Getting Rid of Investor-State Dispute Settlement

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There has been a great deal of dispute over the proposed Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership. Such controversy is overblown. However, the one aspect of these agreements that should be done away with is the Investor-State Dispute Settlement, says Daniel Ikenson, director of Cato Institute's Herbert A. Stiefel Center for Trade Policy Studies.

The Investor-State Dispute Settlement (ISDS) mechanism is a tool that allows foreign investors to sue host governments in third-party tribunals for maltreatment and asset value loss due to government actions or policies. Basically, it is intended to protect foreign companies when host governments fail to meet certain standards of treatment.

With negotiations over the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP), American negotiators have sought to include ISDS rules in the agreements. Proponents argue that it provides assurances to companies that they will receive fair treatment from host governments and encourage the influx of investors to regions that need capital.

Ikenson argues that ISDS actually weakens the rule of law, forces public subsidization of investment risk and encourages outsourcing. He gives some reasons that ISDS should be dropped from TPP and TTIP:

- ISDS is overkill: Governments compete to attract investment, so transparent, fair and predictable policies are key to encouraging that investment. Multinational companies can evaluate the risk of investment on their own without ISDS assurances.
- ISDS socializes the risk of foreign direct investment: Company A, a multinational corporation, might see investment in Country X as too risky, but might be willing to make that investment knowing that ISDS is in place. Company B, on the other hand, might be able to make that investment even without ISDS. By reducing the risk of investing, ISDS serves as a subsidy for more risk-averse companies.
- ISDS encourages discretionary outsourcing: Discretionary outsourcing is investment that goes abroad unnecessarily thanks to policies that make local investment more expensive. The United States currently has an advantage in attracting global investment because of our respect for property rights and rule of law. Those advantages are mitigated by ISDS,

which could encourage a company that might otherwise invest in the United States to invest in Brazil, for example.

- ISDS reinforces the myth that trade primarily benefits large corporations: Despite the fact that it is the poor who stand to gain the most from trade liberalization, the myth that trade agreements benefit large corporations has persisted. By granting these legal privileges to multinational corporations, the ISDS provision stands as a risk-mitigating subsidy for large corporations and allows foreign corporations to circumvent U.S. court procedure.

Any benefits from ISDS are outweighed by the additional costs created by the policy.

Source: Daniel J. Ikenson, "A Compromise to Advance the Trade Agenda: Purge Negotiations of Investor-State Dispute Settlement," Cato Institute, March 4, 2014.