences of BITs before choosing to violate any property rights.

To conclude, an analysis of the planning stage period offers support for the strategic, rather than the ideological argument. The government estimated in 2004 that

[97] For some of Silva Calderón's deliberations in the legislature, see Congress of the Republic of Venezuela (1991, 831–832).

the oil price would continue its increase in the future: in June 2004, a few months before the first nationalistic measure, the government projected a 24% price increase for the coming year. Interestingly, the government had worked actively to create such opportune economic conditions for its actions: the OPEC meeting Chávez coordinated in Caracas in 2000 was crucial in restoring discipline in the organization, leading to tighter production quotas and, consequently, to higher world prices. The government officials also knew BITs and their potential costs, as evidenced by various members of Chávez's oil team's vocal opposition to the treaties in the early 1990s, and the employment of an American law firm that specializes in the topic. Expecting opportune price development in the future, and prepared for the legal consequences of BITs, the government began the implementation of the nationalization in October 2004.

ASSESSING THE ARGUMENTS: IN WHAT WAY DOES THE LEADER PURSUE NATIONALIZATION?

When the government enacts nationalization and the negotiations between the parties begin, the ideological and strategic arguments predict the process to advance in different ways. The ideological argument anticipates hostility towards the global investment system on the part of the government, together with unyielding behavior at the negotiation table and unwillingness to negotiate at all, even when faced with the threat of arbitration. The discussion below will show that Chávez's behavior does not correspond to these predictions. First of all, his government was willing to compromise with the companies in the negotiations and, in fact, it encouraged some companies to drop their arbitration cases in exchange for new exploration rights. This indicates that the politicians did not challenge the firms' right to move the dispute on to the legal front and they were willing to bend in front of the threat of arbitration.

Second, the government did not challenge the investment regime as such. To be clear, Chávez did take some measures against the regime: he started the process of terminating Venezuela's BIT with the Netherlands in April 2008 and withdrew from ICSID in January 2012. Overall, however, the government did not seem opposed to the investment regime: Chávez in fact signed four new BITs,[98] and he advocated for a new arbitration center hosted by the new regional organization *Unión de Naciones Suramericanas* (UNASUR). Therefore, rather than opposing the international investment regime out of principle and refusing to acknowledge the firms' rights stipulated in BITs, the government was realistic about the consequences of its actions and pursued the negotiations in a much more flexible manner than the ideological argument would have predicted.

The strategic argument, in contrast, expects the government to maintain a calculating, rational approach throughout the nationalization process. Cognizant of the economic price of lengthy arbitration cases, strategic politicians would encourage companies to agree with the government's terms in the negotiation stage, rather than take the dispute to international legal forums and, in this way, create additional legal expenditures for the state in the longer term. In short, the government's overall behavior in the midst of the nationalistic reforms should be characterized by its willingness to sit down at the negotiation table with the companies and its ability to find compromises with them.

The negotiation stage began in Venezuela in October 2004 when Chávez announced the basics of his oil and gas policy, *Plena Soberanía Petrolera*. As discussed above, his first nationalistic measure, the tax hike in some of the projects in the Orinoco

[98] The new BITs signed and ratified under Chávez were with Iran, Belarus, Vietnam, and Russia.

Belt, was not a radical measure. However, in the ensuing months the government started to tighten the screws on the multinationals. In mid-2005, taxes on additional projects were increased and companies were cited for tax violations and overproduction (Manzano and Monaldi 2010, 442).[99] About a year later, the Chávez-controlled legislature terminated some of the existing contracts. The vast majority of the firms went along with these reforms and accepted the new terms the government was setting.[100]

The period of amicable settlements seemed to come to an end in early 2007, when the most intense period of negotiations began. In February 2007, Chávez ordered the association agreements and risk exploration agreements in Orinoco to conform to the new laws in the sector, despite the earlier promise not to apply these laws retroactively (interview with Lameda Montero 2013). This so-called "migration" of the existing contracts to the new institutional framework was to be finished in four month's time, and the government's end game was to increase state participation in all projects to at least 60% (Eljuri and Tejera Pérez 2008, 483). Again, most firms accepted the new terms. However, ExxonMobil and ConocoPhillips failed to find an agreement with the state, left the country, and commenced arbitration proceedings.

If Chávez's nationalization team acted strategically during this negotiation stage, we should find evidence for its attempts to sway the companies to agree to the new contractual terms rather than pursue arbitration. The team seems to have acted in line with this expectation, utilizing both positive and negative bargaining tactics in its meetings with the multinationals. Specifically, the global importance of the Venezuelan oil reserves in Orinoco gave the government an important bargaining tool, as any

[99] Specifically, the government increased the taxes in the OSAs and AAs.

[100] The National Assembly terminated the OSAs in April 2006. On the basis of this measure, Eni Dación commenced arbitration proceedings in ICSID and ExxonMobil sold its minority stake to Repsol. All other companies agreed to the government's new terms.

company with existing operations in the country would wish to have access to these reserves. The state did not hesitate to use this bait to its advantage in the negotiations. According to a private lawyer in the sector, government officials offered access to Orinoco as a carrot: by agreeing to the new terms and foregoing arbitration, the companies would be rewarded with new exploration and extraction areas in the Belt (interview with Lawyer 2 in Venezuela 2013). Another lawyer stated that the government persuaded Eni to drop its arbitration case in ICSID by offering it access to Orinoco (interview with Lawyer 4 in Venezuela 2013).[101]

The government also used access to the Orinoco Belt as a negative inducement: by challenging the state in international arbitration, the government threatened, a company could lose its future stake in the region. As a private lawyer who advised a multinational in the process noted, the government negotiators said, "go ahead, sue me in ICSID… but if you do, you can forget about Orinoco!" (interview with Lawyer 3 in Venezuela 2013). By using the Orinoco Belt as a bargaining chip at the negotiation table, the government revealed that it was willing to offer the companies specific economic rewards in exchange for their agreement to the new contracts. In this way, the policy-makers were acting strategically, aiming to discourage the companies from pursuing arbitration and minimizing the costs that the state incurred during the nationalization process.[102]

The government also utilized negative pressure tactics in the negotiations. These were most evident during the migration process in 2007. A representative of an oil multinational in Caracas characterized these meetings as "tough and intense" (interview

[101] Officially, Eni Dación requested the discontinuance of the ICSID proceedings on April 4, 2008. It had initiated the case on the basis of the cancellation of its OSA in April 2006.

[102] For a similar argument regarding the state's willingness to negotiate with the companies, see Guerrero-Rocca (2013, 91).

with Representative of a hydrocarbon MNC in Venezuela 2013). He recalls a particular incident in which the government representative, usually known for his highly technical position in the negotiations, lost his temper, stood up, and started to "shout that we the companies were abusing them" (ibid.). On some occasions, the government even prevented the companies' outside legal counsels from entering the meeting rooms (Guerrero-Rocca 2013, 83).

Finally, in addition to the state's hawkish behavior, the migration process was characterized by short timelines – another pressure tactic to push the companies to accept the new terms (Guerrero-Rocca 2013, 83). A private lawyer describes the interaction between the firms and the state as follows:

> (…) I would say that, in spite of being 'sophisticated' negotiations to some extent, nevertheless, they were conducted under pressure and in an unfriendly atmosphere (…) In sum, the negotiation process, albeit sophisticated to some extent, was also harsh, rushed, unfair, and unbalanced. (cited in ibid.)

Overall, the government's behavior during the negotiation stage suggests that it acted in a strategic manner. Instead of imposing its reforms on the multinationals, the state was willing to sit down with them and tried to find satisfactory agreements. The officials used the valuable resources in the Orinoco Belt as a bargaining chip: by agreeing to the new terms, the companies were promised access to Orinoco in the future. The Orinoco resources were used as a pressure tool, as well, as the state officials told the firms that an international arbitration case would cost their stake in the area. Importantly, while the state was not afraid of threatening the companies at times and assuming an intransigent posture, these instances seem to have served a strategic purpose in particular meetings. Rather than seeking conflict and pushing the reforms through in an inflexible manner, the policy-makers aimed to induce the companies to accept the new terms without international arbitration.

To conclude, the negotiation period offers ample evidence for the strategic argument. As the expropriatory reforms were implemented, the government utilized skillful bargaining tools to lower the future costs of BITs. By offering the companies positive and negative incentives in the negotiations, Chávez encouraged the multinationals to compromise and stay in the country, rather than seek third-party arbitration. In this way, he attempted to maximize the gains of nationalization by minimizing the costs of international arbitration and compensation – a behavior that conforms to the expectations of the strategic argument.

The Aftermath of Nationalization (October 2007 – present): Respecting the Rulings

In the aftermath of nationalization, a government pursuing nationalization in a radical, impetuous manner would challenge the investment regime and assume the costs of such actions proudly. However, Chávez's behavior in this last stage does not indicate such defiance of the arbitration system. In fact, when the international panels rendered their final rulings, the government complied with them in a speedy manner. Chávez even declared his compliance with the system publicly in 2012, as described below. By accepting the decisions and paying the compensation, the government proved its acquiescence with the rules of the investment regime – and refuted the argument that the nationalization was conducted in an ideological way.

The strategic argument, in contrast, predicts high levels of compliance with the final arbitration rulings. If the government acted strategically and followed a carefully crafted plan throughout nationalization, the compensation demands, the arbitration claims and the final rulings would not come as a surprise. In fact, the government would be prepared for these consequences of BITs, and be willing to both engage the companies on the legal front and pay the final awards.

The key cases for detecting Venezuela's behavior in the aftermath of the nationalization process are those of ExxonMobil and ConocoPhillips. In addition to these two firms, at least two other oil companies challenged Venezuela in international legal forums: Eni Dación started proceedings in ICSID in February 2007 and Opic Karinum filed a case in the same venue in 2010.[103] However, these cases of Eni Dación and Opic Karinum were small compared to the claims of ExxonMobil and ConocoPhillips: in the words of Juan Carlos Boué (2013, 17), the initial compensation ExxonMobil demanded, $10 billion,[104] was so high that it could have easily "brought PDVSA to its knees had it been successful." ExxonMobil and ConocoPhillips were thus by far the most significant legal challenges the Venezuelan government faced in the aftermath of nationalization. Moreover, the two firms pursued an aggressive publicity strategy alongside their legal claims. This has led to a significant paper trail of court documents and press releases, which is oftentimes rare in the secretive world of international arbitration.[105] Given the economic relevance of the two companies, and the availability of information, these cases serve as a valuable lens for understanding Chávez's behavior in the aftermath of nationalization.

ExxonMobil and ConocoPhillips began their legal counterattack against Venezuela in 2007, after failing to agree on the new terms of five projects during the migration process.[106] Both companies filed a case in ICSID, ExxonMobil in October

[103] ICSID registered the Eni Dación vs. Venezuela case on February 6, 2007, and the parties settled about a year later, on April 18, 2008. The Opic Karinum case was registered on June 16, 2010, and the final ruling was rendered on May 28, 2013.

[104] More specifically, ExxonMobil claimed that its "cumulative damages exceed US$ 10 billion, before any discounting to present value" and excluding interest (International Court of Arbitration 2012, 28).

[105] For a detailed list of the court documents on the ExxonMobil and ConocoPhillips cases, see Boué 2013 (4–6).

[106] ConocoPhillips disputed projects Petrozuata, Hamaca (or Ameriven), and Corocoro; ExxonMobil Cerro Negro and La Ceiba projects. Petrozuata, Hamaca and Cerro Negro produced, transported and upgraded the extra-heavy crude from the Orinoco Belt. La Ceiba and Corocoro encaged in conventional oil and gas exploration and production. (Boué 2013, 7)

2007 and ConocoPhillips soon after in December of the same year.[107] A few weeks later, in January 2008, ExxonMobil also filed a contractual arbitration case against PDVSA in the International Chamber of Commerce (ICC); ConocoPhillips again followed suit in December 2009.[108] In February 2008, ExxonMobil went even further and attained court orders in the UK, the Netherlands, and the Netherlands Antilles to freeze $12 billion in PDVSA's worldwide assets (*Associated Press* 2008). According to ExxonMobil's press release, the measure was taken to prevent PDVSA from dissipating its assets. However, a U.K. court reversed this move about a month later (*El Universal* 2008). In sum, the aftermath of the Venezuelan nationalization process was characterized by four important legal cases: two raised by ExxonMobil and two by ConocoPhillips. The former's early measure to hold Venezuelan assets abroad through a British court order was cancelled relatively quickly in 2008 and, consequently, the asset hold-up can be seen as a minor incident.[109]

As the firms filed their cases in the arbitration tribunals, the Venezuelan government responded by building up a skillful defense team and adopting an overarching strategy for the cases. Observers had expected the government to be ill-prepared and inefficient in the international legal arena (Guerrero-Rocca 2013, 88). Instead, the government surprised the companies with a high-quality defense. It brought together a group of Venezuelan lawyers and professionals, and it also consulted with an American law firm on the topic. The team pursued a long-term strategy that faced all the

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[107] Both companies invoked the Venezuela-Netherlands BIT.

[108] These cases relate to the claimed contractual violations of PDVSA, whereas the ICSID cases focus on Venezuela's claimed violation of a BIT. The cases of contract violation are included here in the discussion, as the government's compliance with them indicates overall knowledge of the international investment regime and willingness to comply with it. While these cases are different from those in the ICSID tribunals, the Venezuelan government used the same legal team in both forums.

[109] It is important to note that this measure was extremely aggressive and it clearly soured the relations between ExxonMobil and the government. In fact, it may have been the key factor that made an early settlement between the parties impossible (*El Universal* 2008).

arbitration cases as a whole, rather than tackling the cases one by one, in an *ad hoc* manner. More specifically, the government took advantage of the complexities of the international arbitration system and its loopholes. For example, it filed a multitude of different petitions repeatedly aiming to prolong the proceedings. Overall, then, the Venezuelan government embraced the final stage of the process with professionalism and energy: rather than responding to the claims in a nonchalant manner, Chávez formed a skillful defense team to face the companies in the tribunals (ibid.).

The state's behavior in the international legal arena indicates that it was very much willing to embrace the international investment system. In this sense, it acted as the strategic argument predicts, facing the companies on the legal front in a pragmatic manner and mounting a serious defense against the firms' claims. A final question concerns the government's actions once the aftermath of the nationalization process came to an end. Did the government also uphold its calculating, rational strategy when the arbitration decisions were announced?

The first ruling in the oil sector was rendered in December 2011, and it proved the effectiveness of Venezuela's defense strategy. The ICC awarded ExxonMobil $908 million for damages – much less than the $10 billion compensation the company had originally sought. Consequently, Chávez celebrated the arbitration outcome as a victory, telling the press that "the ICC only awarded Exxon ten per cent of what they wanted. You can make your own conclusions" (Arsenault 2012). The ICC's verdict on the case ConocoPhillips versus PDVSA followed in September 2012, when the arbitrators obligated Venezuela to pay the company $66.8 million. The outcome was again considered favorable to the state, since the tribunal rejected ConocoPhillips' separate claim for $102.9 million.[110] Considering the government's careful preparation for the cases, the outcomes were not surprising: by the time the rulings were rendered, the government lawyers and technocrats had worked on the state's defense for years and, in this sense, the rulings validated their work.

Evidence suggests that Chávez complied with the ICC rulings and paid the compensation amounts ruled by the arbitrators. After the ExxonMobil decision, the government stipulated that it has "always indicated that it is willing to compensate investors for decisions made in the strategic interest of the country" (Crooks and Rodriguez Pons 2012). Later that year, the government confirmed to have completed the payment (Pitts and Crooks 2014). In interviews with this author, various private lawyers also reported that Venezuela paid the ICC awards quickly, gaining a reputation as a compliant state (interviews with Lawyer 2 in Venezuela 2013; Lawyer 6 2013). One lawyer even went as far as praising Venezuela for respecting the rules of the game in the aftermath of nationalization (interview with Lawyer 6 2013). In short, Venezuela's aggressive legal defense strategy seems to have been followed by a prompt settlement of the compensation.

While one of the ICSID cases is still ongoing and the final outcome of the other has barely been published, the cases seem to follow the pattern of the ICC cases. The ICSID tribunal announced its ruling on the ExxonMobil case in October 2014. Again, the final compensation, $1.6 billion, was much lower than the firm originally demanded (Pitts and Crooks 2014). Unlike before, the Venezuelan government asked for a revision of the award soon after. Analysts explained this move – fully allowed in the rules of international arbitration but a deviation from the previous behavior characterized by

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[110] This separate case was for losses the company claimed to have accrued due to the OPEC cuts in its Hamaca project (*Bloomberg* 2012).

quick payment – with the government's serious liquidity problems at the time (ibid.). Even during economic hardship, therefore, Venezuela seems to be following the rules of the game rather than ignore the rulings altogether. Even though ICSID has not ruled on the ConocoPhillips case as of July 2015, the government's behavior in the three finalized cases suggest high levels of compliance with the international investment regime. In other words, after embracing the arbitration process as the cases piled up, the state followed through the process by clearing the compensation demands the tribunals confirmed.[111]

To conclude, the Chávez government proceeded in the aftermath of nationalization in an equally calculated manner as during the negotiation phase. It mounted a highly professional group of technocrats for its defense, spending plenty of time and effort to respond to the claims. In other words, the government defended itself in all seriousness, playing according to the rules of the international investment regime. Moreover, the government complied with the arbitration process after the announcement of the final awards. This suggests that Chávez's team knew the costs of BITs in advance and was ready to pay them when the time came. By preparing carefully for the legal cases and by complying with the final outcomes, the government acted in a strategic, calculating manner. Rather than protesting against the international arbitration system, the government carried out the consequences of its actions.

