Panel 1) Current Challenges: Assessing and Protecting against Risk

**Political Risk and International Investment Law: Some Skeptical Thoughts**

*Abstract*

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The symposium organizers asked the participants to discuss, among other subjects, challenges in assessing and protecting against risk in infrastructure development projects in emerging economies. This paper responds to that invitation by exploring some of the conceptual and operational difficulties related to measuring the risk, and to the promise, actually rather limited, of international law to provide significant protection against political risk.

It’s helpful to begin by thinking about what we mean by “risk”. The standard definition of the concept in the general literature on risk is relatively intuitive and easy to grasp. Risk is typically defined as the probability that an event will happen, where the event will have adverse consequences (costs) for the relevant party. Risks are “greater” when the product of probability and costs is higher; and risks are lower when the product is lower.

With that general definition in mind, the next step is to think about (how to think about) the kinds of adverse events that we are interested in predicting. We can approach that task at the ultra-micro level, attempting to identify any possible adverse event that might impose a cost on a business operation. Because such speculative risks are more or less infinite, cataloging them, assigning reasonable probabilities to them, and then adjusting corporate behavior in response, is an obviously impossible task. Rather, corporate risk assessors, or academics who write about corporate risk management in a normative or descriptive sense, tend to place various kinds of risk into conceptual categories. The notion of “political risk” is probably one of the most important standard categories of international business-related risk, and it is not surprising that the Symposium’s thematic statement mentions political risk explicitly.

However, theorizers of political risk don’t agree as to what the concept actually entails; moreover, their definitions are often relatively simplistic or even somewhat incoherent. Second, it is difficult to come up with a concept that is of obvious operational utility, in part, but not exclusively, because existing data, as well as the inherently multi-causal complexities of modern society, will often make it rather impossible to calculate with any real accuracy a probability that “political” event $x$ will happen, and if it happens, it will impose cost $y$ on this project or that with probability $z$.

Perhaps reflecting these difficulties, it turns out that companies don’t really do political risk assessment with much regularity or sophistication. In other words,
companies don’t act as if “political risk” is a useful (or useable) concept, suggesting, perhaps that it is indeed not.

The role of international law

While the concept and the operationalization of political risk is problematic, so too is the notion that international law has an important role to play in reducing that risk. In the last thirty years states have signed a large number of bilateral investment treaties, or BITs, that extend international law protections to foreign investors, including the right to enforce the treaties through compulsory arbitration. The treaties are often justified as serving the valuable purpose of reducing political risk, thereby encouraging greater investment flows. While it is certainly true that the treaties have been used by investors, sometimes successfully, to collect money damages from host states for mistreatment, it would be an exaggeration to say that the treaties meaningfully reduce “political risk” for investors generally. In large part this is because the rights that the treaties give to investors are relatively narrow, and don’t address many situations that would fall under “political risk” as construed by risk theorists. The “risk” covered by the treaties is not coextensive with “political risk” as a theoretical category of risk. Moreover, the treaties are costly for investors to use, and many investors, despite the formal protections of the treaties, will find treaty-based litigation to be undesirable. And finally, investors enjoy a number of alternative and potentially more effective ways to protect themselves from “political risk”, however defined, than through BITs. And in fact, empirical studies suggest that neither investors nor states act as if international law is all that important to investment decisions—suggesting either that “political risk” is not a major consideration, or that international law is not an important tool to reduce it.

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