THE NATIONAL INTEREST

Game On: How to Devise International Investment Law

The debate on Investor State Dispute Settlement is heating up.

By Simon Lester

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In the ongoing, heated debate over Investor State Dispute Settlement (ISDS), the issue of international investment law is often presented as a simple binary choice. Either you are for an international legal system of protection of foreign investment that includes direct complaints by investors against governments, and obligations such as "fair and equitable treatment"; or you are against such rules and would allow foreign investors to be subject to the whims of governments. Supporters believe such international rules are crucial to attract and protect foreign investment; critics allege that the rules will undermine domestic regulation. At first glance, the debate seems unresolvable.

But beneath the surface of this conflict is a middle-ground position on international investment law, one that prevents many of the problems ISDS supporters warn about, while at the same time eliminating the critics' fears of ISDS lawsuits running amok: A state-to-state dispute-settlement system, like the one used at the WTO, that focuses on a nondiscrimination obligation. Such a system would allow governments to bring complaints against other governments when anti-foreigner bias affects the treatment of foreign investors, in domestic courts, legislation or regulation.

This system has worked very well in the trade context. Since the WTO started in 1995, there have been almost five hundred complaints, with hundreds of panel reports, appellate reports and arbitration decisions. By almost all accounts, the system is effective. There are some difficult cases, of course, but that is true in domestic legal systems as well.

An obvious solution to the ISDS controversy, then, is to shift the investment law system to something more like the WTO. When this is proposed, however, the typical response is that having governments, rather than investors, bring complaints would "politicize" the process. In other words, governments would be forced to confront each other on difficult political matters, and that would be undesirable.

This politicization argument is not convincing. First of all, it is hard to imagine that any politicization that occurs with state-to-state dispute settlement would be worse than what is going on now with ISDS. The nature of the existing system has politicized trade agreements so much that it is questionable whether some of them can even be concluded.

In addition, the trade-dispute process has thrived with state-to-state dispute settlement. Disputes do get political at times, but the number of disputes filed makes clear that governments have not been deterred from asserting their rights when faced with protectionism. Moreover, it is worth noting that state-to-state dispute settlement at the WTO contains some rules on trade in services that cover investment, and the system has not been overwhelmed with politicization.

Rather than being a dangerous approach that would undermine foreign investment flows, state-to-state dispute settlement based on nondiscrimination would support the main goals of international investment law, without the controversies of ISDS. It will do this for two reasons.

First, it keeps the obligations focused on what ISDS supporters often say is their main concern: bias and prejudice against foreign companies. If a government treats an investor badly—via an expropriation without compensation, or an unfair court proceeding—because it is foreign, the system is available for the home-country government to file a complaint and rectify the situation. By focusing on nondiscrimination, the system is narrowly tailored to its goals, in contrast to the current system, where broad obligations such as "fair and equitable treatment" leave the scope uncertain and raise concerns about regulatory autonomy.

Second, by limiting complaints to those made by governments, as is the case in international law generally, we can take control of litigation from corporations and lawyers who pursue claims that have limited chance of success, and strain the credibility of the system. The proliferation of sometimes far-fetched claims enriches the legal industry and enrages critics, but does not do much to promote and protect foreign investment.

It is the combination of these two factors in the current system that is the key: The overly broad obligations, and the ability of investors to sue governments directly. If we can keep the obligations narrow, and have international investment law dispute procedures look more like traditional international law, the whole system makes a lot more sense. (And nothing in such a system would prevent foreign investors from putting arbitration clauses allowing direct lawsuits in their contracts with host governments).

As part of the discussion of the Trans-Pacific Partnership, the ISDS debate is heating up, with Senator Elizabeth Warren weighing in with criticism of ISDS, and the White House offering a public response. While the debate on international investment law is playing out as a binary one—you are either with us or against us!—the reality is that it is a more nuanced and complex issue, where a compromise exists—if people are willing to look at it.

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