

# Exporting Capital, Importing Law\*

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## **Abstract**

How do economic elites protect their wealth from state predation (or regulation)? By routing ownership of their domestic assets through offshore shell companies, individuals can become *de jure* foreign investors in their home markets. Engaging in such “round-tripping” of investments not only reduces elites’ tax burdens but also provides access to international investment treaties that were created for foreign investors. Round-tripping then allows elites to sue their own sovereigns in neutral venues; remarkably, these extraterritorial disputes constitute 8% of the cases filed under the international investment regime and account for 41% of the total damages claimed. Analyzing nearly 300,000 shell company incorporations, we find evidence of strategic offshore structuring: elites are more likely to round-trip through offshore jurisdictions that give them access to the multilateral Energy Charter Treaty (ECT), but the opposite is true for Bilateral Investment Treaties. In mechanism tests, we find that this is most likely due to the ECT’s multilateral structure and its high salience among elites. The results have implications for the study of inequality, energy transitions, and the globalization of the individual.

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# 1 Introduction

Offshore finance was key to Mikhail Khodorkovsky’s success. He set up shell companies in places like the British Virgin Islands and the Isle of Man to ensure Yukos, his oil company, minimized its tax burden and accumulated hard currency. In 1999, amid a heated battle with minority shareholder and fellow billionaire, Kenneth Dart, Khodorkovsky hatched up a plan that would make even the most audacious accountants blush—he planned to invert the entire ownership structure of Yukos to turn it into a fully foreign company ([Hoffman, 2011](#)). He would leave Dart and Yukos’s other creditors with an empty shell of a company. With that move, the second largest oil company in Russia would become a *de jure* foreign corporate. Khodorkovsky largely succeeded. But when he lost his political battle with Vladimir Putin, Yukos’s complicated ownership structure provided an additional benefit: access to an international agreement designed to provide extra protections for foreign investors. Since Khodorkovsky used offshore shell companies to make Yukos appear to be a foreign company, his fellow Russian shareholders were able to sue the Russian state in international arbitration courts that were designed for foreign investors—they won a \$50 billion dollar claim, the largest award under the international investment regime.

Khodorkovsky’s experience sheds light on two underappreciated structuring features of offshore finance. First, elites exploit tax havens to become foreign investors in their own country. When making an investment, individuals can choose how to route the transaction. The most straightforward way would be to move money directly from their home location to where they intend to produce or sell goods. But the superwealthy frequently route even their *domestic* investments through offshore shell or holding companies, sending the money abroad before sending it straight back to their home jurisdiction ([Kalotay, 2012](#)). This changes the *de jure* nature of their investments as it will now show up in national accounts as foreign investment ([Linsi and Mügge, 2019](#); [Zucman, 2015](#)). Second, such “round-tripping” of investments can change the sites of conventionally domestic political contestation. If an individual

has structured their business empire through offshore companies, and more specifically using entities in jurisdictions that have an investment treaty with their home state, the losers from a political clash can argue they are foreign investors and then attempt to use international arbitration venues to compensate for their losses. They can use the neutral venues designed for multinational corporations in order to extend a political conflict through international means.

We label this phenomenon - the use of the Investor-State Dispute Settlement (ISDS) to resolve a *domestic* conflict - an “extraterritorial arbitration” (EA). While scholars recognize EA as a recurrent exploitation of the international investment regime, we are the first to systematically document its rise. EAs constitute roughly 8% of the ISDS cases filed between 1987 and 2015, including de facto domestic elite-state conflicts from Russia, Turkey, Egypt, and Kazakhstan. Yet they constitute an astounding 41% of the total damages claimed under the regime. The commitment devices meant to spur foreign direct investment have almost overwhelmingly been used as a source of insurance for domestic economic elites.

We assess how the potential for extraterritorial arbitration influences the way economic elites structure their wealth and minimize predation from their home state. We do so at different levels of analysis that balance out some of the standard non-transparency issues with studying offshore finance. We first analyze the incorporation of 275,000 entities in 44 offshore jurisdictions based on the series of leaks compiled by the International Consortium of Investigative Journalists (ICIJ), examining whether a tax haven signing an investment agreement with an individual’s home country affects the number of incorporations in the tax haven. While the ICIJ data gives us unprecedented access to what is considered a nominally hidden world, it lacks data on the full-ownership chain and does not include data on the industry or amounts of money at stake. As a complement, we then analyze over 10,000 entities from 41 European home states and 65 offshore jurisdictions using qualitative and

quantitative information on the entire wealth chain via corporate services provider Bureau Van Dijk. To the best of our knowledge, both datasets are the most comprehensive versions of their kind.

Contra the expectation of conventional political economy theories of property protection, we find that increased potential for extraterritorial arbitration *reduces* the likelihood of elites utilizing a given tax haven. This negative effect holds for all the legal avenues an elite could use to initiate an extraterritorial arbitration with one exception. Signing up to the the Energy Charter Treaty (ECT) - a multilateral investment treaty signed by more than 50 jurisdictions that gives energy investors access to Investor-State Dispute Settlement mechanisms - spurs elites to round-trip through an ECT covered haven. Why the divergent effects? In mechanism tests, we find two plausible explanations: inter-elite learning and the ECT’s multilateral structure.

First, we find that the more the ECT is exploited via extraterritorial arbitration, the more popular ECT signatory states become as a round-tripping destinations. We interpret this result as an indication of elite learning about the possibilities of extraterritorial arbitration using the ECT; we do not see the same effect with BITs, possibly because the ECT is invoked far more frequently than any given BIT and may thus appear to be a “safer bet” for investment protection. Second, by analyzing incorporations in states that sign trade agreements with an individual’s home state, we show that bilateral PTAs *reduce* round-tripping between signatories while multilateral PTAs *increase* round-tripping.<sup>1</sup> We argue that the robust bilateral-multilateral divergence across treaty regimes suggests that the ECT’s multilateral structure may increase its attractiveness to round-trippers; multilateral treaties offer the same legal protections as bilateral treaties, without the increased diplomatic attention on one bilateral linkage.

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<sup>1</sup>We restrict to PTAs that do *not* offer ISDS access.

The paper then identifies a new set of distributional consequences associated with the international investment regime (Wellhausen, 2016). Research on the regime has generally focused on whether or not its treaties live up to their aims by increasing foreign direct investment. Moreover, they tend to focus primarily on Bilateral Investment Treaties (BITs) rather than incorporating the whole swath of treaties that can influence business-government relations. Here, we expand the legal focus while shifting the analysis toward understanding how the regime not only impacts economic flows, but also alters political flows. In line with how other international institutions are often manipulated, strategic, *de facto* domestic actors can leverage international investment tools for their own domestic ends. And yet not all elites seek easy access to such protections. The findings indicate a need for scholars to better understand the costs generated by transnational non-market strategy and the consequences of exploiting international institutions for private ends more generally.

Moreover, our results call for further work bridging the gaps between international regimes. While regime complexity is now a focal agenda for IR scholars, issue arenas are frequently theorized and assessed in isolation (Clark, 2021). Far less attention is paid to how decisions intended to benefit actors in one regime can spillover, and even change the purpose, of an alternate regime. The way elites are able to exploit rules in the tax arena to access the resources of another regime indicates that regimes are more dynamic than our theories expect (Thrall, 2021). Moreover, it suggests that when a regime relies on nationality as a key access criteria, it will create loopholes that generate inequalities in institutional access.

Finally, the paper indicates one way that the rules of the global economy can create both benefits and liabilities for transnational economic elites (Cooley and Sharman, 2017). While the institutionalization of international trade and finance has no doubt improved living standards, the gains have not been distributed equally. A wave of recent scholarship across

subfields examines the apparent backlash to globalization's imbalanced outcomes. But to comprehensively understand the populist wave we need to fully theorize the winners from the status quo. Emerging market elites is a class of winners that are rarely discussed in such scholarship, but we hope that the paper continues building momentum around a research agenda focused on the IPE of Oligarchy ([Cooley and Heathershaw, 2017](#)).

The article begins by drawing on relevant comparative and international political economy theories to illustrate that we should generally expect elites to structure their wealth to ensure access to ISDS against their home government, before detailing mechanisms that might condition that expectation. The second section begins our analysis of our offshore datasets, where we use a series of difference-in-differences estimators to examine how signing investment treaties influences an elites use of a tax haven. Our fourth section ex-post explains why we likely find differential effects amongst treaty types. In the conclusion, we summarize our findings and delineate a broader agenda on the determinants of global property rights.

## **2 The Political Economy of Extraterritorial Arbitration**

Economic elites want to build and protect their wealth - the state is the biggest threat to both processes, be it in developed or emerging economies. The state has historically confiscated an elite's economic resources through violent and coercive acts that often go under the banner of direct expropriation. More commonplace are indirect measures that cut away at an elite's bottom line - cumbersome regulation, excessive taxation, and arbitrary rule-making.

These are the starting points for a variety of Comparative Political Economy debates

on business-government relations, leading scholars document a range non-market strategies that economic elites employ to mitigate state-directed threats. We frequently see elites try to directly align themselves with state actors, substituting formal institutional protections with informal political connections ([Haber and Razo, 2003](#)). Even as lobbying becomes a default tool for virtually all major actors, we regularly see businessmen run for office themselves, with substantial economic returns for the firms they control ([Szakonyi, 2020](#)). The bulk of scholarship has focused on the domestic tools that plutocrats use to protect their property but recent work has turned to the transnational tools at an individual's disposal. Elites can try to team up with with foreign firms to gain additional political allies, and they can list their companies abroad to garner more attention and alter corporate governance rules ([Betz and Pond, 2019](#); [Markus, 2016](#); [Logvinenko, 2019](#)).

## 2.1 Offshore Finance and Property Protection

The move toward studying the transnational sources of property protection is an important step forward but has generally developed independent of debates on the role of offshore finance in global politics.<sup>2</sup> This is unsurprising given that much of comparative and international political economy scholarship on offshore finance is fundamentally focused on economic arbitrage. The biggest winners from offshore havens are generally regarded as multinational corporations (MNCs) who, with the aid of the major accounting firms, are able to efficiently route their investments and claim their profits in low tax jurisdictions like Ireland, Luxembourg, and the Cayman Islands ([Arel-Bundock, 2017](#); [Hearson, 2018](#)). But a variety of contemporary work documents that countries with even low corporate tax rates, like Saudi Arabia and Venezuela, tend to see the most amount of money moved to offshore sites ([Tørsløv, Wier and Zucman, 2022](#); [Zucman, 2014](#)).<sup>3</sup>

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<sup>2</sup>For a detailed historical account on the development of offshore finance see ([Palan, 2006](#))

<sup>3</sup>On the international rules dealing with money-laundering and financial flows from corrupt behavior see [Sharman \(2011, 2017\)](#). For experimental evidence on the effectiveness of international approaches to money

Part of this pattern can certainly be explained by economic arbitrage. Consider the choice set of an Indian oligarch when deciding to build a new factory at home. They could simply pay money to domestic construction companies and materials suppliers through their onshore balance sheets. Or they could move the money to Mauritius that has a highly favorable tax treaty with their home government, and then move the money back to India. Because of how it is routed offshore the money will show up in India as foreign investment and lock in a lower tax rate for the construction project. This “roundtripping” is rampant across emerging markets and helps explain why Mauritius was historically one of the top sources of FDI for India and why Cyprus regularly takes an even higher spot for investments into Russia (Aykut, Sanghi and Kosmidou, 2017; Xiao, 2004; Ledyeva, Karhunen and Whalley, 2013). In line with the work of academics like Katarina Pistor (2019) and journalists like Oliver Bullough (2018), roundtripping illustrates that the consequences of capital are a result of how it is legally constructed. By changing its *de jure* location, plutocrats can reap substantial economic returns even when only *de facto* investing in their home market. Such actions have been shown to heavily bias many of our core macroeconomic indicators and thereby distort our understanding of global politics. More generally, it indicates that nominally domestic economic elites, much like multinational corporations, can create a portfolio of nationalities by choosing how to route their investments and where they place their wealth (Cooley and Heathershaw, 2017).