ASSESSING THE ARGUMENTS: THE TIMING OF THE EVENTS

Finally, the ideological and strategic arguments expect leaders to time their nationalistic actions differently. An ideological leader is likely to start acting soon after

[111] Venezuela's withdrawal from ICSID in 2012 does not affect the cases that were initiated before the date of denunciation (UNCTAD 2010, 5). Legal experts have not reached consensus over the possibility of starting arbitration proceedings after the denunciation is made official (ibid.).

reaching power. This is because ideological leaders are relatively less concerned about practical issues, such as their survival in office or the economic costs of their actions. Rather, they prioritize their ideological goals and are eager to go after those goals as soon as possible. Consequently, had the Venezuelan government pursued nationalization in an impulsive, ideological manner, we would expect the implementation to begin once Chávez had either stepped into office or consolidated his power.

Contrary to the predictions of the ideological argument, Chávez did not seek nationalization as soon as his position in power would have allowed him to. As mentioned above, he took office in February 1999 – yet he began to implement the nationalization in a gradual manner only in late 2004, saving the more radical measures for 2006 and 2007. To be fair though, the political situation in Venezuela turned extremely complicated between Chávez's first two years in office and his first nationalistic oil reform in October 2004, including the coup of 2003. However, some experts view that he had gained a strong position in power already by late 2000, after winning the elections in July and receiving extensive decree powers in November (Martínez Meucci 2012, 41–42). If he was acting ideologically, he could have tried to capitalize on this situation immediately.

According to the strategic argument, in contrast, leaders pursue nationalization when the economic conditions are opportune, independently of their time in office. The events in Venezuela offer stronger support for this argument than the ideological one. As discussed earlier in this chapter, the Chávez government projected a dramatic oil price increase from 2004 and 2005. In July 2004, the government had estimated a price hike of 2.7%, whereas a year later, a few months before the beginning of the implementation stage of nationalization, that estimation was almost 22 percentage points higher (Medrano Caviedes 2015, 162)! While the price increased also in 2001, as Table 5 shows, this seemed temporary at the time: the price estimates for the following two years were negative. The timeline of the events thus follows the governments' positive price projections, supporting the view that the government chose to act when the global economic forces motivated it to do so.

CONCLUSION

This chapter has analyzed the Venezuelan oil nationalization in order to assess the explanatory power of the strategic and ideological arguments. The analysis reveals that an expectation of high oil prices in the future caused the government's decision to act on its nationalistic goals. The optimistic price projections and my interviews with policy-makers suggest that the increased oil price led the government to make the rational calculation that the benefits of nationalization would exceed its costs. The government also considered the costs of BITs while in the planning stage, and decided to implement its nationalistic measures despite these costs. This suggests that the government expected the gains of nationalization to exceed the future costs of compensation.

The government pursued the nationalization in a strategic manner, keeping BITs in mind during the negotiations as well. By offering the companies both positive and negative incentives, the government aimed to reduce the number of legal cases. In fact, the government raised the issue of arbitration explicitly in some of the meetings with the companies, threatening to punish litigating companies by denying them future access to the valuable resources in the Orinoco Belt. Such carrot and stick tactics confirm that the officials understood the costs of international arbitration and worked actively to lower those costs while the negotiations were ongoing.

This strategic mode of action continued in the aftermath of the process. In fact, Chávez's behavior during the post-negotiation stage may seem surprising, given his aggressive promotion of “socialism of the 21st century” both internationally and at home. Unlike what has often been assumed, however, the government has in fact paid the final awards that international arbitration bodies have rendered. This compliance with the global investment regime again suggests a strategic mode of action. The government did not defy the treaties and the international investment regime in an impetuous, impatient manner. Rather, the power of the treaties failed to deter the strategic actors as the oil price boomed.

Finally, Chávez appears to have timed his measures according to the global oil price trends. Rather than starting to push for nationalization soon after taking office, as the ideological argument would have expected, he waited for years to begin the process. As the strategic argument predicts, his measures followed a dramatic increase in the government’s oil price expectations. Overall, then, the evidence suggests that the cause and the timing of the Venezuelan nationalization process, together with the government’s mode of action during it, are better explained with the strategic, and not the ideological, argument.

Chapter 5: "Nationalization without Expropriation" in Bolivia

Evo Morales did not shy away from radicalism when he nationalized natural gas on International Worker's day in May 2006. Declaring that "the looting by the foreign companies has ended" (Prada 2006), he sent the military to take over some of the gas fields, and there were even reports of occupied gas stations (Ibaibarriaga 2006). The nationalization decree ordered the companies to renegotiate their existing contracts and, until those contracts were signed, the companies were to pay an extra 32% tax, raising the tax on gross production up to a dramatic 82%.[112] Morales also announced that the previously privatized companies in the sector would be returned to the hands of the state. The first two demands, the renegotiation of the contracts and the radical tax increase during the negotiation period, together with the military presence in the gas fields, were unusually harsh measures in the eyes of the private firms.

Soon after, however, evidence against Morales's proclaimed radicalism started to pour in. On May 2, the day after the nationalization decree, Vice President Álvaro García Linera assured that "there are not going to be company expropriations, of course" (Romero and Forero 2006). While some government members continued to threaten to expel the multinationals without compensation, these more radical voices soon found themselves out of power. In the end, the vast majority of the companies agreed to the government's new terms, and the few investors that did take their cases into international arbitration were compensated before any final rulings. Despite its dramatic start, the Bolivian nationalization process concluded in company buyouts and amicable settlements, not confiscations and long-lasting legal battles.

[112] This extra tax applied only to the most productive gas fields.

In this chapter, I assess whether a strategic or an ideological argument can better explain the nationalization process in Bolivia. As discussed in Chapter 4, the theories answer three specific questions: i) What causes the leaders to act on their nationalistic goals and expropriate? ii) In what way do they pursue the nationalization? and iii) How are their nationalistic actions timed? When it comes to the timing of the events, the Bolivian case does not offer conclusive evidence for only one argument, as Morales's choice to act in May 2006 could be explained by either his strategy or ideology. For this reason, the analysis will focus on the first two questions, the cause of the nationalization and the government's mode of action during the process.

After outlining the key events in the Bolivian hydrocarbon sector before and during Morales's presidency, I begin the analysis by assessing what seems to have caused him to act on his nationalistic goals. The analysis centers on the planning stage of the nationalization process, for this is when a government takes the final decision to enact expropriation. According to the strategic argument, this decision stems from an increase in gas prices: a government nationalizes if price trends suggest that the future gains of nationalization will exceed the costs of BITs. The ideological argument, in contrast, explains the expropriation with the leader's commitment to his nationalistic goals. In this view, leaders are willing to accept high costs for their actions and, consequently, they overlook the consequences of BITs at the planning stage. The analysis will show that Morales studied the legal implications of BITs carefully before choosing to expropriate and, moreover, he took the final decision to act amidst rapidly increasing gas prices. The evidence thus supports the strategic, not the ideological theory.

I then examine Morales's mode of action in the planning, implementation and final stages of the nationalization.[113] The discussion pays special attention to the infighting within the government in the early stages of the process, as conflicts between various key politicians and decision-makers offer additional evidence for the strategic argument. Specifically, Morales invited a few advocates of a more radical, ideological mode of action into his administration. Within months, these ideologues were at loggerheads with Morales and his strategic, calculated vision for the nationalization. The ideologues attempted to steer the process on a more radical path, but instead found themselves pressured out of the government by early 2007. Their experience suggests that Morales had chosen the strategic mode of action from the very beginning; when the advocates of a more ideological route challenged his plans, he simply discarded them.

BOLIVIAN NATURAL GAS: PRIVATIZATION SETS THE STAGE FOR MORALES

After the profound economic crisis of the 1980s, the Bolivian hydrocarbon sector was struggling. Since the founding of the state-owned company YPFB in 1936, the state had run the sector as a monopoly (Villegas 2002, 44).[114] When the country entered the economic crisis of the 1980s, the government chose to finance public expenditures with hydrocarbons and, consequently, it ordered YPFB to transfer 65% of its income to the state (ibid., 47). As a result, the sector was plagued by low reserves and declining production, and projections in the early 1990s suggested that YPFB would not be able to meet the domestic demand nor fulfill the export deal with Brazil (Pacheco 2006, 55-56). To address the attendant problems, including high deficits, external debt, and lacking

[113] As the following section will show, there is considerable overlap between the negotiation stage and the aftermath of the process. For this reason, the distinction between the stages in the case of Bolivia is less clear than in the case of Venezuela.

[114] The first nationalization in the sector occurred in 1937, when the government took over Standard Oil, and the second in 1969, when it expropriated Gulf Oil.

investment, the governments on Paz Zamora (1989-1993) and Sánchez de Lozada (1993-1997) started to reform the sector. In 1990, the government re-opened the sector for foreign investors, with the goal of ensuring the delivery of gas exports to Brazil in the future (Navajas 2009, 16). According to many experts, however, the changes were "too little, too late" as they would not be enough to turn Bolivia into a competitive gas producer (ibid. 17).

A few years later, after Sánchez de Lozada took office, the reformists got their voices heard. A new hydrocarbon law was passed in 1996, followed by various other structural reforms. The main goal of these reforms was to inject life into the sector by bringing in foreign investors. The process, called "capitalization", included three key changes: a new export agreement with Brazil in 1993, partial privatization of YPFB between 1994 and 1996, and the new law, Ley 1689, in 1996. YPFB was split into five different units: a transportation company, Transredes, and two exploration and production companies, Chaco and Andina, were partially privatized, and the refineries and the distribution plants were sold off.[115] The new law led to the signing of 76 new joint venture exploration and production contracts with multinationals. As this chapter will show, Morales would later challenge these exact measures and call for the re-nationalization of the different YPFB units and a renegotiation of the contracts.

Initially, the capitalization process was a success: starting in 1996, the reforms led to a dramatic increase in investment (Pacheco 2006, 92), and as a consequence, hydrocarbon reserves increased by a yearly average of 124%. The sector had contributed 2.8% to the GDP between 1990 and 1996 but now, after the reforms, its contribution to the economy increased to 6.2%. Overall, the reforms created new investment and

[115] YPFB itself was left with only a few tasks: supervision of the contracts and the export agreements, aggregation of the natural gas exports to Brazil, fiscalization of the exploration and production activities, and monitoring the fiscalized production (Fundación Jubileo 2012, 8).

increase in reserves, allowing the state to respect its export commitment to Brazil, ensure domestic supply, and plan additional future exportation and industrialization. (ibid.)

Much of the success proved to be fleeting, however. Starting in 2002, investment in the sector began to decrease and a decline in reserves followed a few years later in 2004 (Pacheco 2006, 92). Moreover, the early successes of the reforms created an additional problem: the multinationals lacked markets for the new reserves, and as they started to consider potential export opportunities, their plans were politicized in public (Zaratti and Torres 2008, 129). Another source of public dissatisfaction, later picked up by Morales and MAS, rested on the sector's low level of fiscal contributions: the new hydrocarbon law specified a low, 18% tax level for "new" hydrocarbon fields (Fundación Jubileo 2012, 12).[116] The status of many fields as new would later be contested.[117]

Just like in Venezuela, the oil sector reforms in Bolivia coincided with a change in the framework for foreign investment. Bolivia signed its first BITs in 1987, and by 2004 the country had 22 treaties in effect. According to a long-time career diplomat, the treaties faced little to no opposition. Since the productive sector was unable to re-start itself after the economic crisis and the structural reforms, politicians and technocrats wanted to attract new investment and, as a consequence, they did not question the treaties (interview with Alvarado Aguilar 2012). Another diplomat confirmed this view, noting that the past nationalizations, especially in the mining sector but also in hydrocarbons, caused a certain degree of distrust among investors and further incentivized politicians to sign the treaties (interview with J. Murillo 2012). Overall, given this context of post-crisis

[116] For a more detailed analysis, see Mokrani (2010).
[117] In fact, some experts had warned that the fiscal framework that attracted multinationals might later appear too low for the general public (Navajas 2009, 19).

and reform, the adoption of the treaties seems to have been even smoother and faster in Bolivia than in Venezuela.[118]

Mesa Government Faces Growing Demands to Nationalize

Morales and his party, Movimiento al Socialismo (MAS), had influenced the hydrocarbon politics of Bolivia well before his presidency. Two years before Morales's electoral victory, MAS had mobilized masses for a popular uprising that culminated in the Gas War of October 2003. While the conflict had various causes, discontent with the neoliberal natural gas policies and the capitalization process described above was among the most salient issues. The public's dissatisfaction with the structural reforms combined with the suddenly increasing commodity prices allowed MAS to frame the multinationals as exploiters of the country's valuable natural resources and accuse the status quo leaders of mishandling the sector (Lehoucq 2008, 114–115). MAS acted tirelessly to politicize Bolivian gas, holding workshops and lectures on the topic and distributing leaflets in the streets. The strategy worked: MAS succeeded in generating wide, national-level support for its political project (ibid.) and, in particular, for its demands to nationalize the sector.

After the Gas War and the resignation of President Gonzalo Sánchez de Lozada in October 2003, the centrist Vice President, Carlos Mesa, took over the country and the masses calmed down temporarily. Mesa promised to hold a referendum over the gas reform, both to accommodate the popular demands for nationalization and to re-enforce

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[118] As this chapter will show, Bolivia has since taken a somewhat stronger stance against the arbitration regime than Venezuela. The consequences of its measures are, nevertheless, somewhat limited; While Bolivia left ICSID in May 2007, international lawyers and experts do not agree on whether the BITs allow companies to use this arbitration venue anyways (UNCTAD 2010, 3–5). The 2009 constitution subjects all foreign investors to Bolivian law but, at the same time, it allows YPFB to sign contracts with multinationals, making the status of international arbitration unclear (Aguirre 2012, 58–59). The constitution also requires a denouncing and renegotiation of the treaties, but while Bolivia has notified the treaty partner countries about renegotiation, it is not clear whether this process has progressed (ibid., 65).

his public mandate. He also started to draft a new hydrocarbon law immediately upon taking office (Zaratti and Torres 2008, 130).[119]

Faced with Morales's demands for nationalization and the popular support for this option, Mesa was forced to adopt an increasingly leftist position in the sector over the course of his government. His initial reform plan rested on a tax increase that would not violate the companies' existing contracts (interview with Nogales 2012). Since sovereign states are free to set their taxes, Xavier Nogales, the Minister of Hydrocarbons and Energy at the time, reasoned that a modest tax rise would not allow the companies to invoke their BITs (ibid.). In the view of some of the firms, however, this plan was already a significant departure from the status quo in the sector (interview with Lawyer 2 in Bolivia 2012).

The government moved even further left in May 2004, when Superintendent of Hydrocarbons, Guillermo Torres, replaced Nogales as Minister of Hydrocarbons and Energy. During 2003, in his previous position, Torres had implemented a string of regulatory measures to pressure the multinationals, propelling at least one firm to consider international arbitration (interview with Lawyer 1 in Bolivia 2012).[120] As a Minister, he went further than Nogales and proposed a change in the existing contracts (interview with Torres 2012; Zaratti and Torres 2008). With this new demand, Mesa's government took a more nationalist position, both in the eyes of observers (interview with del Granado 2012) and the multinationals (interviews with Lawyer 2 in Bolivia 2012; Lawyer 1 in Bolivia 2012).

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[119] The referendum was held in July 2004. 92.2% of voters agreed that "the Bolivian State should recover ownership over all hydrocarbons at the wellhead" (Arrarás and Deheza 2005). Both Mesa and Morales claimed that the result, and especially the strong support for the question over state ownership, supported their own agenda (for the government's view, see Zaratti and Torres 2008, 140). Ultimately, this gave MAS additional ammunition to challenge Mesa's less radical reform attempts.

[120] For a description of these measures, see Zaratti and Torres (2008, 133-136).

As Mesa geared towards the left, the companies went on full counter-attack. Trying to pressure the government to back down, they threatened to leave Bolivia and sue the state if their existing contracts were challenged. Oftentimes, these threats were delivered in public. For example, after a meeting with the government in September 2004, a manager of Repsol told the press:

> The most problematic article in the proposed law is the forced migration of the contracts into new ones. In fact, if the wording of this article remains, it would be really hard for the law [and Bolivia] to win arbitration. This is to say, we came here under certain conditions and if these conditions are changed, it will be really hard for the Bolivian state to defend itself in international arbitration. (*La Razón* 2004)

The message was equally threatening in private, as the multinationals reminded the state of their rights in writing and expressed their discontent with the Superintendency's measures (interview with Torres 2012). Overall, the firms' pressure tactics worked; years later, Mesa lamented that he had acted too timidly in front of the companies, believing that their threats of international arbitration were real and fearing that such proceedings would cause foreign investors to desert Bolivia (Mesa Gisbert 2015; see also Webber 2010, 62–63).

Mesa's hesitation in the sector stemmed from the economic situation. As the analysis below will show, the estimates for the gas price in the government budget were more or less constant at the time. Consequently, Mesa could not count on the state's ability to afford the companies' compensation demands. This economic rationale is evident in his comment to the author when asked about his decision not to act more radically in the sector:

> We were still in the context of the Washington consensus. To me, these threats [of international arbitration] seemed real. I thought that I was jeopardizing both foreign investment in the country and the operation and development of the hydrocarbon sector. I really believed that there was a risk of international

> arbitration. You have to remember that we faced a deficit of 8% of GDP, a chronic deficit. I was in no condition to answer to cases of international arbitration, unlike the current government. The conditions at the time made me think that I was putting the country at risk. The events afterwards showed that the threats were not real but, at the time, they seemed very real. (interview with Mesa Gisbert 2013)

By late 2004, the cross-pressures from the companies and the nationalistic opposition had frustrated Mesa and, at that point, any governmental action in the sector seemed unlikely. MAS gained the presidency of *Comisión de Desarrollo Económico*, the Economic Development Commission, in Congress in August, after a change of directives in the legislature. In this position, MAS was now able to block the government's proposals for the new hydrocarbon law.[121] In October, Mesa attempted to find an agreement with Morales and his technocrats but the meeting was unsuccessful (Mesa Gisbert 2008, 188). Soon after, the government withdrew its experts from drafting the bill altogether.

