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Investor-State Proponents Need A Better Rebuttal To Senator Warren's Opposition

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On nearly all matters of trade and investment, I am more likely to agree with Gary Hufbauer of the Peterson Institute for International Economics than with Massachusetts Senator Elizabeth Warren. But Hufbauer's attempted takedown of the substance of Warren's argument against the investor-state dispute settlement (ISDS) mechanism comes up short. Hufbauer's a smart guy and a straight-shooter, so the porousness of his ISDS defense should be seen as further validation of the critics' concerns.

In full disclosure, like Warren, I have argued that ISDS should be jettisoned, finding the institution to be a subsidy to business that comes at the expense of domestic investment and the rule of law. But I have been waiting – indeed, almost expecting – to hear the definitive argument to prove me wrong, considering how confident proponents seem to be about, not only the propriety, but the necessity of ISDS to global trade and investment. After reading Hufbauer's analysis (and some from CSIS, the Chamber, and the NAM, and hearing the views of four prominent pro-ISDS conferees at an event we hosted at the Cato Institute last year), I remain unaware of a comprehensive pro-ISDS argument that acknowledges and extinguishes the legitimate concerns raised about ISDS. The White House gave it a shot, but Simon Lester was unconvinced.

Hufbauer, like most other ISDS proponents, bases his argument on three rickety assertions: that ISDS has been around for a long time, so it must be necessary; that ISDS has protected U.S. investments overseas, so it must be sound; and, that the United States has never lost a case brought against it by a foreign investor, so those concerned about domestic sovereignty and democratic accountability are tilting at windmills. But what passes for the central tenets of this argument are that, so far, ISDS has worked to protect U.S. companies that invest abroad and, so far, no U.S. law, regulation, or policy has been found to violate investor's rights.

Now, take a step back and ask whether these rationales answer the concerns of ISDS skeptics. Perhaps they help neutralize some of the sensationalism surrounding the issue, but they plainly do not answer the serious indictments against ISDS: that it encourages outsourcing to the disadvantage of U.S. workers and communities; that it confers greater procedural, if not substantive, legal rights on foreign investors than U.S. investors in the United States; and, that it exposes U.S. laws and regulations to scrutiny by an unaccountable body of arbitrators, insulated from checks and balances, that can result in U.S. taxpayers having to pay damages to the foreign investors. And, for those who have tapped into the abundance of evidence to rebut broader claims made by Sen. Warren and other anti-corporate crusaders that trade only benefits rich corporations, the existence of ISDS makes that task more challenging than it should be.

While there is absolutely nothing wrong with outsourcing, it shouldn't be subsidized as a matter of public policy. By defraying political risk through mutual access to arbitration, ISDS subsidizes outsourcing. It benefits companies inclined to invest abroad at the expense of companies that would invest at home. It benefits risk-averse companies at the expense of more risk-taking enterprises, the latter of which are essential to the dynamism that generates new ideas and propels capitalism. And while there is nothing wrong with foreign companies suing host governments within that country's legal system, it wouldn't sit well with most Americans if they knew that foreign companies can circumvent the U.S. legal system and possibly win judgments that put them on the hook to pay damages. It's also unfair to U.S. companies that foreign investors get two bites at the apple. Whereas U.S.-based companies can avail themselves of the U.S. legal system to settle these kinds of issues, foreign-investors have the additional option of ISDS.

About Warren's argument, Hufbauer writes:

> The Senator claimed that ISDS would favor big multinational corporations, undermine US sovereignty, and expose US taxpayers to huge payouts to foreign firms. These claims, and some other criticisms of the TPP, have no foundation in the long history of ISDS provisions that have been in existence for more than 50 years… Often these ISDS provisions are part of bilateral investment treaties (BITs), of which more than 2,200 are now in force worldwide. The United States has 41 BITs with countries near and far, and is actively negotiating a BIT with China, aimed at strengthening the rights of investors in a country that has not always been fair. Starting with the North American Free Trade Agreement (NAFTA) in 1994, the United States has also included ISDS in the investment chapters in nearly all its free trade agreements (FTAs), now numbering 20. Given this rich history, Senator Warren should be able to cite actual examples of the multiple abuses that she claims have occurred.

Actually, Sen. Warren did not once claim that any abuses had occurred, but wrote only in the conditional future tense, suggesting that bad things could happen if ISDS were included in the TPP. The number of ISDS cases – after decades as a quiet backwater of international arbitration – has been increasing with the growth in foreign direct investment and proliferation of the bilateral investment treaties Hufbauer mentions. Consider this: from the inception of ISDS in 1959 through 2002, the number of known ISDS claims worldwide stood at fewer than 100. But between 2003 and 2012, the cumulative total increased to 514 cases. In 2012, claimants initiated 58 ISDS cases worldwide, which was the greatest number of initiations in any year, surpassing the previous record set in 2011. In 2014 there were 42 new cases initiated and 42 cases decided – one of which involved a $50 billion award, "the highest award by far in the history of investment arbitration," according to the United Nations Conference on Trade and Development.