But a number of researchers have called attention to the political gains from placing money abroad, and in particular how it facilitates institutional arbitrage (Sharman, 2012). By moving money into tax havens, investments become *de jure* governed by the laws of the foreign jurisdiction. Elites may gain access to the domestic courts in these jurisdictions and if a rival, be it a fellow private actor or the state, wants to seize one’s wealth that is placed

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laundering see Findley, Nielson and Sharman (2014)



abroad, they would need to go through the domestic legal system of the tax haven. Not only does that add greater transaction costs, the opacity of these jurisdictions also often means that rivals may not even know the money has been placed there. It is often “hidden” wealth. Most importantly, for our purposes, systematic quantitative work has confirmed the insights of a number of early offshore finance scholars. [Bayer et al. \(2020\)](#) show that more offshore companies are registered in tax havens when the threat of expropriation rises in an emerging market. Using a variety of micro data, [Earle et al. \(2019\)](#) find that Ukrainian oligarchs with the weakest political connections are most likely to obfuscate their wealth through tax havens. As one lawyer told us, “[Offshore structures] are an instrument of survival.”<sup>4</sup>

We link these two schools of thought on offshore finance to help us better understand how elites can protect their wealth from state predation. Tax havens all generally offer low tax rates and strong institutions, but they are not created equally. They vary in terms of their international engagement, and that has important consequences for the *international* property protections they can provide. More specifically, they have different degrees of integration into the international investment regime, which we argue conditions the strategic toolkit of economic elites.

## **2.2 Legal ambiguities interacting with shell companies gives elites potential transnational property rights**

Since its inception in the late 1950s, the modern international investment regime has grown to be comprised of 3,000 bilateral investment treaties (BITs). When two states sign a BIT, they make a commitment to apply a certain set of protections to each other’s foreign investors; for example, they promise not to expropriate assets without compensation or pass domestic regulations that discriminate against their partner state’s investors. Further, if a

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<sup>4</sup>Author interview with London-based lawyer February 2018

BIT-protected foreign investor believes that the host government has violated one of these protections, they are able to sue for damages in international arbitration courts through a process called investor-state dispute settlement (ISDS). ISDS awards are binding; if governments fail to pay, investors may lawfully seize state-owned assets to recoup damages.<sup>5</sup>

By giving foreign investors the ability to sue their host governments, the general aim of these treaties was to spur foreign direct investment in emerging markets (Wellhausen, 2019; Simmons, 2014). Under the regime states have limited recourse against infringements by multinational corporations, but the playing field is made even more asymmetric because of offshore finance and tax planning. As scholars like Gray (2020) and Thrall (2021) have documented, MNCs exploit their multi-jurisdictional structure to treaty shop—they can use their subsidiaries to file cases against a host government even if their main home government does not have an investment treaty with its host state. For example, when Czech businessman Vladimir Beno was prosecuted by the Czech government on tax evasion charges, he sold some of his assets to an Israel-headquartered firm called Phoenix Action and filed a dispute against the Czech Republic under the Israel-Czech Republic BIT (Gray, 2020, 20). Firms who adopted multi-jurisdictional structures primarily in order to lower their tax burdens can also benefit from third-party investment treaties; Thrall (2021) gives the example of an American firm, Bancroft Group, that routed its Croatian assets through a Dutch subsidiary (B3 Croatian Courier). Adopting this structure allowed the parent firm to lower its withholding tax rate from 15% to 0%, and—when a dispute arose with the Croatian government—Bancroft Group used its Dutch subsidiary to file the dispute rather than doing so directly.

Such “shopping” is possible because of two interacting features. First, the key governing

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<sup>5</sup>For example, Scottish energy firm Cairn Energy is currently attempting to seize airplanes owned by Indian state-owned enterprise Air India following the Indian government’s failure to pay a \$1.2B USD ISDS award. See Benjamin Parkin, George Parker, and Nathalie Thomas, “Cairn Energy sues Air India over \$1.2bn arbitration award”, *Financial Times*, 16 May 2021.

principal of the investment regime is discrete nationality ([van Os and Knottnerus, 2012](#)); if a business is registered in a jurisdiction, it gains access to its investment treaty provisions independent of how the rest of your business may be structured. Second, MNCs by definition have a portfolio of nationalities, which are already set up for normal business or tax purposes, which they can then choose to file cases with. As we’ve discussed, economic elites also frequently create such portfolios and they even take advantage of offshore structures for *de facto* domestic investments. Our contention is that domestic economic elites, and their legal teams, recognize the potential for international institutional arbitrage that MNCs exercise when they treaty shop. Routing investments through offshore vehicles can give them access to international treaty provisions that their home states lack. More importantly, roundtripping investments puts elites in a position to challenge their home state. Because of the investment regime’s nationality principal, disputes that are *de facto* domestic can then be adjudicated via international venues.

## 2.3 The value of ensuring access to Extraterritorial Arbitration

The gains from choosing an offshore haven that has an investment treaty with an individual’s home government go above and beyond those from simply placing money offshore. An elite’s wealth would likely still be hidden regardless of the location choice, and they are going to have access to stronger domestic institutions. But when a conflict arises with the home state—the primary threat to most plutocrats’ wealth—many offshore sites would leave them with limited recourse. A case filed against a sovereign state in courts of places like the British Virgin Islands or Singapore would almost certainly fail on jurisdictional grounds because of sovereign immunity. But by claiming to (legally) be a foreign actor, and using the provisions in virtually all BITs, plutocrats can sidestep those issues through international arbitration venues.

We label this phenomenon, when an individual turns a conflict with their home state into an international arbitration via their offshore wealth structures, an extraterritorial arbitration (or EA). These situations are unlikely to occur for common disputes between the state and the wealthy such as a fight over taxation rates since extraterritorial arbitration will not come without costs. By initiating a case, elites will inevitably have to detail some of the various methods used to structure their wealth, such as where their primary holdings companies are registered, as part of the legal proceedings. Moreover, filing a case against the state could alert other elites who may not have offshored their wealth to follow in a filer's stride, thereby reducing the power the state may have over economic elites. This could increase the threat from the state.

Nonetheless, there are two complimentary logics that should generally incentivize elites to incorporate offshore to gain such protections. First, it could act as a deterrent to any state-directed threats, be it direct or indirect expropriation. In general, when elites send money abroad they can conceal the ownership and origins by routing them through layers of shell companies. But the effectiveness of such concealment reduces when it comes to round-tripped entities - when the money gets sent back home, it will register in the state's national accounts and governments will then learn where at least part of the money is hidden (Ledyeva et al., 2015; Kalotay, 2012). The state is then likely to be aware of whether a powerful economic actor has gained offshore property protection, and may be dissuaded from confronting the individual in fear of having to defend a public and costly investment dispute.

ISDS can, however be a long and cumbersome process, taking years to come to any resolution, giving the state ample time to still reap gains from expropriating a rival. So, second, the possibility of filing EAs could instead be used as a political insurance mechanism even if the deterrence logic fails. In line with our assumptions, the power of economic actors creates a commitment problems between the state and the economic elite, which can lead to political

clashes, the end result of which is frequently expropriation by the state. While historically many of these intra-elite battles would end at this stage, the combination of offshore finance and the investment regime may extend the conflict. Now economic elites have the option to outsource political clashes to the international stage via extraterritorial arbitrations. Qualitative examination of the EAs that have occurred suggests political conflict, rather than standard economic disputes or regulation like we see in MNC-state ISDS, is the primary driving force before behind the outsourcing of authority.

Khodorkovsky and the Yukos Affair, which begins and motivates this paper, is now well known amongst observers of the investment regime. The political stakes and sums of money are easy to write off as an aberration, but our contention is that it largely symbolizes a broader pattern of extraterritorial arbitrations that turns ISDS into an intra-elite battleground. We find that 58 of the 723 ISDS cases filed between 1987 and 2015 are extraterritorial arbitrations.<sup>6</sup> This means that, in 8% of all known cases, the nominally foreign investor is actually a domestic elite who has routed ownership of their investments through a foreign company. Further, due in large part to the behemoth Yukos cases,<sup>8</sup> extraterritorial arbitrations compose 41% of the total damages claimed despite making up only 8% of cases.<sup>9</sup>

Table 1, which compares the most frequent respondent states in EAs and conventional ISDS cases, suggests that political clashes drive both seeking out offshore protection and eventually taking advantage of the generated property rights. Argentina and Venezuela are among the most common recipients of non-EA claims, due largely in part to the frequency

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<sup>6</sup>These figures are based on newly collected data from Thrall (2021) that identifies and examines all cases of extraterritorial arbitration between 1987 and 2015. For each firm that was listed as a claimant in every ISDS case filed through 2015, Thrall searched business databases, corporate registries, case documents, specialized news outlets, and other sources in order to identify whether the firm was owned by another firm or individual; if so, Thrall coded the nationality of the ultimate owner. For example, if a case was filed by a Dutch firm, but the Dutch firm was in turn a subsidiary of a US multinational, the ultimate owner would be coded as American. Using this data, we identify extraterritorial arbitrations as cases in which the nationality of the ultimate owner is the same as the nationality of the host government.<sup>7</sup>

<sup>8</sup>In *Hulley Enterprises v. Russia*, the claimants sought \$91B USD in damages—the largest sum ever sought in an ISDS case.

<sup>9</sup>Note that damages claimed do not reflect damages received.

Table 1: **Top 10 recipients of ISDS claims: extraterritorial arbitration vs. all others**

| Extraterritorial | Conventional ISDS |
|------------------|-------------------|
| Russia (7)       | Argentina (58)    |
| Czechia (6)      | Venezuela (35)    |
| Egypt (6)        | Spain (28)        |
| Turkey (6)       | Czechia (27)      |
| Spain (5)        | Canada (25)       |
| Venezuela (4)    | Mexico (23)       |
| Kazakhstan (3)   | Poland (23)       |
| Ukraine (3)      | Ecuador (21)      |
| Panama (2)       | Egypt (20)        |
| Albania (1)      | India (16)        |

with which they expropriate foreign investors, default on sovereign debt, and impose capital controls. On the other hand, EA cases—in which a state is sued by its own nationals—are dominated by post-communist states (Russia, Czechia, Kazakhstan, Ukraine, Albania) and other countries with relatively powerful oligarchies such as Egypt and Turkey. While governments like Saudi Arabia can be characterized as having control over their elites, and those in places like Indonesia are generally considered captured by oligarchs, states that face EA claims are jurisdictions where domestic politics are characterized by frequent power struggles among competing political factions. These competitions can be internationalized via extraterritorial arbitration.

Table 1 further indicates this is not a solely Russian phenomenon. Mukhtar Ablyazov was the primary challenger to Kazakhstan’s multi-decade ruler Nursultan Nazarbayev. After being imprisoned in the early 2000s, he struck a bargain with the state, leaving the country to re-build his wealth. He returned a handful of years later as the chairman of BTA Bank. The latter was eventually nationalized in the midst of the global financial crisis, which Ablyazov claims was a veneer for the regime to dispose of its clearest threat (Cooley and Heathershaw, 2017; Burgis, 2020). Ablyazov used thousands of offshore vehicles to protect his wealth (Nougayrede, 2015), and settled on using a shell company in the Netherlands to

make an ISDS claim worth \$1.5 billion (*KT Asia v. Kazakhstan*).

Similarly, after clashing with Erdogan in the early years of his tenure, the Turkish Uzan family may have inspired Khodorkovsky. They used the Energy Charter Treaty to strike back against their home government, seeking 3.5 billion for the cancellation of electricity concessions and the seizure of their conglomerates assets (*Uzan v. Turkey*). These additional examples highlight how political clashes become extended through ISDS. They further illustrate that EA is not a silver bullet to a fleeing elite's woes - the Uzans lost out on jurisdictional grounds while Ablyazov's case was resolved in favor of the state.

In sum, we expect economic elites to arbitrage the international property protection regime through offshore financial vehicles. MNCs have led the charge, taking advantage of their multi-jurisdictional structures to treaty shop. But the necessary nationality portfolios are also a common part of the emerging market plutocrat's toolkit. They recognize that moving assets abroad can give them international institutional protections. Round tripping investments, which are generally viewed as a source of economic arbitrage, creates political gains by allowing elites to protect themselves against their own sovereigns through treaties designed for foreign investors.

## 2.4 Mechanisms Driving Selective Offshore Incorporation

The investment regime was intended to solve the obsolescing bargaining between foreign investors and their host states. We have laid out how and why domestic investors may use those same protections by routing their investments through tax havens with investment agreements with their home governments. The obsolescing bargain driving the spread of investment treaties afflicts domestic economic elites and the state as well, creating incentives for the former to roundtrip investments to both deter state predation and to seek interna-

tional recourse if those protections fail (i.e. when we see intra-elite conflict occur). The resulting EAs do not fit with the general expectations of how the regime is supposed to function, and yet they constitute nearly 41% of the damages claimed under the regime.

