U.S. Trade Deals May Finally Drop Special Protections for Investors

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August 18, 2020

The special protection that investors based in the United States have long enjoyed when they do business abroad seems to be on its way out, and it's about time. Unlike other private parties, including workers and consumers, foreign investors have access to special arbitration arrangements to protect their businesses in partner countries that sign bilateral investment treaties or preferential trade agreements with the U.S. This mechanism, known as investor-state dispute settlement, or ISDS, has attracted increased scrutiny since the U.S. insisted on including an expanded version of it in the North American Free Trade Agreement in the 1990s. Now, both President Donald Trump and presumptive Democratic presidential nominee Joe Biden have expressed opposition to, or at least deep skepticism about, this relic of the mid-20th century.

ISDS procedures began to be included in bilateral investment treaties, especially those negotiated by European countries, in the 1950s and 1960s, when a number of newly independent countries, many of them former European colonies, adopted nationalist economic policies. Their governments sometimes expropriated foreign investments that they viewed as exploitative and refused to pay compensation. Even though those treaties and others since then are between sovereign governments, the ISDS system allows private corporations to bring complaints about government behavior before independent international tribunals that can order the government to pay compensation if it is found to be in violation of the treaty.

The U.S. never relied on investment treaties as heavily as many European countries. But beginning with NAFTA, U.S. trade negotiators began incorporating ISDS panels in the investment chapters of bilateral and regional trade agreements. Controversially, the NAFTA model expanded the traditional model—which typically focused on expropriation or other blatant discrimination against foreign investors—to include "regulatory expropriation." That allowed corporations to bring complaints against governments for regulatory actions that were allegedly arbitrary or capricious and that lowered the value of the investment.

After corporations used the ISDS privileges under NAFTA and other trade agreements to challenge environmental or health and safety policies around the world, progressive groups and a number of congressional Democrats denounced the system. They focused their ire on high-

profile cases challenging water pollution regulations in California, for example, and tobacco regulations in Australia and a number of developing countries. These cases also made clear that the ISDS system was no longer just about redress for expropriation in developing countries. Even though independent arbitration panels ultimately rejected many of the challenges, critics argued that the entire dispute-settlement system infringed on national sovereignty and that even unsuccessful claims could undermine public policies by causing regulators to hesitate in making new rules because of concerns about costly litigation.

The original public policy rationale for having ISDS was that they would help attract investment to poor countries in need of capital to develop. It is hard to make that case for these investor protections today. Most developing countries are already doing whatever they can to attract foreign investment, often including offers of tax holidays or other financial incentives, and expropriation has become much less common. Corporations also have the option to buy political risk insurance, which is often subsidized by their home governments. The evidence that the ISDS protections stimulate foreign investment in countries where the rule of law is weak is thin at best.

Moreover, as seen with NAFTA—and frequently in Europe as well—corporations do not limit their use of ISDS privileges to poorer countries with underdeveloped legal systems. Nor do treaties and trade agreements necessarily require investors to exhaust domestic legal remedies before turning to an ISDS panel. Finally, as Biden noted recently, there is little justification for corporations to have access to a special process to protect their rights that is not available to unions or other private entities.

In negotiating the update to NAFTA, rebranded as the United States-Mexico-Canada Agreement, or USMCA, the Trump administration sharply cut back the role of ISDS panels. They will be phased out over three years between the U.S. and Canada, and apply only to a few sectors, mainly resource-based, in Mexico. When asked about plans for including an ISDS process in possible future trade agreements with the United Kingdom or other countries with well-developed legal systems, U.S. Trade Representative Robert Lighthizer said he did not envision doing so. In response to other congressional queries, both Lighthizer and one of his deputies were vague about the Trump administration's plans for investment protection in trade negotiations with Kenya, a developing country where the rule of law is a work in progress.

Biden also expressed skepticism about the investor-state dispute settlement system in a recent candidate survey circulated by the United Steelworkers union. He said that he opposes "the inclusion of such provisions in future trade agreements" and pointed out two features of the ISDS system that trouble him. One, as noted, is that this special mechanism is available only to corporations and not "other organizations." The other is the way that investors have used it, or could, "to attack labor, health, and environmental policies." Simon Lester, a trade analyst at the Cato Institute, interpreted Biden as saying that he would not include ISDS panels in any trade agreements his administration might negotiate. Other trade experts thought he meant only that he would ensure that any such provisions for investors shield those other priorities.

The investor-state dispute settlement mechanism was created in a very different time to address a problem—expropriation of foreign investors' property without adequate compensation—that is no longer a major deterrent to international capital flows. The expansion of the system's reach,

both to regulatory issues and to host countries with perfectly adequate legal systems, primarily reflects the disproportionate influence that corporations have on trade negotiations. Such corporate overreach may finally spell the end for a system that has given investors special privileges and protections, if not for bilateral U.S. trade agreements more broadly, no matter who is elected president in November.