This all widens the scope for litigation, as the number and sophistication of potential plaintiffs increases even more over the next few years, if the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership agreements come into force. Hufbauer continues:

> Over the decades, only 13 ISDS cases have been brought to judgment against the United States. The United States has not lost a single case. Why? Because the United States does not expropriate private property without compensation, and the United States does not enact arbitrary or discriminatory laws against foreign firms. Contrary to what the Senator implies, American taxpayers have not had to cough up millions and even billions of dollars in damages. They have not had to cough up anything.

Again, Sen. Warren did not imply that Americans have had to cough up anything yet. She merely registered concern that American laws and regulations can be exposed to challenge outside the U.S. judicial system with taxpayers more likely to be on the hook for compensation to foreign companies. Cases are not targeted only at brute expropriation – as Hufbauer implies – but at implementation of rules that may have denied foreign investors “fair and equitable treatment,” whatever that may mean to any given ISDS arbitration panel. Hufbauer’s blanket assertion that “the United States does not enact arbitrary or discriminatory laws against foreign firms” is more patriotic than realistic. Regardless of its intent, a law can be found to infringe on an investor’s rights if it has a discriminatory effect.

A law could have a disproportionate ill-effect on a particular variety of products that happen to be made by foreign investors, which could very well be the basis for an ISDS judgment against that law. A few years ago a U.S. law was passed banning flavored cigarettes in the United States, including grape, bubble-gum, and clove, but not menthol. Soon after, the government of Indonesia filed a complaint in the World Trade Organization that the law was discriminatory toward Indonesian exporters, which accounted for the preponderance of clove cigarettes in the U.S. market. If this were truly a public safety issue designed to dissuade youngsters from starting to smoke, the Indonesians argued, then menthol cigarettes should have been banned, too.

Indonesia rightfully prevailed in the case, much to the chagrin of anti-tobacco advocates in the United States. But had the United States and Indonesia been parties to a bilateral investment treaty with an ISDS provision and there was an Indonesian investment — perhaps a distributor or packager — in the United States, the plaintiffs probably could have availed themselves of an arbitration tribunal and won damages from U.S. taxpayers. I find it hard to believe that those optics – foreign tobacco companies suing the U.S. government and winning damages in a tribunal outside the U.S. legal system over a law allegedly designed to prevent children from smoking – would not enflame antitrade passions more than just about anything else imaginable. We may soon witness public reactions to such an outcome, as Phillip Morris brought an ISDS case against Australia for its plain cigarette packaging law, which Phillip Morris (probably rightly) claims caused damages by depriving them of the use of their recognizable brand logos and trademarks.

So, I’m afraid it is wishful thinking to deny that the existence of ISDS is not a huge gray area ripe for exploitation by creative lawyers. And with Korean, Japanese, and eventually Chinese and European, companies becoming eligible to use ISDS to air grievances about U.S. laws and regulations that might arguably favor U.S.-based companies at their expense, it is fanciful to assume that new, deep-pocketed prospective litigants would share Hufbauer's view that the United States is bullet-proof when it comes to discriminatory laws.

Hufbauer writes:

> Senator Warren [believes] that multinational corporations should just take a gamble on national court systems and forget about ISDS. What she ignores are two basic facts of international investment life. First, many developing countries want ISDS provisions in their BITs and FTAs, in order to make themselves more attractive to investments by MNCs. Second, when countries change political course and decide to expropriate the property of American investors, it is not just Wall Street investors that lose. The "investor class" includes Harvard's endowment, the major public employee pension funds like Calper's, and ordinary Americans with retirement savings managed by investment funds. Thus ISDS is needed to protect the pocketbooks of ordinary Americans.

Most countries in the world are competing to attract investment, so any inclination to expropriate or to pass laws that discriminate against foreign investors is naturally muted. But some governments, as Hufbauer suggests, want to be bound by ISDS to provide extra assurances to foreign investors. That makes sense. If governments want to provide those kinds of assurances they can do it contractually, without need of a bilateral commitment from the United States. Sure, some places are riskier than others to invest, but what is the justification for socializing those risks (by agreeing to make ISDS available to foreign investors in the U.S.) when the rewards from the investment are entirely private?

Whether the investors hail from Wall Street or Main Street, the facts remains the same. Foreign investment carries risk. The rewards tend to be commensurate with the risk. ISDS socializes the risk and fair-minded people should see that as problematic.

Finally, Hufbauer concludes with the concession that ISDS isn't perfect and could benefit from some revisions. He suggests that ISDS's imperfection is not a good reason to reject the entire TPP and I share that view. I don't like ISDS, but it alone is not enough to bring me to oppose the TPP. Even though some opponents — perhaps Senator Warren herself — are using the ISDS as a stalking horse to kill the TPP, concerns about the system are legitimate and should be taken more seriously. Doing so will not kill the TPP.

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