The interdisciplinary literature on business-government relations suggest a number of mechanisms that should condition the importance of seeking offshore protection. First, as a huge body of literature in Comparative Politics argues, and the brief analysis of the EAs indicates, the types of conflicts worth taking abroad are more likely to occur in weakly institutionalized environments where the threat of state predation is relatively unconstrained ([Haber and Razo, 2003](#); [Szakonyi, 2020](#)). We should then see economic elites from autocratic regimes, economies where the state has a major presence, and general settings of high political risk, engage in more roundtripping compared to those from developed markets. Each of those factors should increase the likelihood of the political conflicts that our theory and the details of the disputes indicate drive EAs.

Second, political economy and management scholarship argues that the obsolescing bargain at the heart of the investment regime is particularly strong when investors are operating in industries with highly fixed assets ([Kerner and Lawrence, 2014](#); [Bauerle Danzman, 2016](#)). Because they will be unable to move their businesses easily or efficiently, their threat of exit diminishes, and the state is often able to expropriate them more effectively. As elites operating in sectors with high fixed assets are more at risk of becoming embroiled in a political conflict and are aware of this risk, existing theory suggests that they should be more likely to acquire a broader portfolio of nationalities to guard themselves against their home states.

Third, moving to the international cooperation literature, we know that not all BITs are created equally. While 95% of investment agreements provide access to ISDS mechanisms, they vary in terms of the ease of gaining jurisdiction and the broader set of legal harmoniza-



tion that states promise. Studies on MNCs behavior have shown that the legal specifics of treaties condition their effectiveness ([Frenkel and Walter, 2019](#); [Haftel, 2010](#)). Given that domestic economic elites are highly sophisticated actors, and have access to expert lawyers through the transnational legal market, we would expect them to prioritize havens that sign-up to treaties that provide them the strongest protections against their home state in an effort to either deter political conflict or as a future insurance mechanism.

Finally, we know that the world is not static and that actors regularly update their preferences based on new information revealed to them. Some of the defining work on investment treaties shows that learning has been a key mechanism toward the spread investment agreements ([Poulsen, 2015](#)). Moreover, part of the failure of the investment regime in attracting FDI is often attributed to the fact that in the early years MNCs were unaware of their value ([Poulsen, 2010](#)). Extraterritorial arbitration relies on legal ambiguities that need to be exploited - they are not advertised benefits of the treaties. Economic elites needed to experiment with the international legal system to test its viability. Once established as a possible avenue for protection under certain treaties, we would expect elites to learn from each other. In other words the more treaties are used for EAs, the more we should expect other elites to route their investments through the havens that laid the basis for the outsourcing of authority as they seek the protections nominally reserved for MNCs facing political threats to their wealth.

Next, we seek to assess the expectations of our theory and the mechanisms that could drive selective offshore incorporation.

### 3 IIA Coverage and Strategic Corporate Structures

In order to determine whether elites structure their assets to gain International Investment Agreement (IIA) protection, we draw on two complementary data sources. First, we use data on over 275,000 secretly-created offshore entities and their owners that was compiled by the International Consortium of Investigative Journalists (ICIJ) from four separate data leaks. Second, we use a smaller (but more richly detailed) sample of round-tripped investments that analytics firm Bureau van Dijk compiled from publicly available sources such as corporate registries. For both public and private samples, we use the staggered adoption of new IIAs over time to identify the effect of IIA coverage on new offshore incorporations at the bilateral level.

#### 3.1 Evidence from Offshore Leaks

Nontransparency is an obvious barrier to the systematic study of offshore wealth. For economic elites, anonymity is a primary benefit of the foreign shell company. ISDS cases offer us a window into the offshore vehicles maintained by certain individuals, though it is a small and selected sample: extraterritorial arbitrations necessarily occur only once a dispute between investor and host government has already begun. In order to make more general inferences about why (and where) elites choose to hold their capital abroad, we make use of formerly secret data from offshore service providers and national registries that was leaked to the ICIJ.

##### 3.1.1 ICIJ Leaks: Background

The ICIJ, an organization composed of journalists who collaborate on large investigations, was made famous in 2016 when it published the Panama Papers—a massive data leak from law firm and offshore service provider Mossack Fonseca which named thousands of secret shell companies and linked them to their owners. The leak made headline news

due to its exposure of the scope of global tax avoidance as well as the exposure of Mossack Fonseca’s high profile clients (which included, among others, Saudi Arabia’s King Salman and former Ukrainian President Petro Poroshenko).<sup>10</sup> While the Panama Papers attracted the most media attention, it was not the only major offshore data leak published by ICIJ; the organization also broke the “Offshore Leaks” leak (2013), the Paradise Papers (2017), and the Pandora Papers (2021), containing a combined total of over 600,000 offshore entities.<sup>11</sup>

The ICIJ leaks offer an unprecedented opportunity to study the offshore political economy: hundreds of thousands of offshore entities are linked with their beneficial owners, allowing for the study of both the destinations and the origins of offshore capital. Further, the leaked documents include the date of incorporation for each entity, allowing for longitudinal analysis. A number of past studies have used data from the Panama Papers to study the origins of the wealth held in tax havens (Alstadsæter, Johannesen and Zucman, 2018), the effects of expropriation on future offshoring (Bayer et al., 2020), and the effect of being implicated in the leaks on public firms’ value (O’Donovan, Wagner and Zeume, 2019).

### 3.1.2 ICIJ Leaks: Data and Research Design

Our goal is to study whether individuals from state  $i$  incorporate more (or fewer) entities in offshore jurisdiction  $j$  after states  $i$  and  $j$  form an IIA together. To do so, we begin by taking several steps to process the data provided by ICIJ. The ICIJ offshore leaks data contain one entry for each unique entity-owner pairing, as well as information on the jurisdiction in which the entity was incorporated and the nationalities of the owner(s). We first remove owners that are listed as having more than three nationalities; this is usually a sign that ICIJ cannot accurately determine an individual’s true nationality, and including these observations would likely add measurement error. We then remove owners who are

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<sup>10</sup>Michael S. Schmidt and Steven Lee Myers, “Panama Law Firm’s Leaked Files Detail Offshore Accounts Tied to World Leaders”, *New York Times*, 03 April 2016.

<sup>11</sup>The ICIJ also published the Bahamas Leaks, in 2016. However, since the incorporation dates for the entities in this leak are unknown, it is not possible to perform longitudinal analyses with this data.

associated with over 1,000 entities, as these owners are typically offshore service providers themselves rather than true beneficial owners.

Figure 1: **Aggregating the Offshore Leaks data.**

| 1. Entity-Owner format (original) |      |              |                | 2. Entity-Nationality format |              |           |
|-----------------------------------|------|--------------|----------------|------------------------------|--------------|-----------|
| Firm                              | Year | Jurisdiction | Owner (Nat)    | Year                         | Jurisdiction | Owner Nat |
| Firm A                            | 2007 | Panama       | Mx. X (Turkey) | 2007                         | Panama       | Turkey    |
| Firm A                            | 2007 | Panama       | Mr. Y (Russia) | 2007                         | Panama       | Russia    |
| Firm A                            | 2007 | Panama       | Ms. Z (Russia) | 2007                         | Panama       | Russia    |
| Firm B                            | 2007 | Panama       | Mr. J (Russia) |                              |              |           |

| 3. Dyad-Year format (final) |              |            |           |
|-----------------------------|--------------|------------|-----------|
| Year                        | Jurisdiction | Home state | # Incorps |
| 2007                        | Panama       | Turkey     | 1         |
| 2007                        | Panama       | Russia     | 2         |

Next, we aggregate the data up from the entity-owner level to the entity-nationality level. For example, Firm A (as depicted in Figure 1), a Panama-incorporated entity with two Russian owners and one Turkish owner, would be aggregated to one observation for Panama-Russia and one for Panama-Turkey. We take this simplifying step under the assumption that the number of entities incorporated, rather than the number of owners per entity, is a better measure of the strength of the bilateral linkage between home states and offshore jurisdictions. Finally, we aggregate the data again to the dyad-year level by counting the number of entities incorporated in offshore jurisdiction  $j$  that are linked to an owner from state  $i$  in year  $t$ . The resulting variable—the number of entities incorporated in jurisdiction  $j$ , in year  $t$ , with at least one owner from state  $i$ —is our primary dependent variable.

The resulting sample consists of 196 home states and 44 offshore jurisdictions, resulting in roughly 8,500 dyads observed annually from 1980 to 2017. A full list of jurisdictions can be found in Appendix Table A.1. Note that, as most of the offshore jurisdictions also serve

as home states, some dyads are directed (e.g., B.V.I.  $\rightarrow$  Netherlands and Netherlands  $\rightarrow$  B.V.I are treated as two separate dyads).

Our goal is to estimate the effect of treatment (gaining access to an IIA) on offshore incorporations at the bilateral level. Since the treatment is applied to different dyads in different years, the standard two-way fixed effects regression approach is unlikely to produce unbiased estimates (Goodman-Bacon, 2019). For this reason, we instead use Imai, Kim and Wang (2020)’s PanelMatch estimator, which extends the difference-in-differences framework to cases in which different units are treated at different times.

The PanelMatch estimator requires two pre-processing steps prior to estimation: first, each treated observation  $it$  is matched with a set of other observations  $M_{it}$  that had the same treatment status as  $it$  for the previous  $L$  time periods but were *not* treated at time  $t$ .<sup>12</sup> Next, to ensure that the observations in the matched sets can serve as a plausible counterfactual for the corresponding treated observations, the matched sets are pruned (or “refined”) to remove or downweight observations that have covariate or outcome histories that are too different from those of the treated observations. Once the matched sets have been refined, the following estimator is applied to recover the average treatment effect on the treated (ATT):

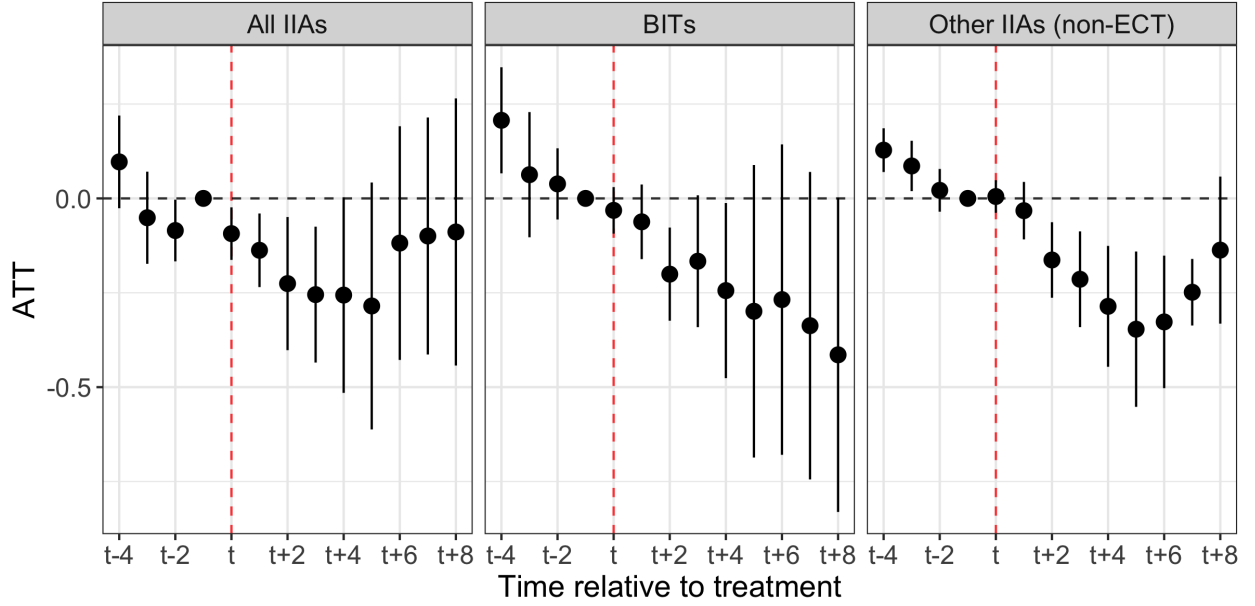
$$\hat{\delta}(F, L) = \underbrace{\frac{1}{\sum_{i=1}^N \sum_{t=L+1}^{T-F} D_{it}} \sum_{i=1}^N \sum_{t=L+1}^{T-F} D_{it}}_{\text{Average over all treated observations}} \underbrace{\left\{ (Y_{i,t+F} - Y_{i,t-1}) - \sum_{i' \in M_{it}} w_{it}^{i'} (Y_{i',t+F} - Y_{i',t-1}) \right\}}_{\text{Treated observation-specific diff-in-diff estimate}}$$

Each matched set serves as counterfactual group for the corresponding treated observation, allowing for the calculation of treated observation-specific difference-in-difference estimates. The IKW estimate is simply the average of these treated observation-specific

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<sup>12</sup> $L$  is a researcher-determined parameter.