In early 2005, MAS' bill passed on to the legislative floor. The law-making process expanded the proposal dramatically, as legislators defended their regional interests.[122] The final law, called "Law 3058," was a combination of the drafts of MAS and the government, and the new articles added in the legislative discussion. In fact, it was so far off from any particular proposal that not one party wanted to claim ownership.[123] Yet, it achieved MAS' key goals: it increased taxes and royalties up to 50% and ordered renegotiation of the existing contracts. These two features would later help

[121] According to MAS, the government's bills were too conformist. For example, the president of Comisión de Desarrollo Económico, Santos Ramírez, noted in an interview that Mesa's first bill included no "nationalist feature" whatsoever (interview with Ramírez 2012).
[122] In particular, the producing and non-producing regions disagreed over the distribution of the new taxes. To accommodate the regional demands, YPFB was divided structurally. For example, the vice presidency of Administration, Contracts and Audits was established in Tarija, whereas the vice presidency of Operations was located in Santa Cruz (interview with Ramírez 2012). A MAS legislator described the law-making process as a "regional, political fight" (interview with Alvarado 2012).
[123] For this reason, the law gained the nickname "Law Frankenstein" (Zaratti and Torres 2008, 142).

the Morales government to pursue nationalization: with the new taxes, he would have more economic security to challenge the companies, and the requirement for new contracts paved the way for his even more nationalistic contracts.

After the legislature passed the bill in early May, Mesa objected to its radical nature and refused to promulgate it. Instead of vetoing it article by article, he made a "conceptual observation" that returned it to the Congress for additional debate.[124] Ten days later, the President of the Senate signed it into a law.

Following Law 3058, Morales's demands for nationalization gained even more traction. Mesa, in turn, faced increasing political opposition and street protests; he was forced to step down on June 6, 2005. While the new hydrocarbon law was technically passed during his time in office, he had not succeeded in reforming the sector.

Mesa's successor, interim president Eduardo Rodríguez Veltzé, started to implement the new taxes stipulated in Law 3058. The companies objected to the measure; in fact, most of them initiated arbitration proceedings against the state (interview with Rodríguez Veltzé 2012; Yapura 2012, 300). Given these pressures, and the societal challenges the government faced over the distribution of the new hydrocarbon revenue, Rodríguez Veltzé decided to leave the renegotiation of the contracts for the next government (interviews with Rodríguez Veltzé 2012; Lazarte Rojas 2013). In a sense, he was setting the stage for the nationalization: when Morales took office in January 2006, he would have the legal and popular mandate to carry out the contract renegotiations.

Morales Implements "Nationalization without Expropriation"

Given Morales's persistent calls for nationalization since the early 2000s, the public and the companies knew what to expect when he took power in January 2006. To

[124] The government was divided on the issue, as many members of the cabined wanted him to sign it (Mesa Gisbert 2008, 291–292).

signal his commitment to radical change, Morales named a well-known nationalist, Andrés Soliz Rada, as the Minister of Hydrocarbons. According to one company representative, this signal did not go unnoticed:

> We were surprised by the appointment of Andrés Soliz Rada as the Minister. That's when we knew we were in trouble! We had expected Morales to name a technocrat in the position, like Santos Ramírez, who had been preparing Law 3058. (interview with Lawyer 2 in Bolivia 2012)

After a few months of quiet preparation, Morales announced the nationalization decree, *Héroes del Chaco*, on May 1st. The nationalization was to consist of two key steps. First, the decree restated the contract renegotiations, already included in Law 3058. However, while the law allowed three types of contracts, the decree forced the existing contracts to be migrated into only one type, operating contracts.[125] Second, the state would take over the previously privatized companies, namely Chaco, Andina, Transredes, CLHB, and two refineries.[126] The first step was the key, as most revenue in the sector originates from the extraction of hydrocarbons. The previously privatized companies operate in other parts of the production chain, such as transportation and storage, and they contribute much less to the state's fiscal revenue.[127] Partly for this reason, the government planned to pursue the renegotiation of the contracts first and only then focus on the previously privatized companies.

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[125] The types of contracts specified in the law were production sharing contracts, operating contracts, and association contracts. In all contracts, the reserves and production would belong to the state and the companies would deliver their production to YPFB. Medinaceli (2007, 93–94) notes that the law is not quite clear, however, as another article mentions two additional types of contracts.

[126] Specifically, the government would acquire 50%+1 ownership of the companies. The decree is not clear about this measure, as it does not specify how the shares would be taken over (Medinaceli 2007, 95).

[127] To be clear, Chaco and Andina are involved in exploration and production, but the two companies reported losses in the late 1990s and early 2000s (Villegas 2002, 218). Transredes is involved in the transportation of natural gas, and CLHB in its storage. Sometimes, the nationalization of aviation fuel company AirBP in May 2009 is considered part of the overall nationalization process. However, the company is excluded from the analysis here, as it is not included in the nationalization decree (Morales Ayma 2006).

The contract renegotiations were conducted over the ensuing 180 days and they were an overall success for the state. Every multinational agreed to the government's terms and none of the signatories took their case to international arbitration.[128] The second step involving the previously privatized companies, however, proved to be somewhat more complicated. The first agreement was reached in May 2007, when the state bought Petrobras's refineries. Negotiations with the next company were finalized a year later, as Andina's key owner, Repsol, agreed to remain in the country. During the next few months, the government took over shares of CLHB, Chaco, and Transredes. Consequently, three owners of the firms took their case to international arbitration. Two of the legal processes were settled quickly in the following months, and when Chaco's owners agreed to the government's compensation offer in December 2014, the nationalization process finally came to its end.

ASSESSING THE ARGUMENTS: WHAT CAUSES LEADERS TO PROCEED WITH NATIONALIZATION?

Both the strategic theory and the competing, ideological argument take the nationalistic goals of the government as given. In the Bolivian case, Morales was known to advocate for increased state ownership in the hydrocarbon sector well before taking office and both theories acknowledge his nationalistic objectives. However, the theories differ in their explanations for his decision to act on these goals and pursue nationalization in May 2006.

According to the strategic argument, the government conducts serious, systematic projections of future hydrocarbon prices in the planning stage of the process. If and only if these projections suggest a significant continuing increase in prices, the government

[128] After the contracts were signed, the press revealed some irregularities in the process. The head of the negotiation team had to resign as a consequence of that scandal (Diariocritico de Bolivia 2007). After some modifications, the contracts were finally approved in March 2007 and they took effect the following month.

can count on the future gains of nationalization to exceed the costs of the treaties. As a result of these calculations, BITs lose their deterrent power. Booming commodity prices and the government's estimates on the basis of those prices, therefore, cause the nationalization; without the expected economic gains that they generate, the government would simply not pursue it.

The alternative argument expects the government to act out its ideology regardless of the consequences. This is because leaders are unconditionally committed to certain principles and they pursue these principles regardless of other, more pragmatic considerations. Their ideological commitment overrides the threat of expensive arbitration processes and causes the leaders to ignore the potential costs of BITs.

Morales's high level of preparation for BITs during the planning stage of the process rules out the ideological argument, however. If Morales had been unconditionally committed to nationalizing, he would not have spent considerable time and effort to get ready for potential cases in international arbitration. Yet, an analysis of his first few months in office suggests a careful preparation for BITs and their legal implications.

In fact, by the time Morales took power, BITs were public knowledge in Bolivia. Mesa had justified his lack of action in the sector with the threat of arbitration.[129] Moreover, the MNCs had long warned the state about the legal measures they were prepared to take. The firms' intimidation seemed real, since a few years earlier U.S. multinational Bechtel had sued Bolivia in ICSID after an infamous investment dispute.[130]

[129] See, for example, Webber (2010, 62–63).

[130] The popular protests against the price increase for water in Cochabamba that Bechtel implemented in 2000 forced the government to revoke the MNC's contract. These events are commonly known as the "Water War". The parties settled the legal case in January 2006, giving even more salience to the issue of international arbitration during the first months of Morales's presidency. Bolivia was facing a few additional cases in arbitration tribunals when Morales took office, but these cases had had much less public exposure.

For these reasons, BITs and their consequences were public knowledge in Bolivia by 2006.

The companies continued their intimidation tactics under the new administration. According to Morales's third Minister of Legal Defense, who worked in the Foreign Ministry in early 2006, the firms notified the government of their intentions to pursue arbitration as soon as the new administration had taken office (interview with Menacho 2012). Other key participants in the process confirmed that the companies used the threat of arbitration to pressure the government in the first months of Morales's term (interviews with Alvarado 2012; Soliz Rada 2012).

The government did not overlook these threats and, in fact, it prepared for the treaties and the possible arbitration cases early on. According to Manuel Morales Olivera, the leader of the government's technocratic negotiation team, the nationalization decree was designed in a way that the companies would not be able to invoke their BITs (interview with Morales Olivera 2012).[131] The negotiation team even sought advice from a U.S. law firm that specializes in international arbitration (Zelaya 2007).[132] The plan for the contract renegotiations and the takeovers of the previously privatized companies were also drafted so as to avoid arbitration cases (interview with Morales Olivera 2012). While the plan for the privatized companies changed over the course of the process, the government's careful preparation for the treaties and their consequences in the planning stage is evident.

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[131] Specifically, Morales Olivera argued that the companies would not be able to invoke their treaties because the decree did not cancel any existing contracts; rather, it stated that YPFB would not be able to execute any contracts that the legislature had not approved, as required in the Constitution (see Morales Ayma 2006, article 4). Since the existing contracts, signed in the early 1990s, had not been individually approved in Congress, keeping them in effect would violate the Constitution.

[132] Moreover, a group of lawyers and technocrats from the Superintendency had travelled to Argentina during the Mesa government to learn from the Argentine experience with international arbitration (interview with De La Fuente 2012). Since some of the personnel stayed in the Superintendency after the change of governments, this knowledge is likely to have carried over to the next administration.

The government's thoughtful consideration of BITs' legal implications offers evidence against the ideological argument. As discussed above, ideological leaders push through their goals and are willing to incur high costs for reaching those goals. Therefore, had Morales's ideological drive caused the nationalization, we would not observe this level of preparation for the consequences of BITs in early 2006. In fact, Morales's legal considerations lend support to the strategic theory. According to this argument, politicians only pursue nationalization if they consider the overall gains of the measure to exceed the costs of BITs. Since the government studied the treaties and their consequences during the planning stage, we can reasonably assume that the final decision to put the plan in action in May 2006 was taken only after considering BITs and estimating how much funds the state might need to allocate for arbitration and the ensuing compensation.

In addition to this preparation for BITs, the strategic argument would also predict careful calculations over the gains of nationalization. More specifically, strategic leaders decide to pursue their nationalistic goals only after estimating that their future revenues will make the costs of expropriation affordable. Unfortunately, there is very little public information on the government's projections of the gas price, and they are not recorded in the Bolivian national budget either. However, the budget estimates royalties to be collected from the companies and these figures offer some insight into governmental expectations.[133]

Table 6 presents the government's estimates for the annual hydrocarbon royalties, which the government calculated and presented to the legislature towards the end of the previous year. The figures prove that the Morales government was expected to start its

[133] The budget also estimates the tax income. However, the tax scheme in the sector underwent dramatic changes during 2005 and 2006, as discussed earlier in this chapter. For this reason, I focus on the royalties, which remained at 18%.

term with an optimistic outlook for the sector: the 2006 budget, which Morales's predecessor Rodríguez Veltzé presented to the legislature, projected an 83% increase in royalties from the year before! Since production was expected to increase only by less than 7% within the same time frame, much of this dramatic boom was to originate from higher gas prices.[134] In other words, the previous government expected a sharp increase in gas prices during the first year of the Morales administration. Since the calculations are based on data from the Ministry of Hydrocarbons and Energy and from YPFB, Morales most likely based his predictions on this same data after he took office in January 2006. Moreover, the hydrocarbon law approved in May 2005 was expected to increase the government tax revenue from the sector dramatically. As will be discussed later in this chapter, this new income, together with the booming prices, would allow the Morales government to respond to the companies' legal claims a few years later.

Table 6 shows that the 2007 budget projected an equally dramatic price increase: the royalty revenue was expected to go up by another 62%. While the forecasts moderated temporarily for 2008 and were negative after the global economic crisis for 2010, they recovered again for 2011. Overall, then, Morales took office at a time when continuous increases in the royalty revenue seemed likely. Since the estimated production was relatively constant throughout the years, the optimistic revenue expectations originated from increasing natural gas prices. In other words, the new government foresaw upward trending prices in the sector.

[134] The reported increase in production is based on observed values, not governmental estimations, since such estimations are not publicly available. However, production volumes are much less volatile than global oil and gas prices and, consequently, we can reasonably assume that the government had accurate estimates of the production levels in the near future.

Table 6: Estimated royalties in the government budget in Bolivia

Year	Royalties (MM Bolivianos)	Increase in Royalties (%)	Increase in Production (%)
2003	589	2.9	15.1
2004	765	29.8	35.8
2005	1148	50.1	21.8
2006	2101	83.0	6.6
2007	3406	62.1	6.4
2008	3602	5.7	4.2
2009	4291	19.1	-14.1
2010	2945	-31.4	17.0
2011	4557	54.7	8.8

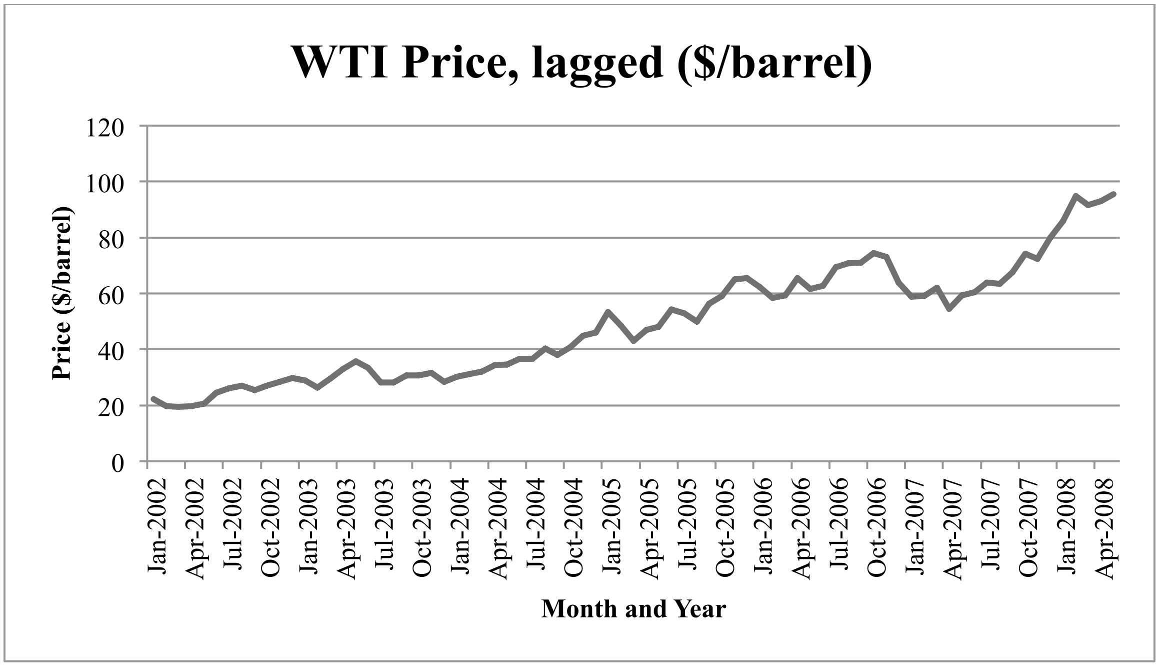
Source: Ministerio de Economía y Finanzas Públicas de Bolivia (2003-2011)

The trend of real hydrocarbon prices certainly makes positive price expectations plausible. Figure 10 depicts the common benchmark for Bolivian gas, the West Texas Intermediate (WTI) crude price, since mid-2002.[135] As the graph shows, the prices increased steadily in the years prior to Morales's election. When he took office in early 2006, he had good reasons to believe that the price trend would remain positive, given the past development in real prices and the estimations by the Minister of Hydrocarbons and Energy and YPFB.[136]

[135] The prices of Bolivian natural gas to foreign markets correlates highly with the WTI prices in the previous quarter (YPFB 2012, 17). In fact, the YPFB statistical reports present the WTI price first, before the export prices to the Argentine and Brazilian markets.

[136] Table 6 and Figure 10 also highlight an interesting point regarding the Mesa government. The government budgets had not projected sharp price increases for 2004 and 2005, as most of the revenue gains during this time seemed to originate from higher production, not higher prices. Figure 10, however, illustrates that the prices were already on an upward trend at that point. Had the government done more optimistic – and realistic – projections, Mesa could have taken the strategic decision to nationalize and let the state use the new revenue to cover the costs of arbitration.

