Forbes®

Eight Reasons To Purge Investor-State Dispute Settlement From Trade Agreements

By Dan Ikenson
March 4, 2014

For a variety of reasons, including poor management of public perceptions, the administration's trade agenda is in trouble. Much of the public's antipathy toward trade agreements can be boiled down to concerns about the so-called Investor-State Dispute Settlement (ISDS) provision. ISDS enables foreign investors to circumvent domestic legal processes and sue host governments in third-party arbitration tribunals for unfair or discriminatory treatment – described hyperbolically by those fanning the flames of opposition as "running roughshod over domestic laws, regulations, and sovereignty."

The inclusion of ISDS in trade agreements subverts prospects for trade liberalization. U.S. multinational corporations *want* access to ISDS, but they don't *need* it. If the trade agenda is the proverbial airplane that is down an engine and losing altitude, throwing ISDS out of the cargo hold to lighten the load is the best way to reduce the chance of a crash.

Following are eight reasons why ISDS should be purged from the Trans-Pacific Partnership and Transatlantic Trade and Investment Partnership negotiations. Here is a link to a new Cato Institute paper that gives background and goes into greater depth and detail about the eight reasons.

First, ***ISDS is overkill***. Investment is a risky proposition. Foreign investment is usually more risky. But that doesn't necessitate the creation of institutions to protect MNCs from the consequences of their business decisions. Multinational companies are among the most successful and sophisticated companies in the world. They are quite capable of evaluating risk and determining whether the expected returns cover that risk. Moreover, MNCs can mitigate their own risk by purchasing private insurance policies.

Second, ***ISDS socializes the risk of foreign direct investment***. When other governments oppose, but ultimately concede to, U.S. demands for ISDS provisions, they may be less willing to agree to other reforms, such as greater market access, that would benefit other U.S. interests. That is an externality or a cost borne by those who don't benefit from that cost being incurred. In this regard, ISDS is a subsidy for MNCs and a tax on everyone else. Taking the argument one step further, ISDS not only subsidizes MNCs, but particular kinds of MNCs. What may be too risky an investment proposition without ISDS for Company A is not necessarily too risky for Company B. By reducing the risk of investing abroad, then, ISDS is a subsidy for more risk-averse companies. It is a subsidy for Company A and a tax on Company B.

Third, ***ISDS encourages "discretionary" outsourcing***. While ISDS may benefit U.S. companies looking to invest abroad, it neutralizes what was once a big U.S. advantage in the competition to attract investment. Respect for property rights and the rule of law have been relative U.S. strengths, but ISDS mitigates those U.S. advantages. Access to ISDS could be the decisive factor in a company's decision to invest in a research center in Brazil, instead of the United States. Why should U.S. policy reflect greater concern for the operations of U.S. companies abroad than for the operations of U.S. and foreign companies in the United States? While we should not denigrate, punish, or tax foreign outsourcing, neither should we subsidize it, and ISDS subsidizes "discretionary" outsourcing.

Fourth, ***ISDS exceeds "national treatment" obligations***, extending special privileges to foreign corporations. An important pillar of trade agreements is the concept of "national treatment," which says that imports and foreign companies will be afforded treatment no different from that afforded domestic products and companies. The principle is a commitment to nondiscrimination. But ISDS turns national treatment on its head, giving privileges to foreign companies that are not available to domestic companies. If a U.S. natural gas company believes that the value of its assets has suffered on account of a new subsidy for solar panel producers, judicial recourse is available in the U.S. court system only. But for foreign companies, ISDS provides an additional adjudicatory option.

Fifth, ***U.S. laws and regulations will be exposed to ISDS challenges with increasing frequency***. The number of cases is on the rise. Most claims have been brought against developing countries—with Argentina, Venezuela, and Ecuador leading the pack—but the United States is the eighth-largest target, having been the subject of 15 claims over the years. As the percentage of global Fortune 500 companies domiciled outside the United States continues to increase, U.S. laws and regulations are likely to come under greater scrutiny. The specter of foreign companies prevailing in challenges of U.S. laws outside the U.S. legal system would frustrate further the task of selling trade to a skeptical public and would reward trade critics who have been warning of just such an outcome for many years.

Sixth, ***ISDS is ripe for exploitation by creative lawyers***. There is a lot of latitude for interpretation of what constitutes "fair and equitable" treatment of foreign investment, given the vagueness of the terms and the uneven jurisprudence. Thus, ISDS lends itself to the creativity of lawyers willing to forage for evidence of discrimination in the arcana of the world's laws and regulations. Among the complaints worldwide in 2012 were challenges related to "revocations of licenses, breaches of investment contracts, irregularities in public tenders, changes to domestic regulatory frameworks, withdrawals of previously granted subsidies, direct expropriations of investments, tax measures and others."

Seventh, ***ISDS reinforces the myth that trade primarily benefits large corporations***. A persistent myth that has proven hard to dispel permanently is that trade benefits primarily large corporations at the expense of small businesses, workers, taxpayers, public health, and the environment. The fact is that trade is the ultimate trustbuster, ensuring greater competition that prevents companies from taking advantage of consumers. Lower-income Americans stand to benefit the most from trade liberalization, as the preponderance of U.S. protectionism affects products and services to which lower-income Americans devote higher proportions of their budgets. But by granting special legal privileges to multinational corporations, ISDS reinforces that myth and is a lightning rod for opposition to trade liberalization.

Eighth, ***dropping ISDS would improve U.S. trade negotiating objectives, as well as prospects for attaining them***. Dropping ISDS would assuage thoughtful critics of the trade agenda, who do not oppose trade, but who believe trade agreements should be more modest and balanced. Meanwhile, what now appears to be an angry mob protesting trade generally will be thinned out, exposing the unsubstantiated arguments of the professional protectionists who benefit by impeding Americans' freedom to trade.

ISDS raised too many difficult questions about the relationship between domestic sovereignty and the imperative of avoiding protectionism in all of its manifestations. It also reflects some of the public's worth fears about trade — fears based on nothing more than myth if ISDS is purged.