Figure 2: On average, new IIAs *reduce* offshore incorporations between signatories.

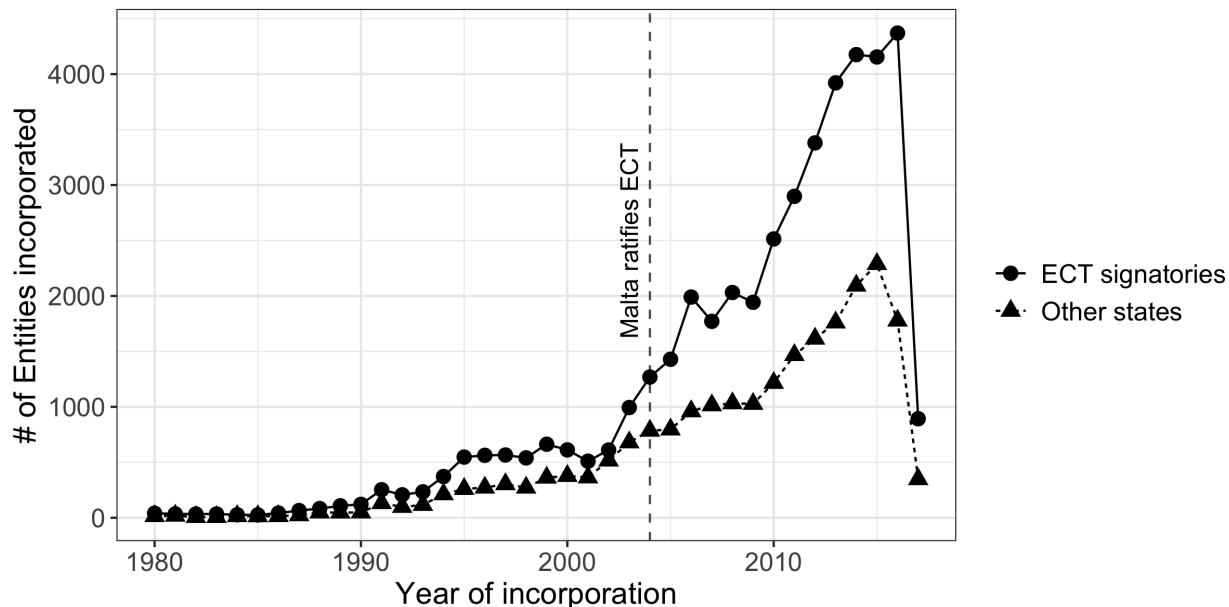


estimates. We set  $L = 4$  and report estimates for each value of  $F$  between  $-4$  and  $8$ . We also use propensity score weighting to refine our matched sets, allowing us to select counterfactual units that are similar on several relevant covariates. Specifically, we adjust for the regime type and political risk level of the home state; the corporate income tax rate (logged), GDP per capita (logged), and legal system of the offshore jurisdiction; and the presence of a bilateral tax treaty between the home state and the offshore jurisdiction.

### 3.1.3 ICIJ Leaks: Results

Figure 2 presents the results for three different treatment definitions: first, all IIAs (BITs, the ECT, and other IIAs); second, BITs only; third, IIAs other than BITs or the ECT. Across all three definitions, new IIAs appear to have a *negative* short-term effect on offshore incorporations between signatories. The average number of incorporations per dyad-year in the sample is 0.85, meaning that the effect size of approximately  $-0.25$  is modest but non-negligible—particularly given that it persists for several years.

Figure 3: **After Malta ratified the ECT, it became a more popular offshore jurisdiction for ECT signatories.** This graph plots the number of new incorporations in Malta, over time, by ECT signatory status of the owners' home states.

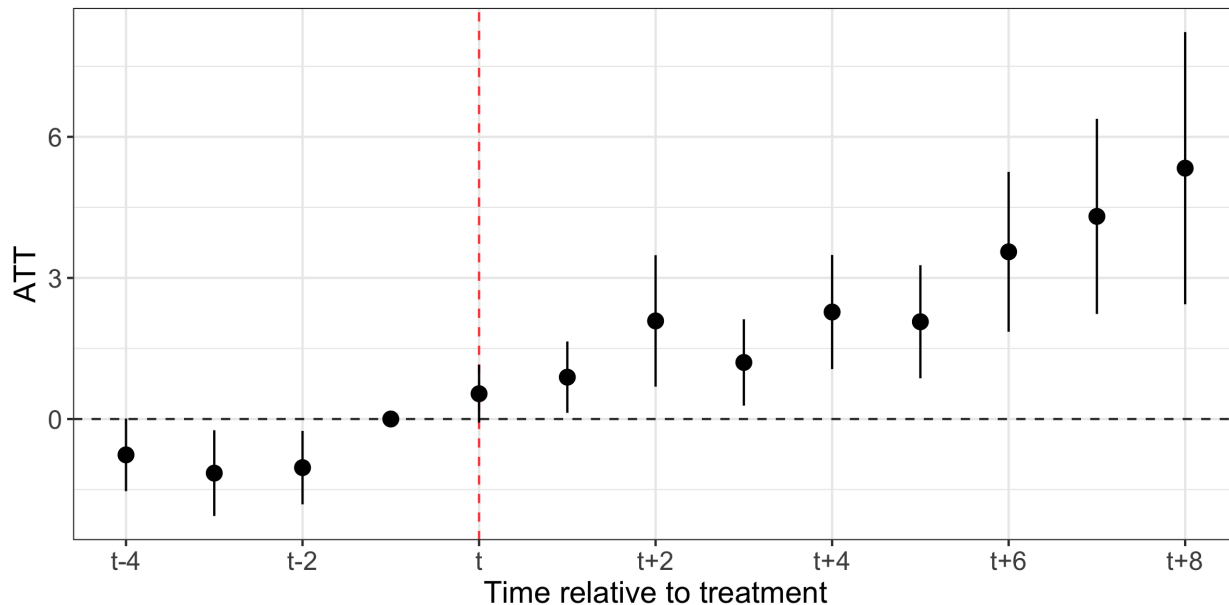


Next, we turn to estimating the effect of the ECT on offshore incorporations. The ECT accounts for the majority of the IIA coverage in the sample beginning in 2004; this is primarily because Malta, an offshore jurisdiction that had its secret corporate registry leaked to the ICIJ in 2017, joined the ECT in that year.<sup>13</sup> As Figure 3 demonstrates, Malta became an increasingly popular offshore jurisdiction among owners from other ECT signatory states after ratifying the agreement, while the difference between signatories and non-signatories had previously been negligible. The raw trends suggest that, unlike BITs or other non-BIT IIAs (such as PTAs with investment chapters), elites may be strategically structuring their assets to gain access to the ECT.

Figure 4 presents the PanelMatch estimates for the ECT. In contrast to the results presented in Figure 2, states who join the ECT are significantly more likely to host offshore

<sup>13</sup>Malta also joined the EU in 2004; to avoid potential confounding, we adjust for joint EU membership when estimating the effect of the ECT. The results in the next section, which relies on a broader set of havens should further alleviate concerns that the ECT effect is driven by individuals seeking to just invest in the EU.

Figure 4: **The Energy Charter Treaty *increased* offshore incorporations between signatories.**

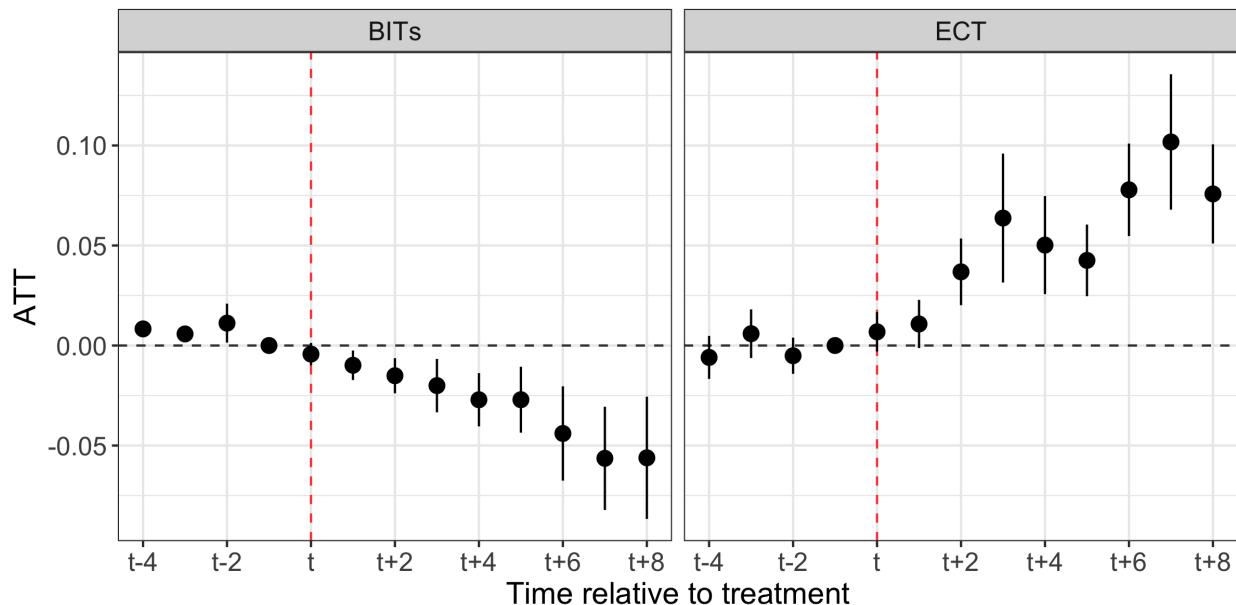


entities created by owners from other ECT signatory states. The effect is not only consistent but appears to grow larger in magnitude over time, reaching over one-third of a standard deviation at eight years after treatment. These results strongly suggest that individuals value ECT access when choosing where to incorporate their offshore vehicles. Even after controlling for tax factors, as well as other potential confounders such as EU membership, owners from ECT member states increase their offshore holdings in jurisdictions that join the ECT.

Using formerly secret data on offshore shell companies, we document a weak and transitory negative effect of IIA coverage on new incorporations. However, this pooled effect masks substantial heterogeneity: while BITs and other non-ECT IIAs have negative effects, the ECT has large and sustained positive effects. Next, we apply the same empirical approach to a smaller but more detailed sample of public (e.g., non-secret) offshore corporate structures.



Figure 5: New BITs decrease round-tripping between partner states, while investors from new ECT signatories increase round-tripping with other signatories.



### 3.2 Evidence from Round-Tripped Investments

The offshore leaks data provide a large sample with high external validity, and the fact that they were made public by a whistleblower reduces the likelihood of bias from sample selection. However, while the leaks data allow us to link offshore entities to their owners, they do not inform us about the holdings of the entities themselves. This is important, because an individual who simply holds assets in an IIA partner state does not gain the ability to file an ISDS case against his own home state; rather, the *investment* must be located in the home state, and the *investor* must be located in the IIA partner state. To achieve this, elites engage in round-tripping: creating an offshore entity in an IIA partner state, and giving that entity ownership of some of the elite's assets in the home state (Kerner, 2014). While it is highly likely that many (if not most) of the offshore entities in the leaks data were created for this purpose, we cannot directly observe their holdings.

To complement the offshore leaks data and overcome this shortcoming, we therefore test

for strategic corporate structuring in an additional sample of verified round-trip investments. To construct this sample, we draw on Bureau van Dijk (BvD)’s Amadeus dataset, which contains financial and ownership information about millions of European public and private firms. The Amadeus dataset, compiled from public sources such as corporate registries, tax filings, and investor reports, is useful in that it also contains information about the firms’ intermediate and ultimate owners.<sup>14</sup> We identify round-tripped investments by filtering this data to include all subsidiaries (assets) with the same nationality as their ultimate owner (the individual) but with a different nationality from their intermediate owner (the offshore shell company). This exercise produces a sample of roughly 10,300 round-tripped investments made between the years of 1980-2019.