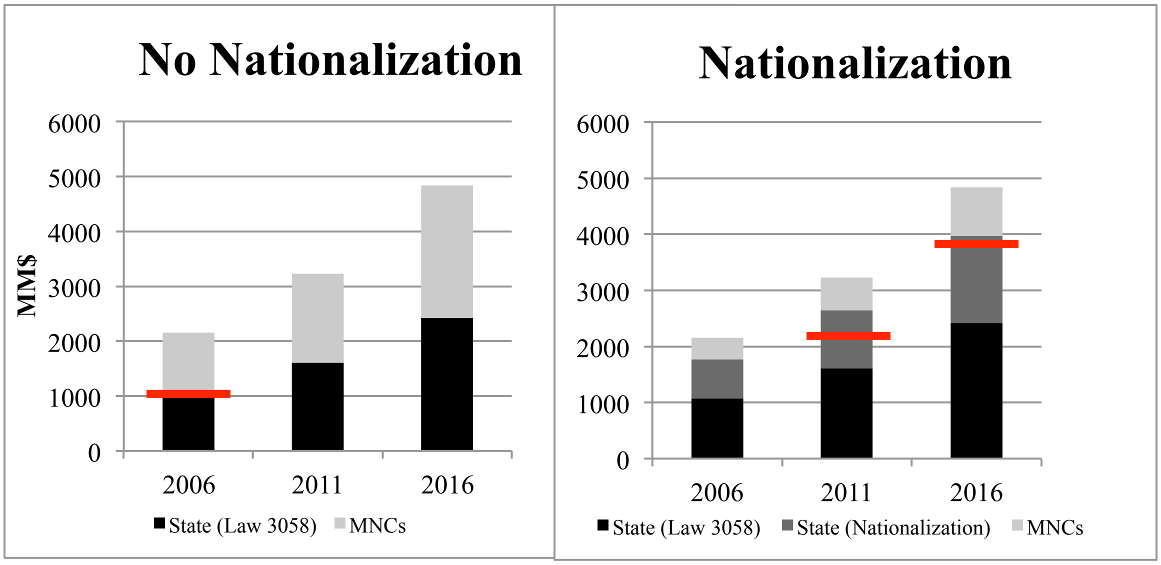
Figure 10: WTI price, lagged to the previous quarter



Source: BP (2014)

Having gained confidence over the economic viability of nationalization, Morales was able to pursue his plan. Figure 11 reconstructs the economic calculation that would explain his decision to put the nationalization plan into action in May 2006. The graph on the left illustrates the accumulation of state revenues if the government was to keep Law 3058 in effect and refrain from any further reforms. The graph on the right, in contrast, figures how dramatically nationalistic measures could increase state income in a few years' time: even if the government needed to compensate the companies with all the revenue they would forgo between 2006 and 2016 (the part marked with dark grey that remains above the red line), the new state revenue due to the nationalization (marked with dark grey), would cover these costs. In other words, the government would be better off with the nationalization than without it, regardless of the potential costs of BITs.

Figure 11: Expected distribution of net gas income between the Bolivian state and MNCs



Sources: Ministerio de Hidrocarburos y Energía, author's calculations[137]

In sum, the nationalization process in Bolivia was prompted by the increasing gas prices and Morales's rational calculations on the basis of those prices, rather than his ideology. With the booming gas prices, Morales forecasted that the new revenue gained through the nationalistic measure would allow him to weather the consequences of BITs and compensate the companies. Against the expectations of the ideological argument, he paid plenty of attention to the legal implications of his actions. In fact, the government spent considerable time and effort to study the concrete consequences of BITs before making the final decision to enact expropriation. The evidence thus supports the view that the price boom served as a trigger for the strategic government to challenge the international investment regime.

[137] The state revenue for 2005 is reported in Estrategia Boliviana de Hidrocarburos (2008, 80). Since Law 3058 established a tax and royalty level of 50%, the firms are estimated to receive an equal amount of revenue. For 2011 and 2016, the net profit is expected to increase by one-third – a conservative expectation, given that the average export price to Argentina and Brazil increased by 55% from 2005 to 2006 (ibid., 122-128). The state is assumed to receive 50% of the total profit as specified in Law 3058, and an additional 32% tax Morales announced in the nationalization decree. While the extra tax was to apply only to the biggest gas fields and only until the new contracts, government comments at the time suggested that it would be permanent. See Ibaibarriaga (2006).

ASSESSING THE ARGUMENTS: IN WHAT WAY DOES THE LEADER PURSUE NATIONALIZATION?

The two arguments also expect the government to pursue nationalization in different ways. According to the strategic argument, the government acts in a calculating manner throughout the process, evaluating the costs and benefits of its actions thoroughly and paying attention to the costs of BITs and compensation at each step of the way. The ideological approach, in contrast, claims that the government conducts the process impetuously and impatiently, disregarding the costs of BITs in the planning and negotiation stages and refusing to comply with them in the aftermath.

This section assesses which argument better explains Morales's mode of action throughout the nationalization process. The discussion in the previous section already highlighted Morales's strategic behavior in the planning stage of the process. Specifically, he weighed the economic benefits of nationalization against the costs of BITs between January and May 2006. Had he behaved in an ideological manner, he would not have been that concerned about BITs at this point. The following analysis will show that the government continued to act in a similarly measured and strategic manner during the implementation stage of the nationalization, as well.

The Negotiation Stage (2006 – 2009): Confronting the Companies and Ousting the Ideologues

The negotiation stage spans from Morales's announcement of nationalization in May 2006 to the end of 2009, when the companies had either settled their cases or decided to pursue arbitration. This section assesses which argument provides a better explanation for governmental actions during this phase of the process. Specifically, did the government follow an ideological mode of action, pushing its preferences through in a unilateral and inflexible fashion, and overlooking BITs and the legal disputes they might have led to? Or, did it employ well-calculated bargaining tactics that aimed to prevent international arbitration? Did it offer the companies incentives to accept its demands and skillfully pressure them to comply? The latter type of behavior would indicate that the government had adopted a strategic mode of action and was willing to sit down at the negotiation table with the multinationals and even compromise.

Morales had planned the nationalization decree during his first three months in office. The first step of the process, the renegotiation of the contracts, was completed in a similarly quick fashion. Over the six months that followed the *Héroes del Chaco* decree, the government and the companies engaged in intense negotiations that ended when all firms signed a new contract in October. The second step of the nationalization process, the takeover of the previously privatized companies, proceeded much more slowly, however. After the agreement with Petrobras over its two refineries in early 2007, there was a long delay before the government approached the remaining three companies. These negotiations were finally initiated in March 2008 (interview with Ramírez 2012), and they resulted in an agreement with Repsol, the main shareholder of Andina. In the following months, the government failed to find common ground with CLHB, Transredes, and Chaco. The first two firms were nationalized by a presidential decree in May and June 2008; Chaco, the remaining privatized company, was taken over in January 2009.

The overall story line of the negotiation stage offers some initial support for the ideological argument. The first set of negotiations was conducted in a pressured manner with a short deadline and the second set of negotiations resulted in various legal disputes. These outcomes suggest inflexibility, even intransigency, on the part of the government. However, a closer look at the events reveals that the government followed a strategic mode of action. First, it used various bargaining tactics during the first set of negotiations to induce agreements and prevent companies from invoking their BITs. Second, between the first and second set of negotiations, it dismissed the most ideological actors from the administration, suggesting that the decision to act in a calculating, pragmatic manner was a deliberate one. Third, during the second step of the negotiations, it moderated and sought amicable settlements, rather than conflict. The following analysis examines these pieces of evidence in detail, concluding that the government conducted the negotiation process strategically, not ideologically.

In the renegotiations of the exploration and extraction contracts, the Morales government offered the companies a combination of positive and negative incentives in order to prevent them from invoking their BITs. As a carrot, it signed a new price agreement with its Argentine counterpart at the end of June 2006, about four months before the end of the renegotiation period. This agreement increased the export price of Bolivian gas to Argentina from 3.2 $/MBTU to 5 $/MBTU and, in so doing, it sent an important signal to the multinationals. Specifically, the deal indicated that the firms could still earn profits in the country, even if they agreed to the government's new contract terms (interviews with Delius 2012; Lawyer 2 in Bolivia 2012). In this way, Morales motivated the MNCs to sit down and compromise, rather than choose the more contentious – and expensive – route of arbitration.

The government gave another concession to the companies when the deadline for the negotiations approached: the new contracts recognized the multinationals' existing investments in the country, against the government's initial threats (interview with Lawyer 2 in Bolivia 2012).[138] Essentially, the government promised to take the firms' past investments into account when writing the new contracts. Since the government

[138] These investments are specified in annex G of the new contracts (Fundación Jubileo 2009, 21).

would compensate the firms for their losses in this way, the move effectively removed the companies' need to invoke their BITs (ibid.). Morales's willingness to back off from his original threat to disregard the existing investments suggests that he was not simply imposing his nationalistic plan. Rather, he was willing to negotiate with the firms and find agreements that would satisfy both parties.

To be sure, the government also employed negative negotiation tactics that aimed to pressure the companies to agree to the new terms. To start with the day of nationalization itself, Morales sent the military to occupy some of the gas fields, together with television crews. While various government officials acknowledged that the move was more symbolic than anything (interviews with Alvarado 2012; Soliz Rada 2012; Duran 2012), it did succeed in capturing attention, as a picture of Morales marching together with solders in a gas field spread through domestic and international media. By showing off its coercive force this way, the government signaled to the companies its resolve for the upcoming negotiations.

The government maintained some of its intimidation tactics during the intense contract renegotiations in 2006. For instance, a company representative recalls how a government negotiator threatened to send the army to the fields again. While the firms suspected a bluff, the company representative admitted that "none of us wanted to test how far he [Morales] would go" (interview with Lawyer 2 in Bolivia 2012). Another company representative describes the beginning of the negotiations as follows: "In our first meeting with the government's technocrats, the head of their team took a very extreme position, as if to show that 'your treaties are paper planes!'" (interview with Representative of a hydrocarbon MNC in Bolivia 2012). With this kind of radical, even militant posturing in public and in private, the administration impressed upon the companies that it would be wisest for them to agree to the government's terms at this point.

Another pressure tactic the government used was to impose short timelines for the negotiations. The companies suspected that the deadline specified for the new contracts, 180 days, was chosen with the possible arbitration processes in mind: if the companies were to invoke their BITs and request arbitration, their 6-month-long cooling off period would exceed the deadline for the new contracts (interview with Lawyer 2 in Bolivia 2012). By initiating arbitration proceedings, the companies would hurt their chances to stay in the country and recover some of their sunk costs, as the legal process would divert the attention of both sides from the contract renegotiations. The companies understood this, and while at least some of them consulted their headquarters about the possibility of arbitration, they chose to sit down and negotiate instead (interview with Lawyer 2 in Bolivia 2012).

The government's combination of positive and negative negotiation tactics had effective results. As noted above, the companies all agreed to the terms of the new contracts and none of them took their case to international arbitration. Moreover, the contracts increased the government's share of gas revenues (interview with Delius 2012).[139] Overall, the first step of the nationalization process ended successfully, as the government managed to induce the companies to accept the new contracts. The government's conduct through the first set of negotiations supports the strategic argument. Rather than pushing for ideological goals in an inflexible manner, Morales was willing to compromise with the companies to some extent and his pressure strategies

[139] It is important to note that nearly everyone in the sector who praises the new contracts also criticizes them for the lack of incentives for exploration. In other words, the contracts succeeded in increasing the government take, but they also seem to contain some problematic provisions when considering the future of the sector.

aimed at reducing the likelihood of international arbitration, rather than pushing through the process regardless of the legal implications.

Conflicts within the government offer additional evidence for the strategic argument. As the deadline for the new contracts drew closer the public began to learn about disagreements within the government. By September, these disagreements seemed to have evolved into internal power struggles. In particular, two contending approaches emerged: some argued that the companies had not fulfilled their contractual obligations in Bolivia, such as promised investments. Consequently, the government could take over the companies without any need for indemnification. Others subscribed to Morales's slogan of "nationalization without expropriation" (Kaup 2008, 1739), arguing that the government should respect the rules of the international investment regime and accommodate the companies' compensation demands.

The media became aware of the conflicts in September 2006, when Soliz Rada resigned from the cabinet, citing "personal reasons" (*Econoticiasbolivia.com* 2006).[140] According to anonymous sources within MAS, Soliz Rada had to leave because of his overly radical views. One party member claimed that "Minister Soliz was one of the hardliners, he did not believe in the nationalization decree of May 1st; he proposed a confiscation of the multinationals" (*Erbol* 2006). Another source noted that Soliz Rada had acted in an overly ideological manner, against the president's instructions and wishes. For instance, he played an important role in the detention of Repsol's manager in Bolivia earlier that year. These unexpected and radical actions conflicted with Morales's more strategic and calculated measures: while Soliz Rada applied legal pressure to Repsol by jailing its manager, Morales was meeting with the Spanish Vice President and

[140] Specifically, Soliz Rada left after the government annulled his Ministerial Resolution that nationalized the commercialization of Petrobras's refined products in Bolivia. For Soliz Rada's account of the events, see *Econoticiasbolivia.com* (2006).

promising that he would not treat Repsol, or other Spanish investors, in an arbitrary manner (ibid.).

In fact, Morales's appointment of Soliz Rada seems to have been a strategic move to begin with. Soliz Rada's nationalistic public image (*La Nación* 2006) gave credibility to the new government. He demanded an audit of all multinationals in the sector to ensure that they had fulfilled their contractual obligations (interview with Soliz Rada 2012; *El Nacional* 2012).[141] These audits, the plan went, would reveal the companies' failure to meet their obligations and, as a result, the government could take over their facilities without compensation (interview with Soliz Rada 2012). However, while the audits were conducted, their conclusions were disregarded and forgotten, to Soliz Rada's great disappointment. In his own view, the government had planned to ignore the audits all along, and his role was simply to serve as a radical façade for the government (interview with Soliz Rada 2012; see also Stefanoni 2006). He refused to accept this role, and enacted a radical Ministerial Resolution in September 2006 that nationalized the commercialization of Petrobras's refined products in Bolivia. This sealed his departure from the government, as Morales ordered the measure cancelled immediately (Stefanoni 2006).

After his exit, Soliz Rada accused the government of excessive moderation, declaring that "some [in the government] want the nationalization to stay on paper; there is a permanent struggle in the government over the implementation of the nationalization decree" (Stefanoni 2006). The advocates of the strategic mode of action countered by calling the demands for more radical measures unrealistic. For example, Vice President García Linera commented in an interview with the author that "no nationalization is done

[141] In fact, the audits are mentioned in the nationalization decree itself, see Morales Ayma 2006 (article 4).

without compensation. Not one. Even Lenin compensated. Those who talk about nationalization without compensation are a small group of radical left drinking in a café" (interview with García Linera 2012).

In fact, Morales had already started to distance himself from the most radical demands before taking office. In May 2005, when Mesa's position in power had started to become shaky, Morales told the press that "maybe I spoke of nationalization in my time as a union leader… when I was for protest and not proposals. But we see now that we have to be serious and that proposals must be viable" (Cáceres 2005; cited in Webber 2010, 56). A day after the nationalization decree was announced in May 2006, García Linera clarified to the press that "there are not going to be company expropriations, of course" (Romero and Forero 2006). These comments indicate that the government was operating in a strategic manner from the very beginning of the process, and the impetuous, ideological actions of Soliz Rada did not align with the government's strategic mode of action.

Following Soliz Rada's departure, other supporters of a more ideological course of action resigned from the administration as well (*Infobae* 2006). Perhaps most importantly, Manuel Morales Olivera, the head of the contract renegotiation team in YPFB, was ousted in early 2007, after the partisan opposition capitalized on some mistakes in the newly signed contracts and on a scandal that revealed details about his team's trip to Cuba (*La Razón* 2007).[142] Morales Olivera had also represented the more radical wing of the government, as he had planned to conduct the takeovers of the privatized firms without any compensation. Following his and Soliz Rada's exit, the

[142] Allegedly, the government agreed to change the terms of one contract after signing. The other mistakes in the contracts were minor (interview with Magela Bernardes 2010). Morales Olivera left the administration soon after the signing of the new contracts but he returned to politics for a short period a few months later: he held the presidency of YPFB between January and March 2007.

government shelved the audits,[143] and there were no more loud supporters of an ideological mode of action left in the government.

After the ideologues were out, the government sought to conclude the second set of negotiations, the takeover of the previously privatized companies, in a strategic, calculating manner. Morales replaced Soliz Rada with an academic, Carlos Villegas, as the new minister of the sector. At this point, Vice President García Linera signaled to the multinationals that there would be no more ideological measures in the sector: he told the press that the government had now "capacity for dialogue and flexibility with the companies" (*Perfil.com* 2006).

Villegas had long advocated for a transfer – not expropriation – of the previously privatized companies to the state (Villegas 2002, 302–303) and he set about to implement this vision in the negotiations.[144] In a way, the appointment of Villegas sealed the government's strategic mode of action; while his predecessor had taken impetuous, impatient measures – such as jailing the Repsol manager or trying to nationalize Petrobras' refineries, for example – and opposed compensating the investors, Villegas advocated for amicable buyouts and negotiations, not further expropriation.

Partly due to these personnel changes, the second set of negotiations was delayed. Petrobras agreed to sell its two refineries back to the state in May 2007 but, after that, the process stalled for almost a year. When YPFB re-started the negotiations in early 2008 (interview with Ramírez 2012), there were two clear signs of moderation on the part of the government. First, Morales instructed the teams to seek only a 51% majority in the

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[143] In fact, Vice President Alvaro García Linera called the audits useless because "many parts of the audits were not concluded; other parts were conducted by anthropologists who know very little of hydrocarbons" (*La Prensa* 2010).