We take the same steps to aggregate the data as we did with the offshore leaks sample, creating a dyad-year structure. We also apply the PanelMatch estimator with the same parameter values, and adjust for the same covariates.<sup>15</sup> Figure 5 plots the results for BITs (left panel) and the ECT (right panel). The results are highly similar to those in Figures 2 and 4: elites are *less* likely to round-trip their assets through their home state’s new BIT partners, and *more* likely to route their assets through states that join the ECT (if their own home state is also an ECT signatory). While the nominal effect sizes are much smaller than those in the offshore leaks sample, this is primarily due to the fact that the Amadeus sample contains far more dyads and far fewer incorporations; the standardized effect sizes are highly comparable, though slightly smaller for the ECT.

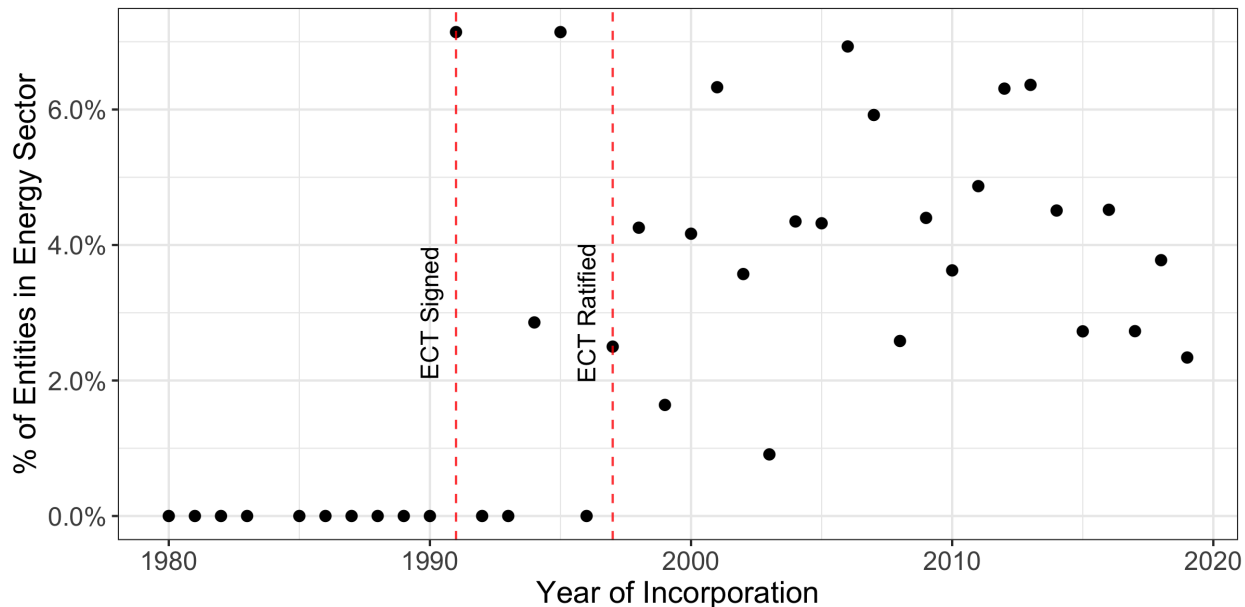
Unlike the offshore leaks data, the Amadeus data contains industry codes for the round-tripped investments, allowing us to see what types of assets elites are holding using offshore structures. This allows us to perform a descriptive robustness test for the ECT results: since

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<sup>14</sup>Note that, while all subsidiaries are European firms, the intermediate and ultimate owners have a wide range of national origins (U.S., U.K., China, Japan, etc).

<sup>15</sup>The only exception is that, since we know the full ownership chain for these investments, we can control for effective withholding tax rates as well (see [Arel-Bundock \(2017\)](#)).

Figure 6: **Round-tripping of firms in the energy sector increased after the ECT was signed and ratified.**



the ECT only applies to investments in energy-related sectors,<sup>16</sup> we should see an uptick in round-tripping in these sectors following the creation and ratification of the ECT. Figure 6 shows that this is the case: zero energy-related assets appear in the Amadeus data prior to the ECT’s signing in 1991, but regularly make up approximately 3-7% of the sample in the years following the treaty’s ratification in 1997.

## 4 What Explains Elites’ Preference for the ECT?

In two complementary samples of offshore investments, we find strong evidence that elites engage in strategic corporate structuring in order to gain protection against their own home states under the ECT; however, we find that the *opposite* is true for BITs.

In this section, we assess mechanisms that prior work on the investment regime have found to be central factors influencing how firms weight the value of different treaties. Our

<sup>16</sup>For a more detailed explanation of the ECT’s sectoral coverage, see Appendix Section A.2.

hope is that such *post-hoc* exploration can help unravel why the divergence in exploiting the ECT over other treaties and thereby generate new insights that can be tested by other scholars in future work. Due to the richness of the data and the fact that we observe the entire ownership chain, all analyses in this section are conducted with the smaller sample of verified round-tripped investments from Bureau van Dijk.

## 4.1 Home State Attributes

Our baseline results reflect average effects of new IIAs on elites’ choice of offshore jurisdiction for round-tripped investments. However, it is possible that elites in certain types of regimes—regimes characterized by greater political risk, greater state ownership of the economy (Kalyanpur, 2020), or more autocratic institutions, for example—may respond differently in important ways that are masked by the average effects. For example, if it were to be the case that elites in more autocratic home states were more likely to seek BIT access and less likely to seek ECT access, it might suggest that the baseline results are not capturing the type of strategic corporate structuring that we seek to estimate.

To investigate this possibility, we use Hainmueller, Mummolo and Xu (2019)’s binning estimator to estimate how the effects of BITs and the ECT on round-tripping vary according to three home state attributes: political risk, state ownership of the economy, and regime type.<sup>17</sup> Regressions are estimated with the same set of control variables as the PanelMatch models, as well as dyad and incorporation year fixed effects.<sup>18</sup>

Appendix Figure B.3 presents the results of six sets of models; each facet presents both the linear marginal effect as well as the binning estimates (in red), which allow for nonlin-

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<sup>17</sup>All three variables are drawn from the V-Dem dataset.

<sup>18</sup>To ensure that the use of two-way fixed effects does not introduce bias due to staggered treatment timing, we first validate that the baseline OLS estimates are similar to those produced by PanelMatch; see Appendix Section B.1.

earity and address potential issues of overprojection. Note that there is very little effect heterogeneity for either treaty type with regard to political risk or regime type. While the latter may be driven in part by the fact that most European states are developed democracies, the former is quite interesting; it suggests that strategic offshore structuring may be less of a response to outright state predation, and potentially more of a response to the threat of costly regulation (Moehlecke, 2019; Pelc, 2017). There is some indication that investors from states characterized by high levels of state ownership of the economy are more likely to adopt strategic offshore structures; however, this holds true for both BITs and the ECT, and thus it cannot explain the divergence in elite preferences towards the two.

## 4.2 Treaty Design

Figure 7: The ECT is slightly more favorable to investors than the average BIT.

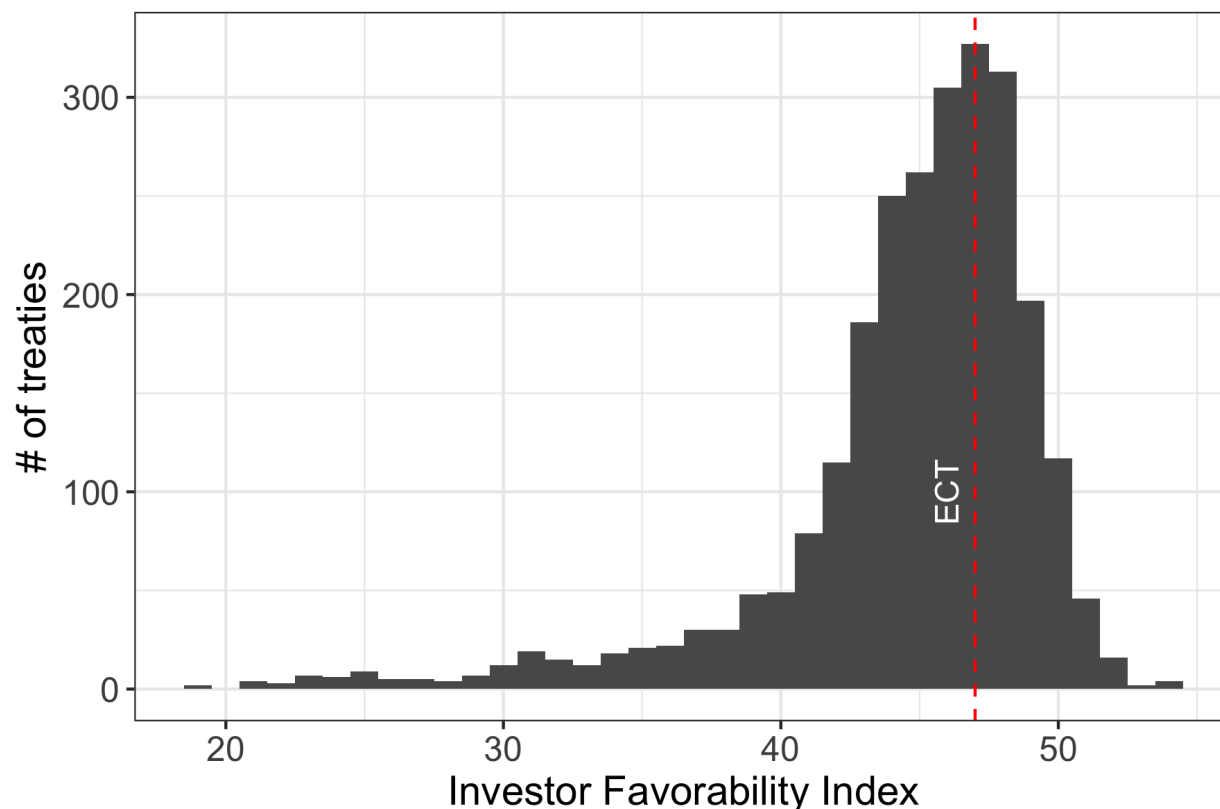


Table 2: **BIT-level design factors do not meaningfully affect round-tripping.**

|                         | DV: Number of offshore incorporations |                      |                      |
|-------------------------|---------------------------------------|----------------------|----------------------|
|                         | Model 1                               | Model 2              | Model 3              |
| ECT                     |                                       | 0.161***<br>(0.029)  | 0.247***<br>(0.056)  |
| BIT (high favorability) | -0.042***<br>(0.010)                  | -0.059***<br>(0.013) | -0.052***<br>(0.011) |
| BIT (low favorability)  | -0.018<br>(0.015)                     | -0.041**<br>(0.017)  | -0.032**<br>(0.014)  |
| BIT (unmapped)          | -0.006<br>(0.017)                     | -0.055**<br>(0.022)  | -0.056***<br>(0.016) |
| Dyad FE:                | Y                                     | Y                    | Y                    |
| Year FE:                | Y                                     | Y                    | Y                    |
| Controls:               | N                                     | N                    | Y                    |
| Num.Obs.                | 253,736                               | 253,736              | 150,339              |
| R2                      | 0.144                                 | 0.147                | 0.156                |

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ 

Functional legal logics could explain round-tripping investors' preference for the ECT over BITs. Not all IIAs are created equal, and the strength of investor protections and especially differences in ISDS access appear to influence investor behavior [Frenkel and Walter \(2019\)](#); [Haftel \(2010\)](#). The ECT may simply have more pro-corporate provisions than most BITs. To assess this possible mechanism, we use data on detailed treaty-level design features from the UN Conference on Trade and Development (UNCTAD)'s IIA Mapping Project. The data records nearly 100 distinct design features—for example, whether the treaty applies to dual nationals, or whether it provides its own definition of “investor”—for over 2,500 BITs. To enable comparison, we use the IIA Mapping Project's codebook to record the corresponding features of the ECT.

We begin by constructing an investor favorability index for each treaty, drawing on 56 of the coded design features that meaningfully affect the protection that the treaty offers to

investors, either at the extensive or intensive margins.<sup>19</sup> Figure 7 plots the distribution of the favorability index for all mapped BITs, with the dashed line indicating the position of the ECT. Interestingly, the ECT’s index of 47 puts it above the BIT-wide average, but only slightly so; the median BIT has an index of 46.

To determine whether the ECT’s favorability among round-trippers may be a function of its investor-friendly design features, we replicate our models of offshore incorporations after disaggregating BITs by whether their investor favorability is above or below average. The results, which can be seen in Table 2, suggest that treaty design alone cannot explain differences between BITs and the ECT; neither high- nor low-favorability BITs are associated with increased levels of round-tripping. Still, individual design features may still play a role for investors choosing between various jurisdictions; for example, the ECT explicitly allows investors with permanent residency status in a state to qualify as nationals of that state, a feature that substantially expands the potential coverage of the treaty and which is only present in 11% of BITs.

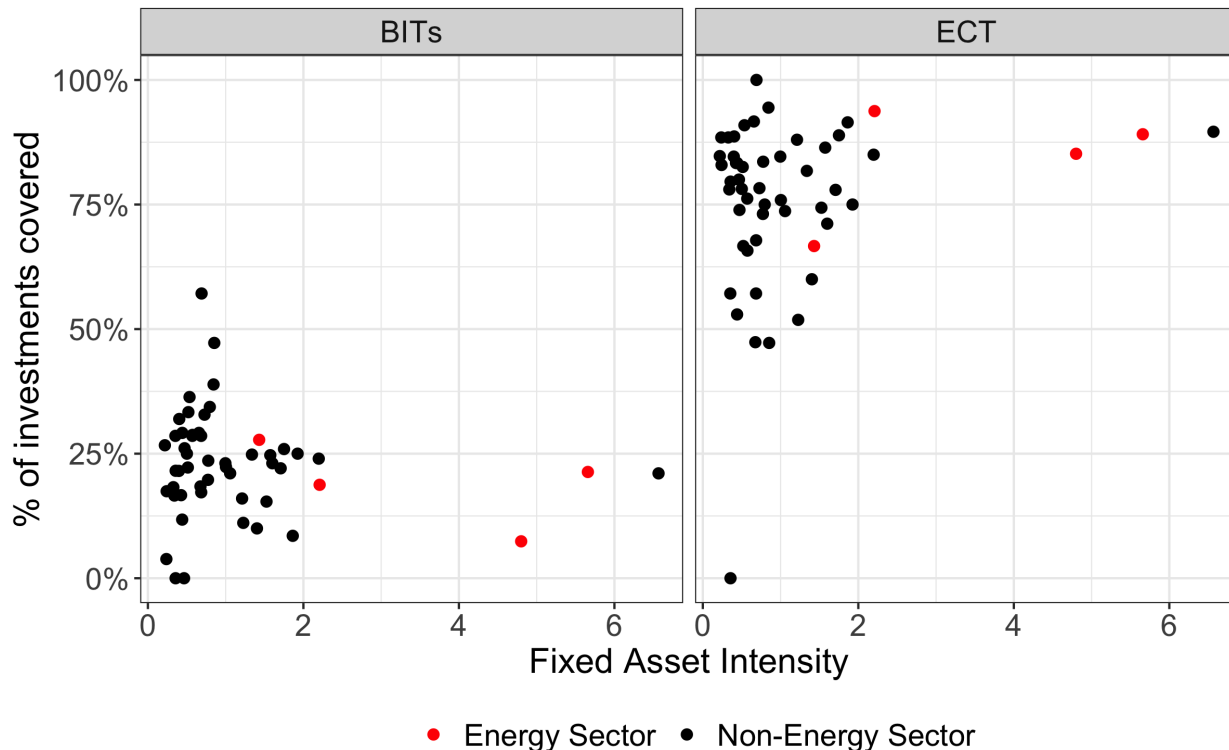
### 4.3 Fixed Asset Intensity

An alternate functionalist perspective would explain the ECT’s popularity as a result of the nature of the assets covered by the treaty. As the name implies, the Energy Charter Treaty only extends to energy related investments. A large body of scholarship in political economy and management argues that highly fixed assets tend to be the ones most at risk of expropriation (Kerner and Lawrence, 2014), and these sectors tend to see the highest FDI inflows into a country following BIT ratification Bauerle Danzman (2016). Energy investments rank in the highest echelon of risk as per these theories and thereby make the projects most in need of international institutional coverage. The positive effect of the ECT on offshore

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<sup>19</sup>The full list of index components can be found in Appendix Table A.2.

Figure 8: **Fixed asset intensity is not correlated with strategic offshore structuring at the industry level.**



incorporations could then be driven by the intensity of assets under an individual's control rather than by any particular feature of the ECT itself.

To assess the plausibility of this mechanism, we make use of the more fine-grained information included in the Amadeus dataset. While we do not have data on the fixed asset intensity of individual investments, we can measure industry-level fixed asset intensity (defined as fixed asset stock as a proportion of annual output) using publicly available data from the U.S. Bureau of Economic Analysis. We plot, in Figure 8, industry-level fixed asset intensity against the proportion of round-tripped investments that give an elite access to a BIT (left panel) or the ECT (right panel). We find no correlation between fixed asset intensity and treaty coverage for either BITs or the ECT, though we do find that energy-related sectors have some of the highest levels of ECT (but not BIT) coverage. In sum, it is unlikely



that elites' preference for the ECT over other investment agreements is driven by the high fixed asset intensity of energy-related sectors.

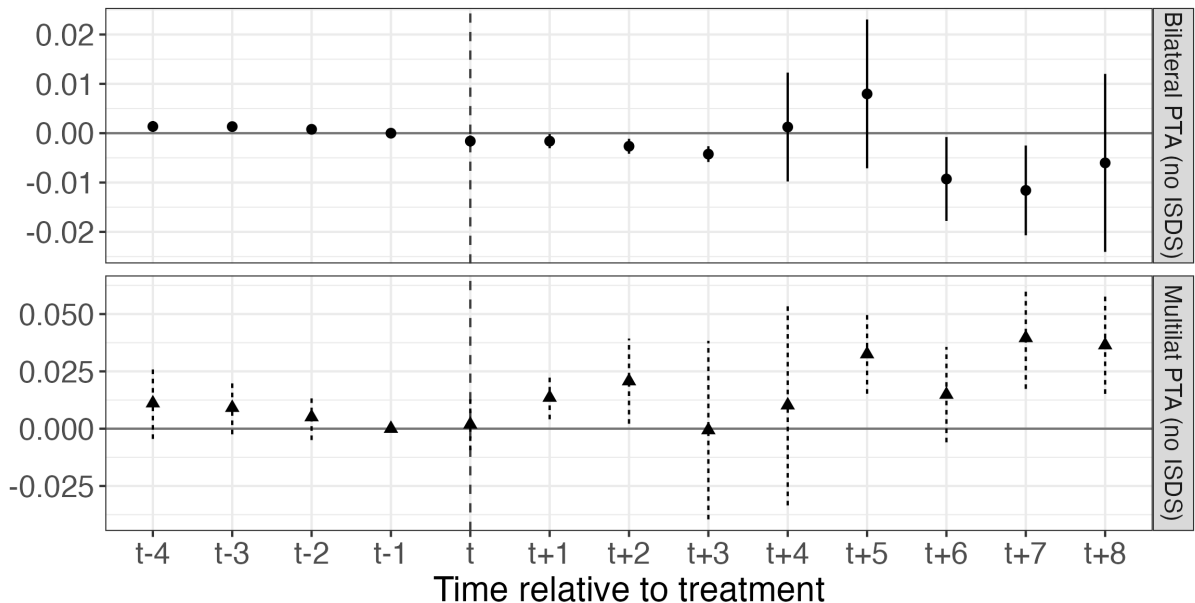
#### 4.4 Safety in Numbers?

Our difference-in-differences research design relies on the formation of *new* treaties—both new BITs, the ECT, and other IIAs—in order to study the effect of investment treaty coverage on strategic round-tripping. However, from the perspective of an economic elite who is seeking protection against their own government, the creation of a new bilateral treaty may have countervailing consequences. On one hand, a new BIT provides elites who round-trip through the partner state with access to ISDS, which they could use to file an extraterritorial arbitration against their own state.

On the other hand, the formation of a new bilateral treaty might send a signal to would-be round-trippers that their home government has strengthened (or is in the process of strengthening) bilateral diplomatic relations with the partner state. This could mean that the partner state is growing closer to the current home state regime, and thus that the partner state might be a less hospitable place for those seeking to contravene it; it might also result in increased information sharing between the two governments, thus decreasing round-trippers' ability to hide assets in the jurisdiction. Further, the formation of a bilateral treaty may simply signal to elites that their home government intends to pay greater attention to their bilateral relationship with the partner state, increasing the likelihood of detection and negative publicity for round-trippers.

In sum, BITs and other bilateral IIAs incentivize round-tripping by providing access to ISDS, but disincentivize round-tripping to the extent that they serve as signals of stronger diplomatic relations between governments. Multilateral IIAs such as the ECT also provide

Figure 9: **Bilateral PTAs *decrease* round-tripping between signatories, while multilateral PTAs increase round-tripping.**



access to ISDS, but unlike bilateral agreements they do not necessarily signal a strengthening of diplomatic relations between any given pair of signatories. For example, the ECT has 51 signatory states, resulting in 1,275 unique dyads that are covered by the treaty; compared to BITs, which cover one dyad each, such multilateral agreements are less likely to signify the strengthening of any given bilateral linkage. Multilateral IIAs may give round-trippers the same benefits as bilateral IIAs with fewer of these geopolitical risks, explaining their divergent effects on offshore incorporations.

In order to test this explanation, we note that BITs are not the only types of bilateral treaties that prospective round-trippers might perceive as signals of closer diplomatic relations, leading to fewer offshore incorporations. Rather, the bilateral vs. multilateral dynamic we identify should operate in other domains as well. We turn to the related but distinct regime of preferential trade agreements (PTAs); these are also economic treaties, which can be both bilateral or multilateral, and which are typically deep international agreements that may plausibly carry a signal about states' diplomatic relations. If we see a similar bilateral

vs. multilateral divergence in the effect of PTAs on round-tripping, even when limiting the sample to non-ISDS PTAs, it would support the theory that round-trip investors prefer the ECT due in part to its large membership.

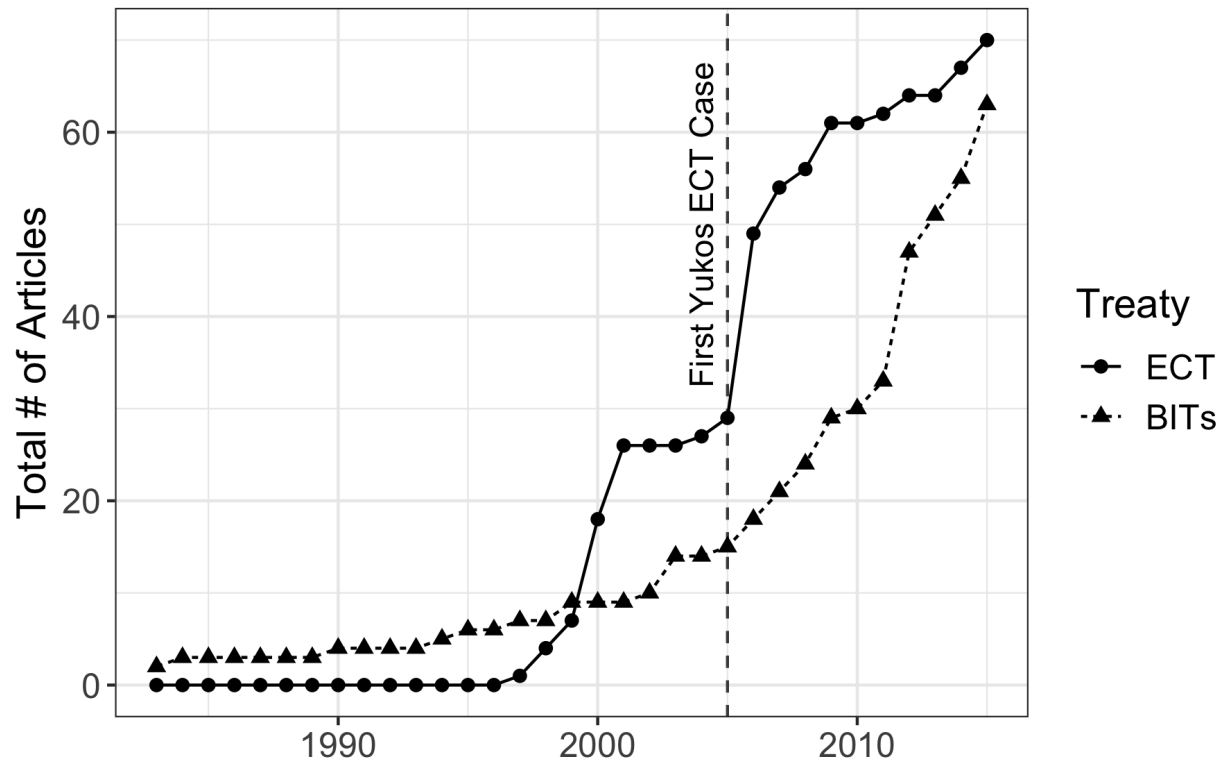
To conduct this test, we first use data from DESTA to classify all PTAs signed since 1980 as either bilateral or multilateral, and to identify agreements that do not provide investors access to ISDS. We then replicate Figure 5 using bilateral and multilateral PTAs as the treatments instead of BITs and the ECT. The results, presented in Figure 9, support our expectations: even among PTAs that do not provide access to ISDS, bilateral agreements *decrease* round-tripping between signatories while multilateral agreements have the opposite effect.