[144] This, in turn, would be done by transferring the shares owned by the pension funds to the state (Villegas 2002, 302–303).

companies. Two members of the government's negotiation teams confirmed that they were instructed not to negotiate a 100% takeover of the firms (interviews with Technocrat in the Ministry of Hydrocarbons 2012; Lawyer in the Ministry of Hydrocarbons 2012).[145] Second, Morales advised the teams to find amicable settlements with the companies and *avoid* cases that would end up in international arbitration (ibid). Both of these measures aligned with Villegas's buyout plans and, by early 2008, the demands for more radical nationalization without compensation had been shelved.

With the revenue gained from Law 3058, the renegotiation of the new contracts in 2006, and the high natural gas prices, the government could now afford to pay the companies. As mentioned above, the first agreement was reached with Petrobras, when the government agreed to pay $112 million for the two refineries that the firm had bought from the state for $104 million in 1999 (*AFP* 2007). The second agreement followed in May 2008, when the state promised to pay Repsol the stock market value for shares required for majority ownership of Andina (interview with Participant in negotiations with privatized companies in Bolivia 2012). The negotiations over the rest of the companies will be discussed in the following section of the chapter, as they ended only after the investors had initiated arbitration proceedings. The agreements with Petrobras and Andina, however, confirm that the state was implementing a buyout of shares, rather than a radical takeover of entire companies. In other words, the government was using the revenue gained through the earlier, nationalistic measures to conclude the final step of the nationalization. It was acting in a pragmatic, calculating manner, avoiding the costs of BITs.

[145] Specifically, the goal of the negotiations was to make YPFB the majority shareholder by buying 4-5% of the shares (Cairns and Delgado Camprubi 2006). In three of the companies, namely Chaco, Andina, and Transredes, the Bolivian pension funds Fondo de Capitalización Colectiva had been an important shareholder. The nationalization decree transferred these shares back to YPFB. After this move, the government only needed to gain control of some additional shares (ibid.).

The government seems willing to acknowledge that its mode of action at the negotiation stage was strategic, rather than ideological. One of the key figures behind the process, Vice President García Linera, described the negotiations over the privatized companies as a "strategic calculation": "[F]irst, do we have the money? Second, do the companies agree to the price we propose? Third, is it more convenient for us to pay now instead of going to arbitration?" (interview with García Linera 2012). Since the government ended compensating all the firms either before or during arbitration, this comment illustrates the economic feasibility of the nationalization – and, especially, the affordability of compensation – in the government's eyes. Instead of challenging the owners of the privatized companies, Morales chose to buy out the investors that stood in the way of the state's majority ownership. At that point, the government knew that it had the means to compensate the companies either immediately or after arbitration. In the end, it chose to avoid legal battles and pursue amicable settlements.

To conclude, the negotiation period offers strong evidence for the argument that the government proceeded strategically, not ideologically. During the first set of negotiations, Morales aimed to attract the companies to sign the new contracts by increasing the export price of gas to Argentina and by offering compensation for the firms' past investments, as well as by using harsh negotiation tactics and implementing short timelines. In so doing, the government aimed to minimize the costs of BITs by pushing the MNCs to agree. The tactic was a success: each firm signed their contract without appealing to international arbitration bodies. During the second set of negotiations, the government decided to use its new riches to conclude the nationalization process and take over the privatized companies through buyouts. By this point, the government had forced out the advocates of the ideological mode of action, and consolidated the strategic, calculated path to nationalization. Instead of ignoring the costs of BITs and pursuing radical expropriation, the decision-makers settled with the companies, using the revenue gained through the nationalistic law and the renegotiated contracts to fend off the consequences of BITs.

Aftermath of Nationalization (2008 – 2014): Paying One's Way out of Arbitration

The government's actions in the aftermath of the process allow us to assess its level of commitment to the rules of the international investment regime. On the one hand, if the government challenged the regime and refused to play according to its rules, we would conclude that its was behaving in an ideological, radical manner. On the other hand, compliance with the system would lend support to the strategic argument, suggesting that the government knew to expect the legal disputes and was ready to face the companies in the international legal arena, as well.

Some evidence may create the impression that Morales acted ideologically in the final stage of the process. Specifically, he left the World Bank arbitration body ICSID in May 2007, calling the venue "biased" and its methods "unclear" and "arbitrary" (Fiezzoni 2011, 138). Furthermore, the new constitution of 2009 prohibited Bolivia from signing any new BITs. Importantly, however, these measures had no concrete effects on the hydrocarbon nationalization. This is because they cannot be applied retroactively and, as a result, the expropriated firms retained their treaty protection. A technocrat involved in the negotiations and arbitrations described Bolivia's exit from ICSID as a political decision that did not affect their work (interview with Lawyer in the Ministry of Hydrocarbons 2012). In withdrawing from ICSID and forbidding new BITs, Morales simply exercised his right to choose arbitration venues and avoided incurring additional legal obligations for Bolivia. In this sense, his measures were not as radical or ideological as commonly framed.

The government's interaction with the companies in the aftermath of the process also refutes the ideological argument; rather than challenging the multinationals further and disregarding the legal disputes, the government continued to engage and compromise with them. The specific takeovers that led to legal battles involved some of the owners of Transredes, CLHB, and Chaco.[146] Ashmore, the owner of Transredes, registered the first arbitration case in the Stockholm Chamber of Commerce in July 2008. The second case followed in January 2010 when CLHB's owners Oiltanking and Graña y Montero took the state to arbitration in the Permanent Court of Arbitration. Lastly, Pan American Energy registered a case in ICSID over Chaco in April 2010. All cases rested on the BITs that the investors' home countries had in effect with Bolivia.[147]

Morales continued to engage with the companies even after these legal cases were registered (interview with Menacho 2012), and the negotiations were successful. The first settlement was signed in October 2008 when Ashmore, which had demanded $500 million for its share in Transredes (*Los Tiempos* 2008), accepted a compensation of about $240 million (*Reuters* 2008). Next, Oiltanking and Graña y Montero, which claimed losses worth $30 million for CLHB, agreed to the government's compensation of $16.44 million in December 2010 (*ANF* 2010). Finally, the Chaco case ended in December 2014, when the company scrapped its earlier demand of $1,496 million and accepted a payment of $324 million (Lazcano 2014).

Officials' public statements suggest that the government decided to settle the cases out of economic rationale. In 2014, after the agreement with Chaco's owners,

[146] The Brazilian and Dutch owners of Gas Trans Boliviano also initiated proceedings in UNCITRAL against Bolivia in 2008 over disagreement about taxes but the case was settled a few months later (Aguirre 2012, 73).
[147] Specifically, the Transredes case rested on the Luxembourg-Bolivia BIT, the case involving CLHB on the Germany-Bolivia and Peru-Bolivia treaties, and the Chaco case on Bolivia's treaty with the US.

Attorney General Héctor Arce told the press that the state revenue from the company since its nationalization in 2009 was more than double the amount of compensation (Lazcano 2014). After the deal with Ashmore in 2008, Minister of Hydrocarbons Carlos Villegas commented that the government had weighed the pros and cons of international arbitration and, consequently, decided to compensate without completing the legal process (*El Universal* 2009). These comments indicate that the government chose to settle the cases after considering the economic costs of arbitration and the benefits of nationalization. In other words, the choice of paying off the companies was a strategic decision: instead of waiting out the arbitration processes and possibly ignoring the final rulings, as an ideologically behaving government would do, Morales chose to end the nationalization process in early compromises. This behavior suggests compliance with the international investment regime and overall agreement with its rules.

Finally, the state's legal defense team went through important personnel changes over the course of the process. Cecilia Rocabado, Minister of Legal Defense in 2008 and 2009, shared Soliz Rada's view of nationalization. Specifically, she argued that the multinationals should be audited first and, if they had not respected their contracts, they would not be compensated (interview with Rocabado 2012). Rocabado soon noticed that she held a minority view in the administration: already in 2006, the government's discourse had shifted from "nationalization" to "migration of contracts"; according to Rocabado, a fear of international arbitration caused this moderation in the state's demands (ibid.).

Rocabado left the government in 2009, after a scandal that was unrelated to the hydrocarbon nationalization.[148] The next Minister of Legal Defense, Pablo Menacho, did

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[148] Specifically, Rocabado agreed with an Italian telecommunication company to change its arbitration venue and, allegedly, she was not authorized to do so (*Eju* 2010).

not consider the state's pragmatism problematic. He admitted that BITs and the possibility of international arbitration created some economic pressures for the government, forcing politicians to evaluate the costs of arbitration vis-à-vis the gains of nationalization (interview with Menacho 2012). However, he emphasized that the state always intended to compensate the firms, suggesting that the government held its strategic approach from the beginning (ibid.). The contrast between his view and that of Rocabado, nevertheless, suggests a change of positions in the state's legal defense. While the original leadership had advocated for an ideological mode of action, the ideologues were replaced with strategists who did not object to compensation and, in fact, considered it an inherent part of nationalization.

The analysis of the aftermath of nationalization underscores a few important points. First, Morales did not let the arbitration claims stall his nationalization process; for this reason, the aftermath was marked with continuous negotiations with the companies. In the end, his government settled all the arbitration cases early, before any final rulings were rendered. Second, the government seems to have fared well in these negotiations, as the settlements are far from the companies' original demands. Both of these points indicate that the government was acting in a pragmatic manner: instead of disregarding international arbitration, Morales's teams interacted with the firms and used the new hydrocarbon revenue to finalize the nationalization relatively quickly. Third and finally, the choice between a strategic and ideological mode of action seems to have been a conscious one, as the more ideological leadership of the state's legal team was replaced with a more pragmatic, strategic minister.

To conclude, the analysis of the different stages of the process indicate that the government pursued its nationalistic goals in a strategic, calculating manner. During the planning stage, it assessed the costs and benefits of its future actions and it chose to enact expropriation only after determining that the gains would exceed the costs. Importantly, BITs were a part of its assessment. This effectively refutes the ideological argument; had the government pursued the nationalization in an ideological manner, it would not have been concerned about the consequences of the treaties early on.

The government stayed on the rational, calculating course during the negotiation stage of the process. When renegotiating the exploration and extraction contracts, it offered the companies both carrots and a stick. The carrots arrived in the form of an increased export price of gas to Argentina and a promise of compensating companies for their existing investments. As a stick, Morales employed pressured negotiation tactics and imposed short timelines on the firms. With these tactics, he aimed to minimize the costs of BITs by pushing the firms to agree. As the government had hoped, all the firms signed their contract without requesting arbitration. In the negotiations over the previously privatized companies, the government chose to conclude the process by buying itself a majority ownership in each firm. By then, the government had ousted the advocates of the ideological mode of action. The strategic politicians settled with the companies, using the revenue gained through the nationalization to shoulder the costs of BITs, just as the government had planned.

Finally, in the aftermath of the process, the government continued to negotiate with the companies. Instead of escalating the legal conflicts or embracing the legal processes, as we saw in the case of Venezuela, the Morales government chose to compensate the companies early on. This behavior again aligns with the expectations of the strategic argument: the government accepted the rules of the international investment regime, but took the deliberate decision to end the legal disputes early, rather than wait for the final rulings.

CONCLUSION

The Bolivian hydrocarbon nationalization follows the expectations of the strategic argument when it comes to the government's decision to pursue its nationalistic goals and its mode of action in doing so. According to the strategic view, the decision to nationalize depends on the world price of the commodity in question. In particular, if the government expects continuous price increases, it can expect the future price to multiply the revenue created by the nationalization while the compensation amount will remain constant. Consequently, the gains of the measure will exceed its future costs and the government can proceed knowing that the compensation will be affordable. In the Bolivian case, the expectations for future natural gas prices jumped dramatically just when Morales took office and they remained high for the ensuing years. The analysis also revealed that the government was well prepared for BITs. This combination of optimistic price expectations and a deep understanding of the treaties' costs allow us to conclude that the government took the decision to nationalize only after calculating the consequences of the price increase.

Morales's careful preparation of the process in the planning stage also offers evidence for the strategic argument when it comes to the government's mode of action. Instead of simply acting out its nationalistic impulse, as the ideological argument would expect, Morales planned his steps carefully and readied himself for the consequences of BITs. He acted in a similarly strategic manner during the negotiations with the companies. Specifically, he offered positive and negative incentives for the firms to accept the new terms. In this way, the government aimed to minimize the future cost of compensation for the state. Morales's strategic mode of action became particularly evident in the negotiations over the privatized companies, when he advised his technocrats to end the nationalization process with amicable settlements. While some of the companies challenged the state and began arbitration proceedings, all these cases were settled out of court. Morales's willingness to negotiate and compromise, rather than to push for full state ownership and deny the companies their compensation, indicates that he was acting in a strategic manner.

Overall, then, the government's behavior during all three stages of the process is characterized by economic calculations and pragmatism. Moreover, the government ousted various radical people from the leadership early on in the process. Minister of Hydrocarbons, Andrés Soliz Rada, who opposed any compensation, had to leave the cabinet before the new contracts were signed. The head of the technocratic team, Manuel Morales Olivera, who held a different vision than Soliz Rada but also objected to compensation, left some months later. The new Minister of Hydrocarbons, Carlos Villegas, shared Morales's strategic vision and led the state to buy out some of the investors in the firms, rather than expropriate the entire companies without compensation. A similar transformation occurred in the state's legal arm, where the government replaced Soliz Rada's supporters with pragmatists who emphasized their respect for the rules of the neoliberal investment regime.

When it comes to the timing of the events, the Bolivian case does not help us assess the competing arguments. This is because Morales's schedule aligns with the expectations of both theories. On the one hand, the strategic argument expects the government to time its actions following the commodity price in question: the process begins once the leader is convinced that the future price increase will wash away the cost of the treaties. In Bolivia, the prices allowed Morales to make that prediction in May 2006. Following the ideological argument, on the other hand, we would expect expropriation soon after the leader takes power. Especially since Morales had proven his commitment to nationalization already during Mesa's term, he would be likely to act on his ideology soon after finally gaining power in 2006. Both theoretical arguments can thus explain the events in Bolivia. In terms of the causes of nationalization and Morales's mode of action, however, the evidence points overwhelmingly towards the strategic argument.

Chapter 6: Conclusion

This dissertation set out to answer two questions: First, how effective has the neoliberal investment regime of the 1990s been in deterring nationalistic acts in the new millennium? Second, what has allowed leaders like Hugo Chávez and Evo Morales to take over multinationals and bypass this regime? Specifically, how have they been able to nationalize some of the biggest oil companies in the world, despite the protection that bilateral investment treaties, the key pillar of the global investment system, offer for foreign firms against such actions?

Various political scientists have connected BITs to increasing amounts of FDI, suggesting that the treaties have allowed leaders to credibly commit to investors' property rights.[149] According to this view, the third-party arbitration provision included in BITs raises the costs of expropriation enough to prevent the host-country leader from acting on his or her nationalistic motivations. However, other scholars have highlighted the prevalence of property rights violations even in the era of BITs, concluding that the treaties do not protect foreign property to the extent expected (Wells and Ahmad 2007, 4; Post 2008; Manzano and Monaldi 2010, 451; Simmons 2011, 30; Post 2014; Wellhausen 2015, 33–34). Given these conflicting findings and observations, we need to evaluate the treaties' deterrent power in a systematic manner.

My statistical tests suggest that the treaties have *not* prevented nationalization of foreign firms. An analysis of expropriation of multinationals in 19 Latin American countries between 1985 and 2012 reveals that BITs have not decreased the probability of nationalization. On the contrary, the results indicate that the treaties have had a positive

[149] For a review of this literature, see Chapter 2.

effect: a host appears more likely to take over a company from a treaty-partner country than a firm whose home state has not signed a BIT with the host nation.

This surprising positive effect of BITs might be explained by the relative costs of different types of expropriatory measures. Without the treaties, nationalization is much more expensive for the host than less dramatic, regulatory measures, given the potential backlash from the investor's home country. However, with the treaties, companies can already sue their host for the smaller regulatory changes. If the firm has no other investments in the host country, or if it does not wish to return there in the future, arbitration offers a reasonable means to seek indemnification for losses that went uncompensated in the past. In such a world, if the affected firm is likely to sue anyways, outright nationalization creates less additional cost for the host government.

Since my statistical analysis indicates that BITs do not prevent nationalization, we need to turn our focus to particular nationalization processes in order to understand the causal mechanisms behind the treaties' deterrent failure. This dissertation has focused on hydrocarbon nationalization in Hugo Chávez's Venezuela and Evo Morales's Bolivia. According to the common wisdom, these processes are best explained by the leaders' ideology: Chávez and Morales were so committed to their leftist goals that the threat of BITs' future costs was not enough to sway them. I propose an alternative argument that highlights the leaders' strategic calculations. In this view, politicians take the decision to overstep the treaties only after careful considerations of the economic costs and benefits of their actions: expecting future price increases in oil and gas, Chávez and Morales projected the future gains of nationalization to exceed the costs of arbitration and potential compensation. By the time BITs' costs would materialize, the governments calculated, they would have the economic means to pay them off.

These competing arguments help us evaluate and explain three specific aspects of the nationalization process: i) the causes of the enactment of nationalization, ii) the way that leaders pursue their plans, and iii) the timing of events. First, if the strategic argument were correct, the cause of the final decision to nationalize would lie in increasing oil prices and the executives' rational, economic calculations on the basis of those prices. The ideological argument, in contrast, would explain the events with the leaders' leftism: committed to pushing through their nationalistic goals at any cost, leaders in this view would act impetuously and impatiently, disregarding the costs of BITs and ignoring their final consequences.

Process tracing of the events in Venezuela and Bolivia offers evidence for the strategic argument. Both governments estimated hydrocarbon prices to increase in the future, the budget proposals submitted to the legislature prior to the nationalistic measures prove. They also knew the costs that the treaties could inflict: both countries had previous experience with international arbitration, and the key policy-makers in Venezuela had objected to the ratification of the treaties in the early 1990s. Expecting upward-trending prices and aware of the consequences of their actions, Chávez and Morales took the conscious, calculated decision to proceed. In other words, they did not enact expropriation regardless of BITs and their future costs, as the ideological argument would have predicted.