## 4.5 Salience and Learning

Another possible explanation for the relative popularity of the ECT among round-tripping investors is simply that it is more salient—and has been used as the basis for arbitration more often—than any given BIT. Salience and bounded rationality related arguments have been used to explain both the rise of BITs as a foreign policy tool and a mechanism behind why we see mixed effects on FDI - historical and survey evidence indicate that both states and private actors did not fully understand the value of investment agreements Poulsen (2010, 2015). We have, however, witnessed high-profile ECT cases such as the Yukos-related suits, which may demonstrate to other investors the potential benefits of strategic offshore structuring. Figure 10 demonstrates the effect of the Yukos affair on coverage of the ECT in the *Financial Times*, one of the leading periodicals among the world’s economic elite.

Further, while there are more BIT-based than ECT-based extraterritorial cases, the ECT is by far the most common single treaty under which such cases are filed. This may provide reassurance to investors in the protection that the ECT may offer relative to BITs,

Figure 10: **Coverage of BITs and the ECT in the *Financial Times*, 1983-2015.**  
The Yukos affair raised the ECT's public profile.



regardless of whether such differences actually exist as a matter of legal interpretation. If such (asymmetric) learning dynamics are occurring, we should see round-tripping investors seeking out ECT jurisdictions more frequently as more extraterritorial cases are filed under the ECT; we should see no comparable relationship with BITs.

To test the learning mechanism empirically, we examine whether or not round-tripping investors are more likely to seek ECT and/or BIT protection as other investors continue to file (non-)extraterritorial claims under each respective instrument. More specifically, we again model offshore incorporations at the dyad-year level, interacting the ECT variable with both (1) a count of all total cases filed under the ECT to date (as of the previous year); (2) a count of all total extraterritorial cases filed under the ECT to date (as of the previous year). We do the same for BITs, using the total count of BIT cases. A positive and significant sign

Table 3: **Round-tripping through ECT jurisdictions increases as more extraterritorial arbitrations are filed under the ECT.**

|   | DV: Number of offshore incorporations |                      |                      |                      |
|---|---------------------------------------|----------------------|----------------------|----------------------|
|   | Model 1                               | Model 2              | Model 3              | Model 4              |
| ECT                                     | 0.161***<br>(0.029)                   | 0.040***<br>(0.012)  | 0.081***<br>(0.018)  | 0.132***<br>(0.036)  |
| BIT                                     | -0.054***<br>(0.014)                  | -0.029***<br>(0.010) | -0.001<br>(0.017)    | -0.006<br>(0.016)    |
| total ECT cases <sub>t-1</sub>          |                                       | 0.007***<br>(0.002)  | 0.009***<br>(0.002)  | 0.010***<br>(0.003)  |
| total EA ECT cases <sub>t-1</sub>       |                                       | -0.011***<br>(0.004) | -0.015***<br>(0.005) | -0.018***<br>(0.006) |
| total BIT cases <sub>t-1</sub>          |                                       | -0.000<br>(0.000)    | -0.001<br>(0.000)    | -0.001<br>(0.001)    |
| total EA BIT cases <sub>t-1</sub>       |                                       | 0.004<br>(0.004)     | 0.008<br>(0.005)     | 0.011*<br>(0.006)    |
| ECT × total ECT cases <sub>t-1</sub>    |                                       | 0.001<br>(0.001)     | 0.001<br>(0.001)     | 0.001<br>(0.001)     |
| ECT × total EA ECT cases <sub>t-1</sub> |                                       | 0.009***<br>(0.004)  | 0.010**<br>(0.004)   | 0.012***<br>(0.004)  |
| BIT × total BIT cases <sub>t-1</sub>    |                                       | 0.000**<br>(0.000)   | 0.000<br>(0.000)     | 0.000<br>(0.000)     |
| BIT × total EA BIT cases <sub>t-1</sub> |                                       | -0.006***<br>(0.002) | -0.004*<br>(0.002)   | -0.005**<br>(0.003)  |
| Incorp. Year FE:                        | Y                                     | Y                    | Y                    | Y                    |
| Dyad FE:                                | Y                                     | Y                    | Y                    | Y                    |
| Tax/econ controls:                      | N                                     | N                    | Y                    | Y                    |
| Political controls:                     | N                                     | N                    | N                    | Y                    |
| Num.Obs.                                | 252,560                               | 252,519              | 163,885              | 149,420              |
| R2                                      | 0.147                                 | 0.149                | 0.157                | 0.158                |

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

on an interaction term would indicate that round-tripping investors become more likely to seek access to a given treaty type the more that other investors make use of it, suggesting that the learning mechanism may be at play.

The results, presented in Table 3, provide support for the asymmetric learning mechanism. Of all four interaction terms, by far the strongest and most robust is the interaction

between ECT coverage (a dummy indicating that both home and offshore jurisdictions are ECT signatories) and the count of total extraterritorial arbitration cases filed under the ECT as of the previous year. By contrast, investors are actually *less* likely to round-trip through jurisdictions that offer BIT access as more extraterritorial cases are filed under BITs. Further, the near-zero and non-significant interactions between the treaty variables and the count of *total* cases suggest that round-tripping investors are indeed responding to extraterritorial arbitrations, rather than all investor-state disputes filed under the ECT/BITs.

These results indicate that round-tripping intended to gain protection under the ECT has grown more popular as other investors have used the treaty to sue their own governments; the same is not true, and indeed the opposite may be true, in the case of BITs. Potentially propelled by the salience of the Yukos cases, investors have become aware that the ECT may offer them additional legal protection within their own home states and have updated their corporate structures accordingly. As a result, even large investors now openly discuss their use of round-tripping in order to chill government seizures and regulatory actions. For example, in response to the Labour Party’s threat to (re)nationalize UK utility firms in 2019, energy firms National Grid and SSE changed their corporate structures in order to ensure that they would have access to arbitration against the UK under the ECT.<sup>20</sup> A member of SSE’s PR team is quoted as follows: “Switzerland is a party to the energy charter treaty, and the incorporation of a Swiss company is also an additional safeguard... should SSE’s electricity networks businesses and interests in SGN become the subject of proposed legislation for nationalisation.”

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<sup>20</sup>See Thomas, Natalie, “National Grid and SSE shift some UK operations into offshore groups”, *Financial Times*, 24 November 2019.

## 5 Conclusions

Economic elites can and have taken advantage of tax havens to exploit the international investment regime. Setting up offshore entities and then routing the money back home *de jure* turns a domestic elite into a foreign investor. When those tax havens have an investment treaty with an individual’s home country, they can then sue their own governments using provisions intended for foreign corporations. These extraterritorial arbitrations constitute roughly 8% of the cases filed in the international investment regime. They’ve involved some of the most important economic actors in a range of emerging markets from Egypt to Russia, accounting for roughly 41% of the damages claimed under the regime.

Beyond documenting the rise of extraterritorial arbitration, we set out to understand whether elites strategically structure their wealth to ensure access to international legal recourse against their home state. Analyzing close to 300,000 company incorporations in tax havens, we find that individuals generally avoid seeking out such protections. Once a haven signs a bilateral investment treaty with a partner state, elites from the partner state are *less* likely to round-trip through the haven. The robust negative effect is surprising given existing literature on firm-level treaty shopping ([Betz and Pond, 2019](#); [Betz, Pond and Yin, 2021](#)) and merits further study. Supported by the consistent negative effects of both trade and investment agreements on offshore incorporation, one possible explanation is that signing new bilateral treaties with offshore jurisdictions heightens the risk that the potential host would cooperate with an individual’s home state. Roundtripping assets through your adversary’s allies may be undermining the opacity benefits of investment protection for would-be round-trippers.

Nonetheless, we find strong evidence that elites strategically select offshore jurisdictions that will give them access to the Energy Charter Treaty. The effect is not driven by the legal protections of the treaty or the high asset intensity of the industries covered. Instead,

we find evidence consistent with other scholars that point to the importance of salience and learning driving the outcomes of the investment regime. As more extraterritorial arbitrations are filed through the the ECT, we see more offshore incorporations in ECT member states, setting the stage for the treaty to become the most popular mechanism for elites to file arbitrations against their de facto home state. This is normatively concerning; the ECT has frequently been used to sue governments in response to their implementation of climate change mitigation policies,<sup>21</sup> and extraterritorial arbitration dramatically expands the universe of potential litigation. We also find support for the “safety in numbers” hypothesis, demonstrating that—even among treaties with no ISDS provisions—multilateral PTAs *increase* round-tripping between signatory states while bilateral PTAs *decrease* round-tripping. This suggests that bilateral treaties may constitute a bundled treatment, providing arbitrage opportunities but simultaneously signaling increased bilateral cooperation between signatory governments; multilateral treaties offer elites the former, with less risk of the latter.

We hope that the manuscript pushes other scholars to continue developing and testing theories that factor the international institutional environment into models of domestic elite conflict (Farrell and Newman, 2014). A number of theories of political development expect plutocrats to be the driving force behind political development, be it liberalization or democratization (North and Weingast, 1989; North et al., 2013; Albertus and Menaldo, 2014). The general logic is that the development of the rule of law and competitive elections will bind the state from expropriating the wealth of the plutocracy. But we illustrate the conditions under which globalization allows elites to arbitrage the institutions that they traditionally pressured the state to provide. This should plausibly reduce their incentives to fight for reform in their home jurisdictions. We are not the first to indicate a potentially deleterious effect between capital mobility and political development (Pistor, 2019; Sharafutdinova and Dawisha, 2017). But prior work has not incorporated the role of global (investment) insti-

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<sup>21</sup>See for example Jorge Liboreiro, “What is the Energy Charter Treaty and Why is it So Controversial?” *euronews*, 26 October 2022.



tutions in this process. That is critical when plutocrats can access property protections as a spillover of “normal” business practices like minimizing their taxes or seeking safeguard for their foreign investments as our findings suggest.

Finally, the analysis points toward a need to better understand the globalization of the individual (Cooley and Sharman, 2017). One of the starting points of our model is that economic elites are able to build nationality portfolios in a fashion that mimics MNCs. Their ability to build such portfolios are supported by a host of “enablers” - lawyers, accountants, wealth managers, estate agents - whose economic and political incentives merit further research (Harrington et al., 2017). But incorporation is only one path in nationality diversification and thereby legal arbitrage; individuals can buy “golden visas” and passports in the burgeoning mobility market. The elite toolkit continues to expand even as we see the growth of populist movements. In short, the findings call for more academic work on when and why economic interdependence empowers the superwealthy by fostering institutional inequalities.