Second, the arguments also expect the government to act in a particular manner when the nationalization process gets under way and the negotiations between the state and the MNCs begin. According to the strategic argument, leaders maintain their concern for BITs throughout the process. In practice, the government will employ different kinds of bargaining tactics that aim to minimize the costs of BITs, such as offering the firms access to new natural resources in exchange for dropping their law suits. If some of the companies continue down the legal path, however, the government will respond to the arbitration cases and respect the tribunals' final rulings. In short, the nationalizing leader acts in a calculated, pragmatic fashion throughout the process, from the planning of the measure to carrying it out and completing the compensation. An ideological politician, in contrast, would remain unconcerned about the treaties and their costs: true ideologues would not take the possible penalties of expropriation into account in the planning stage, and the negotiations and aftermath of the process would be characterized by similar disregard for BITs. Such leaders would refuse to submit to arbitration and to pay any compensation.

Chapters 4 and 5 document Chávez's and Morales' carefully calculated actions throughout the nationalization process. As the analysis shows, rather than ignoring the threat of international arbitration in the early stages, both leaders took the possibility of law suits seriously and tried to discourage the firms from taking such action. In Venezuela, the huge reserves in the Orinoco Belt offered the state a useful negotiation tool, and the government did not hesitate bringing it up in the negotiations. Bolivia lacked an equally powerful bargaining chip – but it motivated the companies with higher natural gas export prices and pressured them with extremely short timelines for the negotiations. These creative steps suggest that the governments acted in a rational, pragmatic manner, rather than in an ideological, impulsive fashion. Similarly, calculated measures dominated the aftermath, when the leaders chose to engage with the companies on the legal front and followed through with compensation, either after arbitration, as in the case of Venezuela, or settling the legal disputes along the way, as in the case of Bolivia.

Third and last, the arguments anticipate different timing for the enactment of expropriation. Strategic governments should act after increasing oil prices have led them to expect that they can afford to pay compensation. Ideological politicians, in contrast, should not rely on oil price predictions – for them, the simple fact of reaching power should be enough to prompt action. As discussed in Chapter 5, the Bolivian case does not offer conclusive evidence for either argument because the triggering situations both approaches postulated coincided: Morales started the nationalization process after an increase in hydrocarbon prices *and* soon after stepping into office. The Venezuelan case, however, is much more telling: instead of pursuing nationalization right after reaching power in 1999, or after having consolidated his position a few years later, Chávez waited until 2006 to begin terminating some contracts, and until 2007 to begin the migration of other contracts into new ones. Since his actions followed a dramatic increase in the governmental expectations of the oil price, this long delay offers evidence for the strategic argument.

To conclude, the in-depth analysis of the Venezuelan and Bolivian hydrocarbon nationalization processes offer overwhelming support for the argument that the governments acted on the basis of careful, pragmatic calculations. More specifically Chávez's and Morales's strategy, rather than their leftist ideological impulses, better explain the causes, the timing of nationalization, as well as their modes of action.

THEORETICAL IMPLICATIONS

This dissertation contributes to various strands of political science literature. On the most concrete level, I show that BITs have not allowed states to credibly commit to respecting property rights of foreign investors. While political scientists have pointed out that governments have continued to violate property rights even in the presence of the treaties, scholars have not assessed the treaties' deterrent power in a systematic fashion. My research shows that the treaties do not prevent governments from taking over multinationals and offers a theoretical explanation for this deterrent failure. Specifically, when oil prices increase, politicians can calculate that the future gains of nationalization will allow them to shoulder the costs of the treaties. Since the penalties of the BITs regime are conditional on world commodity prices, there are times when reneging on ones' earlier agreements is economically profitable, even in the presence of BITs. In other words, the treaties have not made expropriation, the most outrageous type of property rights violation, obsolete.

Interestingly, my research indicates that BITs lose their deterrent power exactly when multinationals need them most; when increasing commodity prices motivate politicians to renege on their earlier promises, the constraining effect of BITs disappears. Theoretically, this finding speaks to the debate over institutional effects. Treaty advocates hoped that BITs would establish property rights where domestic institutions are weak. However, as institutionalist scholars have noted, institutions produce outcomes only in interaction with other, non-institutional factors. The power of BITs, for example, is tied to economic variables: by forcing host governments to compensate affected firms for their losses, the treaties owe their bite to arbitration tribunals, their compensation rulings, and, ultimately, the economic costs imposed in that way. Before the treaties, much depended on the political clout of the investor's home country: governments would restrict foreign aid or, in the most extreme case, intervene militarily to ensure compensation for their nationals.[150] My research shows that the replacement of political responses with economic penalties has not been as effective as many hoped. When the economic conditions that determine the value of the expropriated good shift dramatically, the treaties and the compensation they can bring about are rendered toothless.

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[150] For the U.S. responses, see Maurer (2013). One of the key goals of the international investment regime was to depoliticize the issue of nationalization: by relying on third-party arbitration panels, the home and host country politics would be removed from the picture (Shihata 1992).

In her study on contract renegotiation in the Argentine water utility sector, Post also underscores the weakness of BITs (Post 2014; Post 2008). For her, their fragility calls attention to actor-level variables, such as firms' nationality and level of diversification in the host country (Post 2008, 324). In contrast, my research stresses the role of the underlying economic forces, not agency. Higher commodity prices can induce leaders to nationalize, as they can expect the relative costs of BITs to decrease dramatically. In other words, market forces can lead the treaties to lose their power, regardless of the specifics of the companies. Just as various scholars have recognized, political outcomes may depend more on the conditions that underlie institutions than the institutions themselves (Przeworski 2004, 527–540; MacIntyre 1972, 11–12; see also Weyland 2002, 57–85; Kurtz 2004, 27).

This finding highlights a problem of institutional design, especially at the international level. On the one hand, institutions change state behavior only if they have built-in concrete enforcements mechanisms (for the seminal work, see Downs, Rocke, and Barsoom 1996). On the other hand, the stricter the enforcement mechanisms, the more states will bargain over their participation in the negotiation stage (Fearon 1998). Tough negotiations, in turn, might prevent states from finding a compromise and decrease the amount of cooperation (ibid.). In a sense, BITs face this dilemma: as their consequences and costs have become more evident, countries have become less and less willing to remain in the regime. In addition to Venezuela and Bolivia, at least Ecuador, Indonesia, South Africa, and Australia have expressed their plans of cancelling some BITs or leaving the treaty regime altogether. The relatively strong enforcement mechanisms of the regime have made countries less willing to commit to it.

My work emphasizes that external, structural changes can reveal institutional effects that were unexpected in the design stage. The cases of Venezuela and Bolivia stress that governments can prioritize other interests than their predecessors, who aimed to attract more FDI, such as national sovereignty over foreign capital. Moreover, structural changes – booms and busts in global commodity prices, for example – can prompt changes in state interests. As mentioned in the introduction of this dissertation, the recent work on escape clauses in international organizations raises some of these issues (Koremenos 2001; Rosendorff and Milner 2001; Koremenos 2005). By including flexibility provisions into agreements, states can allow each other to break their earlier promises temporarily, without violating the spirit of the agreement in question. However, since BITs do not contain such provisions, Chávez's and Morales's decision to take over treaty-protected investment and then respect the treaties afterwards constitutes a different type of compliance. In fact, one can argue that they are not violating the letter of the treaties at all, given that BITs only prohibit expropriations that are discriminatory, not for a public purpose, and not followed by prompt, adequate and effective compensation (UNCTAD 2007, xii). Even if one considers that Chávez and Morales expropriated in a manner that violates this criteria – as various affected companies have argued – the presidents still participated in arbitration proceedings and paid the compensation. Theoretically, therefore, the processes in Venezuela and Bolivia are not cases of full non-compliance – yet their leaders have challenged the regime to some extent, since it contains no escape clause for allowing nationalization under certain economic circumstances.

To be clear, my theory does not rely solely on external shifts in global market forces. The case of Venezuela underscores that the argument accommodates for agency, as well. Before starting his oil reforms, Chávez brought the OPEC member states back together and, through collective action, he succeeded in pushing world oil prices upward. In other words, he did not leave his fate up to the international markets but took carefully planned steps to shape those economic forces. The Bolivian experience illustrates a similar point, albeit to a lesser extent. As pointed out in Chapter 5, the Morales government negotiated together with its Argentine counterpart an increase in the export price of Bolivian gas in mid-2006, a few months before the deadline for the new contracts. While the global commodity boom facilitated this increase, Morales's political measures made the economic context more favorable for the companies and allowed them to find an acceptable solution with the state. In other words, agency mattered, as well.

All in all, my research reveals some shortcomings of the existing literature. Perhaps most importantly, we still do not know to what extent the causal power of institutions relies on actors and structures. This dissertation shows that the BIT regime rests on economic variables, but also on actors that wish to challenge the treaties' underlying purpose. Moreover, we should not underestimate the power of shifting preferences to shape political outcomes, even when it comes to seemingly institutionalized regimes. States established the international investment regime when the forces of globalization appeared unstoppable. Today's context is strikingly different, especially in Latin America where post-neoliberal rulers have discredited the treaties and their goals. The conditions have changed as well, from record-low to record-high oil prices.[151] My work underlines the importance of such structural changes, and changes in actors' preferences, for understanding political outcomes.

[151] To be clear, oil contracts nowadays try to accommodate for price changes, for example through stability clauses that freeze the effects of legislative changes in the host state to the date of the contract (Vielleville and Vasani 2008, 11) Wälde and Ndi (1996, 255) note that instead of stabilization clauses, parties commonly include a renegotiation clause in the contract, which allows them to find a new agreement in case of a major change in the context surrounding the contract. Moreover, most contracts in the sector place the risk of governmental disruption on the state company. Wälde and Ndi emphasize, however, that none of these methods is "absolutely foolproof; they cannot exclude the possibility that the state, no longer party to the contract, might annul such contracts by legislative fiat" (ibid.). Additionally, while some arbitration

With regards to the new left in Latin America, this dissertation cautions against labeling Chávez's and Morales's FDI policies as "radical". The leaders' nationalistic economic policies are usually explained with their leftist beliefs. I argue that the Venezuelan and Bolivian governments pursued their nationalistic goals in a strategic manner, not ideologically. In classifying the leaders as radical (Ellner 2014a, 2) or contestatory (Weyland 2010, 3), we should make sure to distinguish which facets of policy-making we have in mind.[152] In their politics of FDI, Chávez and Morales have been more strategic than has been commonly acknowledged.

This is not to say that the leaders' overall conduct in the hydrocarbon sector has been economically optimal. Especially in Venezuela, the sector has suffered a decrease in production and an increase in accidents (Monaldi 2012) – both outcomes that politicians of all stripes want to avoid. In this sense, Chávez and Morales have behaved like "rational fools" (Sen 1977): in pursuing their nationalistic goals strategically, they have produced suboptimal outcomes in the hydrocarbon sector in general. This dissertation argues that the Venezuelan and Bolivian leaders acted out of strategy, not ideology, when implementing hydrocarbon nationalization, but it does not assess whether the final outcomes were welfare-generating.

It is also important to note that the Chávez and Morales governments have not been able to avoid the reputational costs of their actions. As Yackee (2007b, 22) notes, arbitration awards can turn potential investors away by publicizing the facts of the dispute and, in this way, spreading the word of the host's hostile behavior. Allee and

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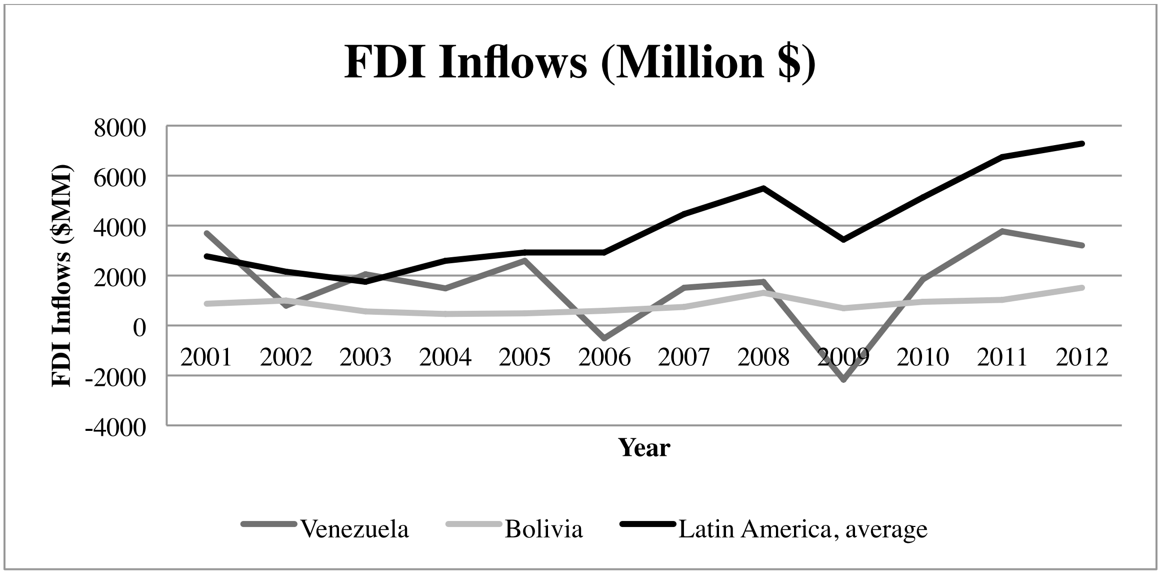
tribunals consider the clauses when determining the amount of compensation, other tribunals disagree (see Maniruzzaman 2007, Chekol, n.d.).

[152] As mentioned in the introduction, only a few scholars have examined the economic policies of the Latin American new left (Flores-Macias 2010; Weyland, Madrid, and Hunter 2010; Flores-Macias 2012) and, overall, political economy has not been a popular research topic among contemporary Latin Americanists (Luna, Murillo, and Schrank 2014, 5). My study contributes to both of these literatures.

Peinhardt corroborate this argument empirically, showing that host states lose FDI after a case is registered against them in ICSID (2011, 421-426). If the state loses the case, its incoming FDI decreases even further, as firms gain further confirmation of the state's anti-investor nature (ibid.).

In the case of Venezuela and Bolivia, investors seem to have learned their lesson. Figure 12 graphs the inward FDI in the two countries, alongside the average foreign investment for all of Latin America and the Caribbean. In the beginning of the new millennium, both Venezuela and Bolivia were quite close to the regional average and, for a few years, Venezuela even outperformed the region in attracting multinationals. Over the course of the decade, however, the situation changed. Bolivia's FDI levels remained relatively constant, whereas the amount of FDI fluctuated dramatically in Venezuela. Compared to the rest of Latin America, both countries underperformed: by 2012, they had moved further away from the regional average than ten years earlier. In fact, Venezuela received less FDI in 2012 than in 2001.

Figure 12: FDI inflows in Venezuela, Bolivia, and Latin America



Sources: UNCTAD (2015a), based on data from Banco Central de Venezuela, and Instituto Nacional de Estadística and Banco Central de Bolivia; average calculated on the basis of data from the World Bank (2013)

This development suggests that Chávez's and Morales's compliance with the arbitration regime and its rulings have not been able to prevent alarming potential investors. Even if the leaders expected to avoid the reputational costs of expropriation by respecting the international investment regime, foreign capital was not convinced. In this way, Chávez and Morales had to pay a price for violating the global investment system.

Venezuela's and Bolivia's poor performance in attracting new FDI suggests that the investment regime can have concrete effects, even if it has not prevented outright nationalization. Overall, then, my research highlights both the power of BITs and its limits. Unlike supporters hoped and opponents feared, the treaties have not constrained states' ability to re-establish their sovereignty and take over multinational corporations. However, such actions do not come without a cost: even when nationalistic governments follow through with their commitments to the investment regime, like the Chávez and Morales administrations did, potential investors can consider them as hostile to new FDI.

Finally, as mentioned in the introduction, my research has plenty of practical implications. Whether one thinks that developing countries should not tie themselves into the international investment regime (Rodrik 2010, 558; see also Van Harten 2010; Van Harten 2008), or whether one aims to improve the level of protection BITs offer for firms, the findings offer concrete suggestions. Since my focus is on evaluating the existing regime, however, I do not make specific policy recommendations. Nevertheless, the final section of this conclusion will discuss the future of the treaty regime.

EXTENDING THE ARGUMENT BEYOND LATIN AMERICA

The return of economic nationalism has not been confined to oil and gas in Latin America. In fact, analysts and observers often invoke the terms "resource nationalism" and "petro-nationalism" to describe the recent trends across the globe, as various governments have proceeded to increase taxes, demand new contracts and, in the most extreme cases, nationalize foreign-owned assets in the sector.[153] The list of nationalistic governments includes Equatorial Guinea, Kazakhstan, Algeria, Angola, Russia, Ecuador, and Argentina – in addition to the administrations of Venezuela and Bolivia (Anderson 2008).

Interestingly, however, natural resource nationalism elsewhere has mostly gone less far: unlike Chávez and Morales, other nationalistic heads of state have tended to shy away from outright expropriation. In this section, I will introduce the recent oil and gas reforms in Kazakhstan, which have advanced to full nationalization, to explore how well my theory travels to other regions of the world. Kazakhstan presents another rare case

[153] In political science, Terry Lynn Karl (1997) made the seminal contribution on petro-states: she argued that a state's fiscal reliance on oil creates particular incentives for politicians. As a consequence, oil exporting countries end up with weak institutions that are characterized by political distribution of rents, rather than state-building.

that involves actual state takeovers and, as the discussion will show, it seems to conform to the expectations of the strategic theory.

Nationalization in Kazakhstan – Ideological or Strategic?

The current wave of economic nationalism has often relied on increased state control and fiscal demands, rather than outright nationalization. The case of Kazakhstan, however, resembles the full-scale expropriation processes in Venezuela and Bolivia: after a string of regulatory measures starting in the 1990s, the government took a more nationalistic direction in 2004 and proceeded to take over private oil firms.

For this dissertation, the case of Kazakhstan offers a few additional insights. First of all, leftist ideology played no role in the events. Kazakhstan's last Soviet leader Nursultan Nazarbayev has ruled the country ever since its independence in 1991 and his authoritarian power has not been challenged seriously during this time. The following analysis will present in some detail the roller-coaster of oil policy during his stay in office, starting with the privatization of the 1990s and the early nationalistic reforms in the late 1990s, and culminating in cases of outright nationalization in the new millennium. Since Nazarbayev has led the country during these decades, his ideology seems an implausible explanation for these enormous policy shifts. In fact, Kazakh politics are not aligned along the traditional left-right continuum to begin with. Rather, politicians are divided along clan and regional affiliations, in addition to different economic groupings (Junisbai 2010, 236). For these reasons, the ideological argument cannot explain the weak deterrent power of BITs in Kazakhstan.

Second, the timing of the events offers evidence for the strategic argument, indicating that my theory is not confined to the Latin American context. The Kazakh government turned more nationalistic in 2004, exactly at the same time as Hugo Chávez on the other side of the globe and exactly when the oil price started to increase dramatically. Evidence presented in the following section indicates that this decision was taken with full awareness of BITs and their consequences. The case thus conforms to the expectations of the strategic theory: leaders overstep the treaties only if they expect to be able to cover the treaties' costs in the future – an outcome that commodity booms make possible. Overall, the Kazakh case supports the argument that the weak deterrent effect of BITs is best explained by leaders' economic calculations, not by their ideological impulses.

Kazakhstan has a long trajectory in oil: production started in 1911 and increased in volume under Soviet rule in the 1960 and 1970. However, the most dramatic jump in production occurred in the mid-1990s, after the fall of the USSR and the privatization of the sector. As the country declared its independence in 1991, it lacked technology and capital to develop the sector and, as a consequence, it invited in multinationals. The first major foreign oil company to enter was Chevron, and other American, as well as British, Chinese, Russian, French, Italian, Indonesian, and Dutch companies soon followed (Campaner and Yenikeyeff 2008, 14-18).

Today, Kazakhstan's reserves and production are the second-largest among the former Soviet republics, after Russia (U.S. Energy Information Administration 2015, 1). The sector plays a key role in the country's economy, and its role has increased over time; at the time of the fall of the USSR, in 1990, oil rents formed 15% of the GDP (World Bank 2013). 15 years later, in 2005, the share was 40%, and has since consolidated around 30% (ibid.).

However, in contrast to what this positive trend in production might suggest, the legal framework in the sector has been unstable. In 1993, the government agreed to a joint venture with Chevron in Tengiz, one of the main oil fields of the country, and Mobil bought into the project a few years later (Campaner and Yenikeyeff 2008, 14–15; Luong and Weinthal 2010, 263). The development of the project was slow, however, partly because of disagreements over a pipeline that would transport the oil from the land-locked country to the Black Sea (Yergin 2011, 68–72).[154] Additionally, the government began to pressure the companies starting in the late 1990s, demanding additional fiscal contributions and sometimes withholding licenses and permits in order to get its way (Luong and Weinthal 2010, 294–295).

The politics surrounding two other key oil fields, Kashagan and Karachaganak, follow the same pattern. These fields were developed under production sharing agreements with some of the world's biggest oil multinationals, including Eni, Total, Shell, Conoco, and BP (Campaner and Yenikeyeff 2008, 8). Here, too, the government started to increase taxes in the late 1990s – in fact, Luong (2010, 2) notes that by the turn of the millennium tax increases had become a "common practice" in the sector. Moreover, the government established a national oil and gas company, KazMunaiGaz, in 2002, and soon started to expand its role in the sector, at the expense of the multinationals.

After years of challenges and pressure on the private investors, the government shifted into even higher gear in 2004. The consortium in Kashagan blocked BG from selling its share in the project, and the government introduced a new law that required the state-oil company KazMunaiGaz to have a greater share in future contracts (Campaner and Yenikeyeff 2008, 15; Luong 2010, 1). According to Luong, these changes marked a transition from a strategy of forced contract renegotiations to outright nationalization

[154] The pipeline was finally finished in 2001, integrating Kazakhstan into the global oil markets (Yergin 2011, 72).

(Luong 2010, 3). Other scholars agree; Kennedy (2011, 17), for example, notes that the state's role in the sector expanded substantially after these reforms.[155]

Since the government's nationalistic turn in 2004, at least two multinationals have accused it of expropriation. First, Caratube claimed that the Minister of Energy and Mineral Resources terminated its contract unilaterally in January 2008 (Allen & Overy 2010, 4). The company responded by invoking the US-Kazakhstan BIT and taking the dispute into ICSID in June of the same year. Second, Ascom and others argued that the government seized their assets in July 2010, after a long string of unilateral measures and pressure (Stockholm Chamber of Commerce 2013, 12). The company took the case to the Arbitration Institute of the Stockholm Chamber of Commerce, on the basis of the Energy Charter Treaty, the European initiative to strengthen property rights comparable to BITs.

Importantly, the government ramped up its nationalism while being aware of the legal consequences. Kazakhstan had joined the New York Convention and the Energy Charter Treaty a few years after the fall of the USSR. The Nazarbayev administration had also embraced BITs, signing most of its 33 treaties over the course of the 1990s.[156] As a consequence, by the beginning of the new millennium, the country had embedded itself in the global investment regime (Shmatenko 2012, 31). In fact, when the government took its nationalistic turn in the oil and gas sector in 2004, it had already gained some first-hand experience with international arbitration: foreign investors had raised at least five cases against the Kazakh government in different arbitration bodies, one of which was based on a dispute in hydrocarbons.[157] It is thus reasonable to assume that the

155 Sarsenbayev (2011, 376) considers that the government intensified its nationalism a little later, after the renegotiation of the Kashagan field in 2007-2008.

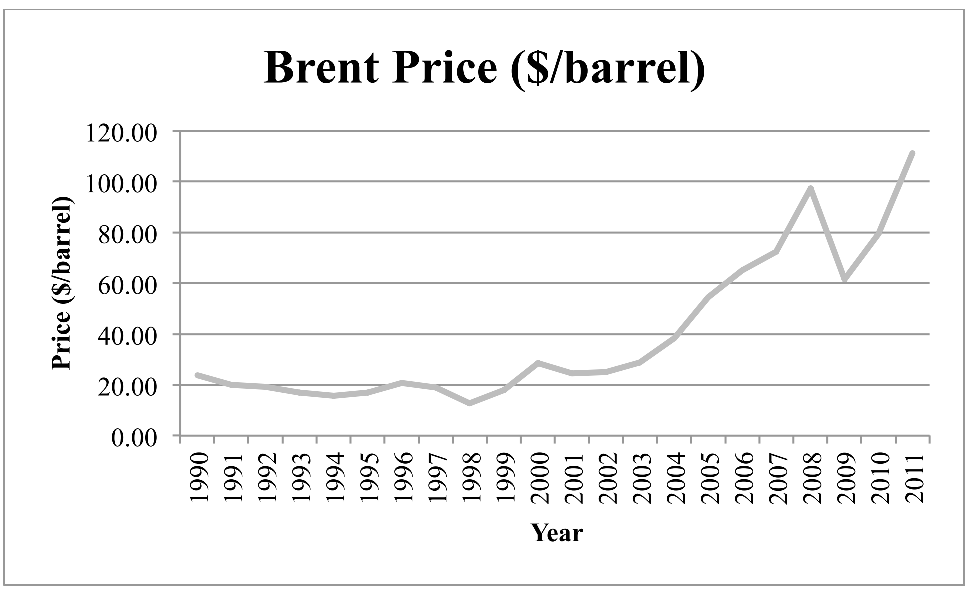
156 In total, Kazakhstan has 49 signed BITs (UNCTAD 2015b).

157 Three in ICSID, as listed by the arbitration body, and two in the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) (Shmatenko 2012, 25).

government knew about the legal implications of expropriatory actions in 2004, before it chose to intensify its nationalistic efforts in the sector.

In other words, the global legal framework that Kazakhstan had embraced during the earlier decade was not enough to prevent the nationalistic turn. Notably, the turn coincided with a sharp increase in oil prices. As Figure 13 illustrates, the price of Brent crude, a common benchmark for Kazakhstan's oil, started to hike in the early 2000s, and increasingly so in 2004. This development offers evidence for the strategic theory, as this is about the same time when the Nazarbayev government left the regulatory tax increases and other less dramatic measures behind and opted for more nationalistic acts, including outright expropriation.

Figure 13: Brent price



Source: BP (2014)

Overall, the events in Kazakhstan thus resemble those in Venezuela, where Chávez took a few, less nationalistic measures and proceeded then, after oil prices began to skyrocket, to challenge the existing contracts and push the multinationals in a more dramatic manner. The fact that Nazarbayev was already involved in multiple arbitration cases at the time of his truly nationalistic turn suggests that, as with its Venezuelan counterpart, the Kazakh government decided to expropriate with full knowledge of BITs and their costs.

A comment from an affected company offers further evidence for the argument that the government overstepped BITs while anticipating their future legal costs. According to the oil firm that accused Nazarbayev of nationalization in 2010, the government "apparently concluded that if it was going to face arbitration claims anyway, it might as well take the assets for free and posture a termination basis for the coming arbitration fight" (Stockholm Chamber of Commerce 2013, 12). This comment suggests the government was aware of the price to be paid for its actions when it chose to implement its nationalistic goals. It also supports the argument that BITs may push governments to act in more radical ways; as the government learned from the companies' response to its tax increases in the late 1990s, it decided to pursue a more dramatic course of action in the new millennium.[158]

In conclusion, the oil and gas reforms in Kazakhstan corroborate my argument: the government increased its grip over the sector when oil prices started to increase, aware of the future costs of the BITs. Unfortunately, we lack information about the government's compliance with the investment regime in the aftermath of the process. In fact, some reports suggest that enforcement of the arbitral awards has been somewhat difficult (Kuatbekov and Korobeinikov 2009, 204). Nevertheless, at least some experts note that the Kazakh government has indeed embraced the international arbitration

[158] In Sarsenbayev's view (2011, 376), as well, the government learned from its earlier regulatory reforms and, as a consequence, intensified its measures.

regime and is increasingly trusting its dispute resolution mechanisms (Kenjebayeva and Tukulov 2012, 312).

The brief analysis of the Kazakh case suggests that my argument can travel beyond the context of Latin America. Leaders are emboldened to take over BIT-protected firms when increasing oil prices allow them to calculate that the gains of nationalistic measures will exceed the future costs of the treaties. Just as in Venezuela and Bolivia, Nazarbayev started to implement the nationalistic reforms after the beginning of the oil price boom. Additionally, the case offers further evidence against the ideological argument. The Kazakh leader who chose to implement nationalistic reforms had been in power for a long time before the reforms. Moreover, his earlier policies in the sector were designed to attract foreign investors – the opposite of nationalistic reforms. This indicates that while underlying nationalistic goals are required for leaders to pursue expropriation, ideology *per se* does not explain why, when, and in what way politicians overstep BITs and take over protected multinationals.

THE FUTURE OF THE INTERNATIONAL INVESTMENT REGIME

This dissertation has uncovered that BITs, the key pillars of the international investment regime, have failed to prevent nationalistic leaders from expropriating oil multinationals. While the treaties may have offered foreign firms redress against some governmental actions, as suggested by the increase in number of disputes over smaller, regulatory changes in different sectors, they have not made hydrocarbon nationalization extinct. This finding is particularly important because the treaties were designed with the oil and gas sector in mind. Treaty advocates hoped that BITs would motivate host governments to hold their original promises even after foreign companies had made their expensive up-front investments. However, my research shows that when rising oil prices embolden nationalistic leaders to act, the treaties do little to stop them.

As the nationalization processes have unfolded in Venezuela and Bolivia, the international investment regime has evolved, as well. In fact, two interesting developments have taken place in the field during the past decade or so. On the one hand, countries and experts have challenged the arbitration system directly, essentially calling for a dramatic makeover of the regime. On the other hand, practitioners within the system – international lawyers and arbitrators – have tried to reform the regime in a more gradual manner. The former group of actors has aimed to strengthen the role of the state, whereas the latter group seems to have focused on investors, rather than the host states. These somewhat contradictory reform movements raise questions about the future of the regime: will progressive countries succeed in dismantling the BIT regime or remodeling it in a way that gives governments more control over FDI? Or, alternatively, will the next generation of nationalistic leaders face stronger BITs that leave no room for any violation of property rights whatsoever?

Despite these reform efforts, the global investment regime is likely to retain its form in the near future. This is for a variety of reasons. First of all, while the backlash to the regime is real, its effects have been limited so far. As the earlier chapters discussed, both the Morales and Chávez governments cancelled some of their BITs and withdrew their country from ICSID, Bolivia in 2007 and Venezuela in 2012.[159] The states justified their withdrawal by accusing ICSID of inconsistent rulings, lack of transparency, and high costs, among other reasons (Fiezzoni 2011, 135–136). However, Bolivia and Venezuela have not denied the overall importance of international arbitration. In fact,

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[159] Ecuador has taken similar measures, departing from ICSID in 2009.

starting in 2010, they started to work through UNASUR to establish their own, regional dispute resolution center that would avoid what they perceived as the biases of ICSID (ibid. 140). While pursuing the new regional center, the Chávez government agreed to arbitration clauses in some of the new Orinoco projects (Cárdenas García 2011, 277). Bolivia has also allowed for dispute resolution of its oil contracts (Aguirre n.d.). Overall, then, these countries have taken some measures to challenge BITs and ICSID – but they have not attacked the international arbitration system as a whole.

While other states have taken similar steps against the BIT regime, these measures have been even more limited. In the past few years, countries such as South Africa, Malaysia, and Indonesia have announced that they will terminate their BITs, and some have proceeded to do so. These nations are challenging the international investment regime to a certain extent, yet their actions do not threaten the system as a whole in a serious manner. This is because these states are essentially opting out of the system, rather than contesting it directly. Given the continuing popularity of the regime elsewhere, their actions are unlikely to prompt any major change in international arbitration.[160]

Some analysts and experts have echoed these countries' concerns about the fairness of the system. Rodrik (2007, 20), for example, argues that BITs are particularly harmful for developing countries because they offer multinationals more guarantees than local firms. Additionally, legal scholars have emphasized that certain characteristics of the system – such as a lack of tenure for arbitrators, for example – make the challengers' claims about the fairness and impartiality of the system legitimate (Van Harten 2008;

[160] In fact, even multinationals from countries without BITs are taking advantage of the regime. For example, Brazil has refused to ratify any BITs and, as a consequence, Brazilian companies investing abroad are not protected through their home country. Yet, some Brazilian firms register themselves in third-party countries with the goal of gaining treaty protection (Cristofaro and Teixeira Pinto 2012, 92).

Van Harten 2010). There have even been efforts to popularize a new model of treaty that places an emphasis on promoting sustainable development in the host countries (Mann et al. 2005; see also Maul and Vyborny n.d.). These views offer support for countries like Venezuela and Bolivia in their attempts to modify the global arbitration system but, just as the concrete steps host governments have taken, these opinions have remained somewhat marginal so far.

Overall, the backlash to the BIT regime is not only limited but also waning. UNASUR's initiative to establish a regional arbitration center in Latin America has been stalled for years, suggesting that the plan might have relied mostly on Venezuela's oil money and the access that certain Venezuelan legal experts had to their government through Chávez. With petrodollars and these channels of influence gone, the future of the new arbitration center is unclear. Moreover, departures from the BIT regime have been confined to a small number of countries and, as such, do not seem to be leading into a major makeover of the system.[161]

Another set of reforms has taken place within the system itself. In general, these measures seem to have focused on the companies' rights, rather than those of the host governments – yet, their effects are also limited. For this dissertation, perhaps the most relevant characteristic of the system under development concerns the compensation to affected firms. As disputes have became more common, arbitration panels seem to be reaching a consensus on the matter. In the 1990s, arbitrators determined the compensation amount by a variety of methods, and they held no consistent preference for a single method (Comeaux and Kinsella 1997, 91–92). Today, in contrast, tribunals

[161] However, these concerns should not be marginalized, either. In the recent trade deal negotiations between the U.S. and the European Union, and in the negotiations over the Trans-Pacific Partnership initiative, dispute settlement has been one of the most hotly contested issues (see, for example, *The Economist* 2014).

appear to be converging on compensating firms for the fair market value of their losses, calculated usually with the discounted cash flow method (Sabahi 2011, 102–103, 118).

A matter of particular interest here concerns the date that arbitration tribunals use to calculate the compensation. Most BITs specify that the compensation should be based on the value of the asset immediately before the expropriation or, if the measure decreases the asset's value, on the value before the intended expropriation became known (Nikièma 2013, 11). However, in 2012, a panel ruled that a host state should compensate an investor for a land taking according to the value of the land on the date of the award (ibid.; International Centre for Settlement of Investment Disputes 2012, 113). In other words, rather than basing the award on the value of the asset at the time of nationalization, as has been the practice, the arbitrators agreed to use a later date. This ruling could have important implications for producers of oil and other minerals. As this dissertation has shown, politicians are motivated to overstep BITs in these sectors when they anticipate increasing commodity prices to bring the cost of compensation down relative to the benefits of nationalization. If the compensation was determined on the basis of future prices, however, presidents could no longer anticipate to pay the future costs of BITs with the revenue gained through the price increase.