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# Appendix

## A Additional Descriptives

### A.1 Offshore jurisdictions represented in the offshore leaks data

Table A.1: Offshore jurisdictions represented in the offshore leaks data.

|                        |                        |
|------------------------|------------------------|
| Anguilla               | Luxembourg             |
| Antigua & Barbuda      | Malaysia               |
| Aruba                  | Malta                  |
| Bahamas                | Marshall Islands       |
| Barbados               | Mauritius              |
| Belize                 | Monaco                 |
| Bermuda                | Netherlands            |
| British Virgin Islands | Netherlands Antilles   |
| Brunei                 | New Zealand            |
| Cayman Islands         | Niue                   |
| Cook Islands           | Panama                 |
| Costa Rica             | Ras Al Khaimah         |
| Cyprus                 | Samoa                  |
| Grenada                | Seychelles             |
| Guernsey               | Singapore              |
| Hong Kong SAR China    | St. Kitts & Nevis      |
| Ireland                | St. Lucia              |
| Isle of Man            | Turks & Caicos Islands |
| Jersey                 | United Arab Emirates   |
| Labuan                 | United Kingdom         |
| Liberia                | United States          |
| Liechtenstein          | Vanuatu                |

## A.2 More detail on the ECT’s sectoral coverage

Article 1(5)(b) of the Energy Charter Treaty defines the “Energy Sector” as economic activity that falls into the following seven categories:

1. “prospecting and exploration for, and extraction of, e.g., oil, gas, coal and uranium;”
2. “construction and operation of power generation facilities, including those powered by wind and other renewable energy sources;”
3. “land transportation, distribution, storage and supply of Energy Materials and Products, e.g., by way of transmission and distribution grids and pipelines or dedicated rail lines, and construction of facilities for such, including the laying of oil, gas, and coal-slurry pipelines;”
4. “removal and disposal of wastes from energy related facilities such as power stations, including radioactive wastes from nuclear power stations;”
5. “decommissioning of energy related facilities, including oil rigs, oil refineries and power generating plants;”
6. “marketing and sale of, and trade in Energy Materials and Products, e.g., retail sales of gasoline; and”
7. “research, consulting, planning, management and design activities related to the activities mentioned above, including those aimed at Improving Energy Efficiency.”

We map these seven categories as closely as possible to the 4-digit NAICS industry codes provided in the Amadeus data, erring on the conservative side when the 4-digit codes are not precise enough to separate energy from non-energy related activities. We consider the following NAICS industries to be in the energy sector:

1. 21\*\*: Mining, Quarrying, and Oil and Gas Extraction

2. 22\*\*: Utilities
3. 324\*: Petroleum and Coal Products Manufacturing
4. 4235: Metal and Mineral (except Petroleum) Merchant Wholesalers
5. 4247: Petroleum and Petroleum Products Merchant Wholesalers
6. 447\*: Gasoline Stations
7. 486\*: Pipeline Transportation

### A.3 Investor Favorability Index: Components

Note: all components and categories drawn from the IIA Mapping Project, and described in depth in the associated codebook.<sup>22</sup>

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<sup>22</sup>See <https://investmentpolicy.unctad.org...Mapping%20Project%20Description%20and%20Methodology.pdf>

Table A.2: **Investor Favorability Index Components**

| Design Item   | Value                          | Index weight |
|---|--------------------------------|--------------|
| <i>Definition of investment</i>                                       |                                |              |
| Definition of investment  | Asset-based                    | +1           |
| Excludes portfolio investment?  | No                             | +1           |
| Excludes other assets?  | No                             | +1           |
| Lists req'd characteristics?  | No                             | +1           |
| Requires "accordance w/host laws?"                                    | No                             | +1           |
| Lists all covered assets?   | No                             | +1           |
| <i>Definition of investor</i>   |                                |              |
| Includes perm. residents?   | Yes                            | +1           |
| Includes dual nationals?  | Yes                            | +1           |
| Reqs substantial biz activity?  | No                             | +1           |
| Defines ownership of entities?  | No                             | +1           |
| <i>Denial of benefits (DoB) clause</i>                                |                                |              |
| DoB clause included?  | No                             | +1           |
| Substantive biz criterion?  | No                             | +1           |
| Applies to investors from states without diplomatic relations w/host? | No                             | +1           |
| Unilaterally discretionary?   | No                             | +1           |
| <i>Substantive scope of treaty</i>                                    |                                |              |
| Excludes taxation?  | No                             | +1           |
| Excludes grants/subsidies?  | No                             | +1           |
| Excludes gov. procurement?  | No                             | +1           |
| Excludes other?   | No                             | +1           |
| Investments covered?  | Pre- and post-treaty           | +1           |
| Disputes covered?   | Not stipulated                 | +1           |
| ISDS included?  | Yes                            | +1           |
| Scope of claims?  | Any investment-related dispute | +1           |
| Limits on provisions subject to ISDS?                                 | No                             | +1           |
| ISDS: excludes policy areas?  | No                             | +1           |
| Type of consent to ISDS?  | Express/implied                | +1           |
| Fora: domestic courts?  | Yes                            | +1           |
| Fora: ICSID?  | Yes                            | +1           |
| Fora: UNCITRAL?   | Yes                            | +1           |
| Fora: others?   | Yes                            | +1           |

Continued on next page. . .

Table A.3: **Investor Favorability Index Components (cont)**

| Design Item                          | Value                       | Index weight |
|--------------------------------------|-----------------------------|--------------|
| Fora: fork in the road? <sup>a</sup> | No                          | +1           |
| Limitation period for claims?        | No                          | +1           |
| Provisional measures?                | Yes                         | +1           |
| Limited remedies?                    | No                          | +1           |
| Case documents transparency?         | No                          | +1           |
| <i>Substantive protections</i>       |                             |              |
| National treatment (NT) clause:      | Pre- and post-establishment | +2           |
|                                      | Post-establishment          | +1           |
| “Like circumstances?”                | No                          | +1           |
| MFN clause:                          | Pre- and post-establishment | +2           |
|                                      | Post-establishment          | +1           |
| MFN: econ integration agreements?    | Yes                         | +1           |
| MFN: tax treaties?                   | Yes                         | +1           |
| MFN: ISDS procedures?                | Yes                         | +1           |
| FET <sup>b</sup> clause:             | Unqualified                 | +2           |
|                                      | Qualified                   | +1           |
| FET: limit by int’l law?             | No                          | +1           |
| FET: list protections?               | No                          | +1           |
| Full protection clause:              | Standard                    | +2           |
|                                      | Reference domestic law      | +1           |
| Arbitrary measures clause?           | Yes                         | +1           |
| Umbrella clause?                     | Yes                         | +1           |
| Entry of personnel?                  | Yes                         | +1           |
| Nationality of personnel?            | Yes                         | +1           |
| <i>Expropriation</i>                 |                             |              |
| Includes indirect exp?               | Yes                         | +1           |
| Carve-out regulations?               | No                          | +1           |
| Carve-out comp. licensing?           | No                          | +1           |
| Relative right to comp:              | MFN and NT                  | +2           |
|                                      | MFN <i>or</i> NT            | +1           |
| Absolute right to comp, ever?        | Yes                         | +1           |
| <i>Transfer of funds</i>             |                             |              |
| Includes transfer of funds?          | Yes                         | +1           |
| BoP exception?                       | No                          | +1           |
| Other exceptions?                    | No                          | +1           |
| Total:                               |                             | /62          |

<sup>a</sup>The “fork in the road” clause means that, after an investor chooses one forum for arbitration, they lose access to the others.

<sup>b</sup>Fair and Equitable Treatment.

## B Additional Analysis

### B.1 OLS estimates of Figure 5

Figure B.1: Coefficients on ECT and BIT variables, iteratively dropping each home state.

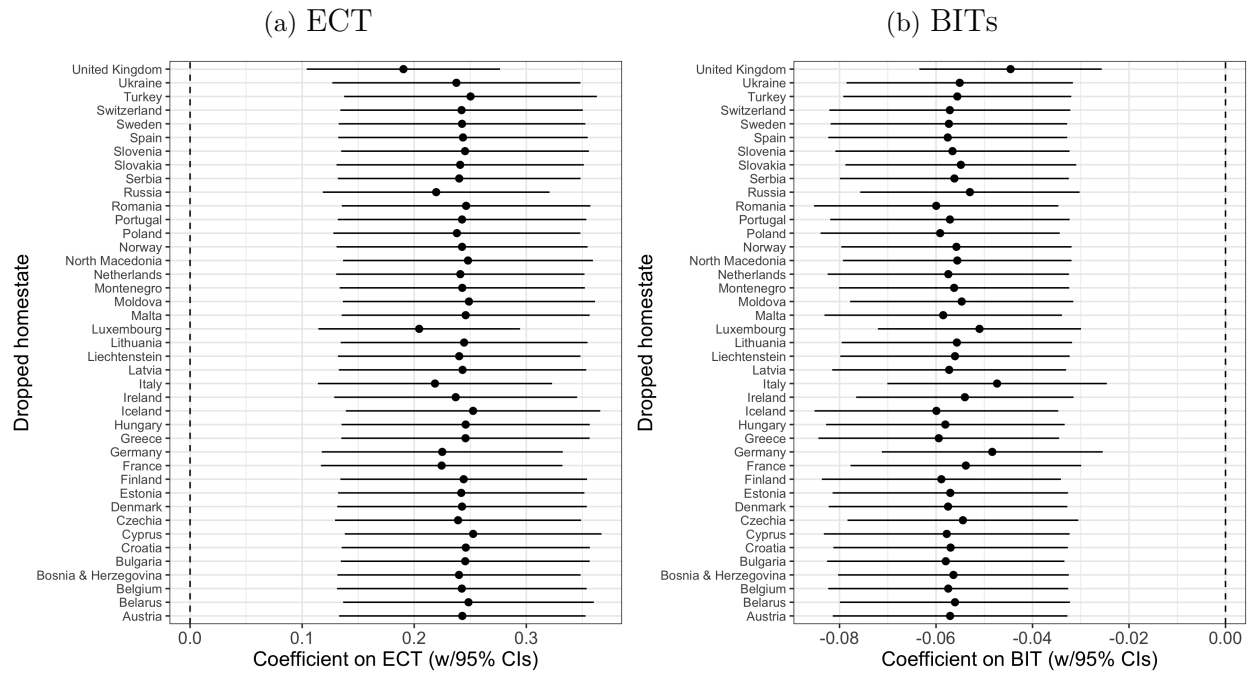
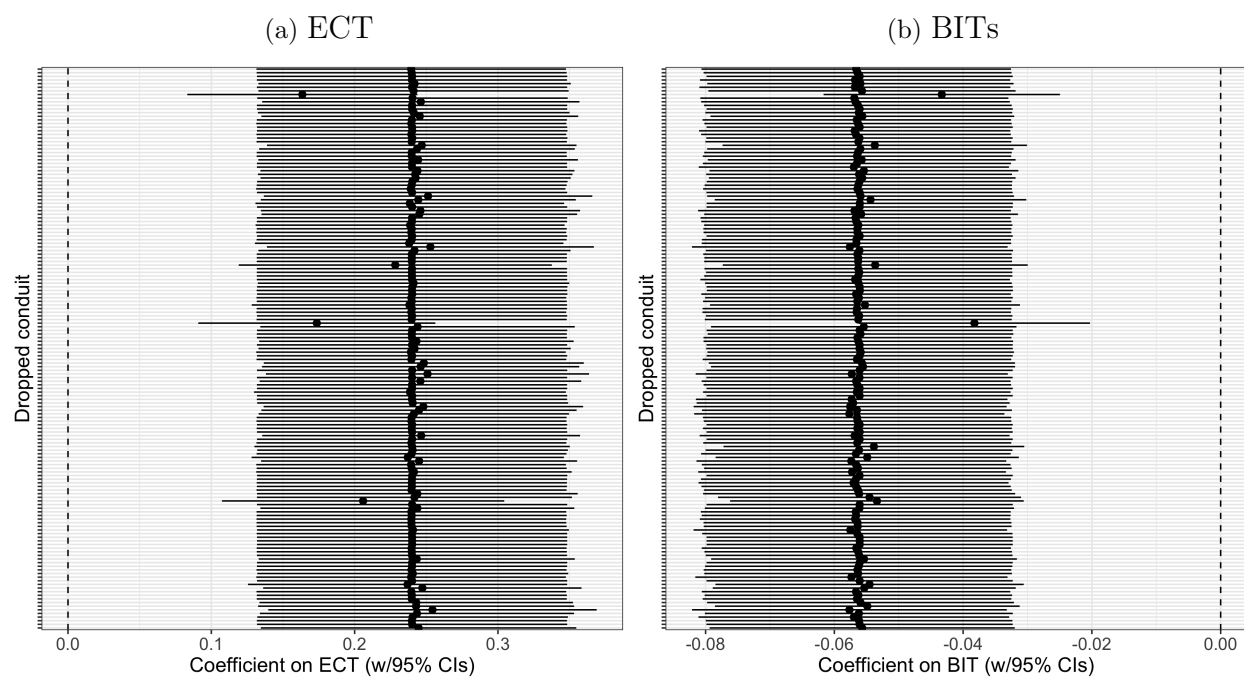


Figure B.2: Coefficients on ECT and BIT variables, iteratively dropping each offshore jurisdiction.





## B.2 Heterogeneity by home state attributes

Figure B.3: Home state attributes and strategic round-tripping.