Other arbitration tribunals are unlikely to make similar decisions, however, for two reasons. First, there seems to be relatively little discussion on the topic in the legal field. To my knowledge, no prominent practitioners have proposed that the compensation amount should be indexed to the price of the asset, for example. This might be a practical matter: as host states have regularly violated the stabilization clauses that are included in some oil contracts to counter price fluctuations (see Maniruzzaman 2007, Chekol, n.d.), it is not clear why countries would be deterred by more detailed clauses in BITs, either.[162]

Second, an important reason for predicting systemic stability lies in the multitude of interests that are embedded in the current BIT regime. BITs have empowered a new group of actors with high stakes in the system, namely lawyers specializing in international arbitration. In fact, the practice of arbitration and the need for legal professionals have grown dramatically in the past few years, prompting some to call the field today an "arbitration industry" (Corporate Europe Observatory 2012). According to a recent OECD study (2012, 71), an average case costs a party over 8 million dollars. Law firms can charge for their services as much as $1,000 per hour, per lawyer (Corporate Europe Observatory 2012). In light of these numbers, any drastic changes to the system seem unlikely; the interests of the actors operating the current regime are simply too strong.

Given the limited challenges to the investment regime on the part of states, and the relatively minor reforms by other invested parties, we can expect the regime to retain its current shape in the future. While this prediction may sound pessimistic for the challenger states, there is also a silver lining: commodity booms will allow leaders to demand new contracts and increase their control over multinationals in the future, as well, regardless of BITs. For the reasons outlined above, the investment regime is unlikely to constrain the hands of tomorrow's nationalistic politicians any more than it constrained Chávez and Morales.

Of course, as the global oil price has fallen, nationalistic leaders are now forced to hold off their nationalistic goals. The Venezuelan government, for example, has had to

[162] For theoretical arguments why the stabilization clauses should not be binding, see Sornarajah (2014, 256). It is also important to note that oil companies have traditionally been willing to assume the risk of expropriation when making their investment decisions (Hajzler 2012, 19).

reverse some of its nationalistic reforms and grant more control to companies that participate in joint ventures with PDVSA (Neuman 2014). The uncertain future of UNASUR's arbitration center exemplifies how economics matter for the international legal field, as well. With Venezuela's oil money gone, any regional arbitration center is unlikely to take over the role of ICSID in Latin America. My research suggests that leaders can overstep their international commitments and challenge the prevailing institutional arrangements when prices boom - but when prices bust, their leverage shrinks.

For Latin American states, the rise of international arbitration is not an entirely negative outcome. This is because various countries in the region have gained considerable experience in the system. Especially, the Venezuelan team has received praise for its complex defense strategy (Guerrero-Rocca 2013). Additionally, various Bolivian and Venezuelan lawyers interviewed for this dissertation spoke about the case of Argentina with a certain degree of admiration, noting that the country has succeeded in building a strong institutional structure for the state's legal defense, employing Argentine lawyers and, essentially, turning them into world-class experts on the topic (interviews with Ortiz 2012; De La Fuente 2012; Hernández Bretón 2013). Bolivia seems to have tried to replicate the Argentine experience, as it created the Ministry of the State's Legal Defense in 2008 and then turned the Ministry into an Attorney General's office in 2010. This sort of institution building can be a very positive development in Latin America, known traditionally for its weak domestic institutions. Increasing state capacity on the international legal front can have positive externalities at home, when it comes to ensuring the respect for human rights or environment, for instance.

Finally, for the Latin American left, the future looks a little bleaker than before. While the states are unlikely to lose more of their autonomy to multinationals and the international investment regime, for the reasons outlined above, the wider public has now been exposed to BITs and their consequences. The nationalizations under Morales and Chávez are only partly to blame for this development, as the 2000 Water War in Bolivia and the high profile cases against Argentina, among others, had already brought the treaties to the public's attention. However, the loud counter-attacks that the oil firms mounted against Venezuela and, to a lesser extent, Bolivia have certainly increased the treaties' salience in the public eye. Since the citizenry knows more about the dramatic legal costs of expropriation, it might be less attractive to politicians with nationalistic demands in the future. Given that state control over the economy is one of the key issues of the left, leftist politicians might have lost a powerful policy issue from their toolkit.

Appendix

Table 7: List of expropriations in the analysis in Chapter 3

Host Country	Home Country	Year	Nationalized Firm	Sector	Sector 2	Sector 3	Coded by
Argentina	Germany	2001	Siemens	SVS			Hajzler
Argentina	Spain	2008	Grupo Marsans	SVS			Koivumaeki
Argentina	Spain	2012	Repsol	OIL			Koivumaeki
Bolivia	US	2000	Bechtel	UTL			Hajzler
Bolivia	France	2005	Suez Lyonnaise Des Eaux	UTL			Hajzler
Bolivia	Brazil	2006	Petrobras	OIL			Hajzler
Bolivia	Spain	2006	Andina (Repsol)	OIL			Hajzler
Bolivia	Argentina	2006	Chaco (PanAmerican Energy)	OIL			Hajzler
Bolivia	US	2006	Transredes (AEI)	OIL			Hajzler
Bolivia	Netherlands	2006	Transredes (Shell); CLHB (Oiltanking)	OIL			Hajzler
Bolivia	Peru	2006	CLHB (Grana Montero)	OIL			Hajzler
Bolivia	UK	2009	Air BP	OIL			Koivumaeki
Bolivia	Switzerland	2007	Glencore International AG	MIN			Koivumaeki
Bolivia	Italy	2008	Telecom	UTL			Koivumaeki
Bolivia	Spain	2010	Banco Bilbao Vizcaya Argentaria-BBVA de España	FIN			Koivumaeki
Bolivia	Switzerland	2010	Futuro (Grupo Zurich de Suiza)	FIN			Koivumaeki
Bolivia	Mexico	2010	Fábrica Nacional del Cemento	MFG			Koivumaeki
Bolivia	France	2010	Corani (GDF)	UTL			Koivumaeki
Bolivia	UK	2010	Guarachi (Rurelec)	UTL			Koivumaeki

Bolivia	Spain	2012	Red Electrica de Espana; Iberdola	UTL	Koivumaeki
Bolivia	Switzerland	2012	Glencore International AG	MIN	Koivumaeki
Dominican Republic	US	2008	Sierra Bauxita Dominicana	MIN	Koivumaeki
Ecuador	US	2006	Occidental Petroleum	OIL	Hajzler
Honduras	UK	2012	SABMiller	AGR	Koivumaeki
Mexico	US	1995	Metalclad	MFG	Hajzler
Mexico	US	1998	USA Waste Services	SVS	Hajzler
Mexico	Spain	1998	Tecmed	SVS	Hajzler
Mexico	US	2001	GAM mills; Grupo Azucero Mexico	MFG	Hajzler
Peru	US	1985	Belco Petroleum Corporation; The Occidental Petroleum Corporation; Oxy-Bridas Consortium	OIL	Minor
Peru	Argentina	1985	Oxy-Bridas Consortium	OIL	Minor
Peru	Switzerland	1986	Nestle	MFG	Minor
Venezuela	Canada	2001	Vannessa Ventures/Gold Reserves	MIN	Hajzler
Venezuela	Canada	2002	Enbridge Corporation	MIN	Hajzler
Venezuela	US	2002	Williams, Northville Industries, Science Applications International Corporation	MIN	Hajzler
Venezuela	UK	2005	Vestey Group	AGR	Hajzler
Venezuela	US	2005	Heinz	MFG	Hajzler
Venezuela	Barbados	2005	Polar	MFG	Hajzler
Venezuela	Canada	2005	Crystalex	MIN	Hajzler
Venezuela	Colombia	2006	Compania de Cementos Argos SA	MFG	Hajzler
Venezuela	Italy	2006	ENI Dacion B.V.	OIL	Hajzler

Venezuela	France	2006	Total	OIL			Hajzler
Venezuela	US	2007	ExxonMobil, ConocoPhillips, AES Corp (Electricidad de Caracas), Seneca (CMS Energy), Anónima Nacional de Teléfonos de Venezuela (Cantv)	OIL	UTL	SVS	Koivumaeki
Venezuela	Panama	2007	Opic Karinum	OIL			Koivumaeki
Venezuela	Argentina	2008	Ternium Techint	MIN			Koivumaeki
Venezuela	Mexico	2009	Cemex SAB	MFG			Koivumaeki
Venezuela	France	2009	Lafarge SA	MFG			Koivumaeki
Venezuela	Switzerland	2009	Holcim Lld, Flughafen Zurich	MFG	SVS		Koivumaeki
Venezuela	Spain	2009	Banco de Venezuela	FIN			Koivumaeki
Venezuela	Chile	2009	Gestion e Ingenieria IDC SA	SVS			Koivumaeki
Venezuela	Canada	2008	Crystallex	MIN			Koivumaeki
Venezuela	US	2009	Cargill, Coca Cola - Femsa, Williams Companies Inc, Exterran Holdings, Blackstone Group	MFG	OIL	SVS	Koivumaeki
Venezuela	Ireland	2009	Smurfit Kappa	AGR			Koivumaeki
Venezuela	UK	2009	BHB Billiton	MIN			Koivumaeki
Venezuela	Argentina	2009	Techting	MIN			Koivumaeki
Venezuela	Japan	2009	Grupo Acero Kobe Steel	MIN			Koivumaeki
Venezuela	Luxembourg	2009	Tubos Tavsa	MIN			Koivumaeki
Venezuela	Barbados	2009	Tidewater	OIL			Koivumaeki
Venezuela	Canada	2009	Hortensia Margarita Shortt	OIL			Koivumaeki
Venezuela	Netherlands	2009	Longreef Investment Group	MFG			Koivumaeki
Venezuela	Colombia	2009	Sucre or Urenna	MFG			Koivumaeki
Venezuela	France	2010	Casino	SVS			Koivumaeki
Venezuela	Mexico	2010	Gruma	MFG			Koivumaeki

Venezuela	US	2010	Helmerich & Payne, Norpro	OIL	MIN	Koivumaeki
Venezuela	Switzerland	2010	Koch Industries	MFG		Koivumaeki
Venezuela	Barbados	2010	Polar	MFG		Koivumaeki
Venezuela	Spain	2010	Agroisleña	AGR		Koivumaeki
Venezuela	Netherlands	2010	Owens Illinois, Industrias Venoco C. A.	MFG		Koivumaeki
Venezuela	UK	2011	-	AGR		Koivumaeki
Venezuela	Canada	2012	Rusoro	MIN		Koivumaeki
Venezuela	Barbados	2007	Blue Bank International	FIN		Koivumaeki
Venezuela	Spain	2011	Valle Verde	FIN		Koivumaeki

Table 8: Summary statistics of the key variables

Variable	Mean	Standard Deviation	Min	Max	Data Sources
Expropriation	0.00059	0.024	0	1	Minor (1994); Coyle (n.d.) Hajzler (2012); Koivumaeki[163]
BIT	0.056	0.23	0	1	UNCTAD (2013)
Democracy (lagged)	6.45	4.26	-9	10	Polity IV (Marshall and Jaggers 2012)
Left government	0.40	0.49	0	1	Coppedge (1997); Huber et al. (2008); Koivumaeki[164]
Energy price (lagged)	56.15	31.63	23.78	125.56	World Bank Commodity Price Data (World Bank 2014)
GDP per capita (ln; lagged)	8.23	0.78	6.08	10.09	World Bank Development Indicators (World Bank 2013)
GDP growth (lagged)	3.31	4.11	-14.88	23.54	World Bank Development Indicators (World Bank 2013)
FDI (lagged)	2330.19	6240.46	-2169	66660.14	World Bank Development Indicators (World Bank 2013)
Trade (lagged)	84.31	1908.56	0	218086	World Bank Development Indicators (World Bank 2013)
Dollarization (lagged)	0.060	0.24	0	1	Reinhart and Rogoff (2002)
MIGA member (lagged)	0.59	0.49	0	1	Multilateral Investment Guarantee Agency (2015)

[163] I thank Stephen Kobrin (1980), Michael Minor (1994), Thomas Coyle (n.d.), and Christopher Hajzler (2012) for sharing their data.
[164] I thank Grigore Pop-Eleches (2009), Austin Hart (2010), David Doyle (2012), and Russell Shekha (2013) for sharing their codings.

Table 9: Determinants of expropriation, simple probit; robustness tests for the main model

	Model 1	**Model 2**	**Model 3**	**Model 4**	**Model 5**	**Model 6**
Dep. Variable	Expropriation	Expropriation	Expropriation	Natural resource Exp.	Expropriation	Expropriation
BIT	0.996*** (0.108)	0.984*** (0.121)	0.988*** (0.111)	0.916*** (0.187)	1.033*** (0.150)	0.991*** (0.146)
Democracy		-0.140*** (0.034)	-0.129*** (0.028)	-0.117*** (0.033)	-0.049 (0.032)	-0.139*** (0.016)
Left government	0.349** (0.175)	0.374* (0.211)	0.375** (0.183)	0.169 (0.435)	-0.254 (0.457)	0.365*** (0.140)
Energy price	0.013*** (0.003)	0.015*** (0.003)	0.014*** (0.004)	0.019*** (0.003)	0.011* (0.006)	0.015*** (0.002)
GDP per capita	0.013 (0.250)	-0.093 (0.218)	-0.021 (0.271)	-0.162 (0.137)	0.538 (1.566)	-0.087 (0.097)
GDP growth	0.019*** (0.007)	0.042** (0.218)	0.041*** (0.014)	0.058*** (0.011)	0.048*** (0.018)	0.041*** (0.011)
FDI	-1.00e-4 (7.72e-5)	-5.08e-6 (5.23e-5)	-5.62e-5 (5.07e-5)	-1.34e-4 (1.28e-4)	-9.21e-5 (5.62e-5)	-4.36e-5 (3.39e-5)
Trade	2.66e-5** (1.11e-5)	1.81e-6 (2.06e-6)	2.21e-5*** (8.01e-6)	3.18e-5*** (9.45e-6)	1.13e-5*** (2.94e-6)	2.16e-5*** (5.59e-6)
Dollarization	-0.963** (0.037)	-0.972*** (0.292)	-1.006*** (0.298)	-0.826*** (0.317)	2.069*** (0.430)	-0.959*** (0.279)
MIGA member	0.193 (0.235)	0.402 (0.301)	0.314 (0.321)	omitted	0.169 (0.164)	0.336 (0.244)

Time variables	included	included	included	included	included	included
Executive constraints	-0.011 (0.007)					
Amount of trade		2.66e-5 (1.9e-5)				
Economic crisis			-0.021 (0.231)			
Country dummies					included	
N	64524	64524	58658	39827	22648	64524
Wald chi2	5979.34	8216.87	93730.41	6075.81	.	287.33
Prob > chi2	0.0000	0.0000	0.0000	0.0000	.	0.0000
Pseudo R2	0.3327	0.3936	0.3896	0.3999	0.4479	0.3892

Notes: Standard errors in parenthesis. * significant at 10%; **significant at 5%; *** significant at 1% level.

The additional models presented above as robustness tests introduce the following changes to the main model: Model 1 measures the effect of democracy with *executive constraints* instead of the Polity IV democracy index (Marshall and Jaggers 2012); Model 2 includes a control for the *amount of trade* in the dyad (Barbieri and Keshk 2012); Model 3 introduces a dummy variable to capture economic crisis in the host country: the variable *economic crisis* takes a value of 1 if Reinhart and Rogoff (2011) identify any type of economic crisis in the country in the given year measured; in Model 4, the dependent variable is *expropriation in natural resource sectors*; Model 5 adds *country dummies* to the main model; and Model 6 clusters the errors on the host country rather than on the dyad.

As an additional robustness test, I estimate the likelihood of nationalization with rare events logit model. King and Zeng (2001) developed this estimator to analyze infrequent outcomes, such as wars and coups, that are difficult to explain with traditional estimators. In my data, nationalization occurs in less than 0.1% of the dyads, suggesting that the rare events logit estimator can offer less biased and more accurate estimates than the traditional logic model (ibid. 711-712). These results are presented in Table 8.

In Model 1, nationalization is regressed on the BIT between the countries at time t-1 and the remaining independent variables at time t. In Model 2, nationalization is regressed on the instrumental variable, the percentage of the host country's neighbors that have a BIT in effect with the home country at time t, and the other independent variables at time t. The results of both models, presented in Table 10, are consistent with the findings of the main model.[165]

[165] The sample includes non-leftists governments; the results hold when they are excluded.

Table 10: Determinants of expropriation, rare events logit analysis

	Model 1	**Model 2**
BIT_{t-1}	2.637*** (0.358)	
$Neighbors\_BITs_t$		0.025*** (0.006)
Democracy	-0.329*** (0.042)	-0.346*** (0.045)
Left government	0.739* (0.423)	0.729* (0.432)
Energy price	0.032*** (0.006)	0.039*** (0.008)
GDP per capita	-4.07e-5 (6.03e-5)	1.85e-4* (1.00e-4)
GDP growth	0.012 (0.046)	0.001 (0.049)
FDI	-1.77e-4 (1.35e-4)	-2.04e-4* (1.11e-4)
Trade	5.52e-5*** (1.59e-5)	4.81e-5*** (1.28e-5)
Dollarization	-1.772* (1.021)	-1.401 (1.058)
MIGA member	0.644 (0.582)	1.281** (0.599)
Time variables	included	included
N	62910	59340

Notes: Standard errors in parenthesis. * significant at 10%; **significant at 5%; *** significant at 1% level.

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