

# ISSUE BRIEF

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## NAFTA's Investor Dispute (ISDS) Provisions Are Good for Americans

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Trump Administration trade officials and their Canadian and Mexican counterparts are reportedly debating the Investor-State Dispute Settlement (ISDS) provisions in the North American Free Trade Agreement (NAFTA).

Those key investor protections help to secure American property rights protection and the rule of law. They also advance the White House's pursuit of a trade policy that serves the interests of American workers.

ISDS protects Americans by enshrining the principles of U.S. rule of law in each investor dispute, extending to those investors essential private property protections under U.S. law that include fairness and due process, compensation for foreign government seizure of property, and non-discrimination. Through ISDS, U.S. investors have assurance of their legal rights under the U.S. Constitution as well as the Administrative Procedure Act. Withdrawing ISDS would eliminate these basic property rights for U.S. investors.

The principal ISDS provisions of NAFTA are found in:

- Chapter 11, which “establishes a mechanism for the settlement of investment disputes that

assures both equal treatment among investors... in accordance with the principle of international reciprocity and due process before an impartial tribunal”; and

- Chapter 19, “a mechanism to provide an alternative to judicial review by domestic courts of final determinations in antidumping and countervailing duty cases.”<sup>1</sup>

ISDS mechanisms have been included in many trade agreements to secure basic legal protections for a signatory state's nationals abroad. Four basic protections are central to ISDS:

- 1. Minimum standards of treatment.** Host nations must provide investors with fair and equitable treatment and full legal protection and security, either as defined by the agreement or as limited to the international minimum standard.
- 2. Due process.** Nations must follow defined, legal processes. They may not invoke arbitrary and capricious measures in cases involving foreign investors.
- 3. Non-discrimination.** The protections for foreign investors must be the same as those for domestic investors. Moreover, the most favored nation standard<sup>2</sup> mandates that host states may not discriminate between foreign investors from different nations.
- 4. Expropriation.** Nations cannot directly (for instance, by nationalization); indirectly (such

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as by breaking a contract or in other circuitous ways); or “creeping” (by gradual means) render an investment valueless without compensating the investor.<sup>3</sup>

ISDS protections provide a neutral, independent arbitration process that enables investors or business interests to settle disputes without triggering state-to-state conflict. They ensure that, even in foreign or local jurisdictions where preferential treatment may otherwise be given to host entities, Americans are guaranteed fair treatment consistent with the U.S. Constitution and thus similar to the protections they enjoy in the U.S.

These ISDS protections are fundamental to the free flow of trade among NAFTA member nations. They are essential to the protection of secure American interests in any trade agreement due to their ability to safeguard fair, unbiased, and transparent legal processes.

The Heritage Foundation’s *Index of Economic Freedom*<sup>4</sup> makes clear year after year that a free and open investment environment gives entrepreneurs the incentive to expand economic activity and generate productivity improvements that lead to creation of more American jobs.

As the *Index* also notes, protection of property rights is a central motivating force for workers and investors. A key aspect of property rights protection is the enforcement of contracts—one of the foundations of a successful market system. ISDS provisions help to ensure the even-handed government enforcement of private contracts that is essential to ensuring equity and integrity in the marketplace. The ISDS mechanisms that are included in more than 3,000 international agreements require the U.S. and foreign countries to treat all investors equally under the law.

ISDS panels created by trade and investment agreements between nations, such as NAFTA, act

to prevent discrimination against or among foreign investors, either through expropriation, direct discrimination, or other nefarious regulatory actions.

One of the characteristics of the weakened economy since the Great Recession has been depressed levels of investment. The substantial expansion in the size and scope of government, increased regulatory and tax burdens, and the loss of confidence that has accompanied a growing perception of cronyism, elitism, and corruption has severely undermined global competitiveness.

Keeping ISDS in NAFTA will help to protect American companies and workers from unfair treatment by the Mexican or Canadian governments—preventing the seizure of profits and assets without due process. In the past dozen or so years, the U.S. government has won every ISDS case filed against it by foreign investors, often because the U.S. legal system functions well and because U.S. politicians eschew the invasion of investors’ treaty rights.

ISDS lawsuits filed in Canada and Mexico have resulted in settlements for American companies of over \$100 million—compensation that would not be available if ISDS were eliminated from NAFTA. If American companies had to rely on traditional state-to-state dispute-settlement mechanisms and weaker legal protections for private property in Canada and Mexico, the result would be reduced protections for American investors.

ISDS provisions can also open foreign markets for exports of U.S. products made by American workers. Tougher ISDS rules block potentially protectionist efforts by foreign governments, such as local-content mandates, local employment quotas, and export percentages.

ISDS enjoys bipartisan support in Congress. In 2015, a solid majority of sixty Senators rejected arguments by Senator Elizabeth Warren (D-MA)<sup>5</sup> and others against ISDS provisions in the Trade Promotion Authority renewal legislation.

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1. NAFTA Secretariat, “Overview of the Dispute Settlement Provisions,” <https://www.nafta-sec-alena.org/Home/Dispute-Settlement/Overview-of-the-Dispute-Settlement-Provisions> (accessed October 5, 2017).
  2. Since 1998, the “most favored nation” standard has been known in the U.S. as “permanent normal trade relations.”
  3. James M. Roberts, Theodore R. Bromund, and Riddhi Dasgupta, “Investor-State Dispute Settlement (ISDS) Mechanisms: An Important Feature of High-Quality Trade Agreements,” Heritage Foundation *Issue Brief* No. 4351, February 20, 2015, <http://www.heritage.org/trade/report/investor-state-dispute-settlement-isds-mechanisms-important-feature-high-quality-trade>.
  4. Terry Miller and Anthony B. Kim, 2017 *Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2017), <http://www.heritage.org/index>.
  5. “Ensuring Tax Exempt Organizations the Right to Appeal Act—Continued,” testimony before the U.S. Senate, May 22, 2015, <https://www.congress.gov/congressional-record/2015/5/22/senate-section/article/s3290-1> (accessed October 11, 2017).
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Senator Warren has continued the criticism on ISDS from the left, most recently when she urged U.S. Trade Representative Robert Lighthizer to remove ISDS provisions from NAFTA.<sup>6</sup>

The Trump Administration should continue to stand firm against such arguments, and seek to retain the ISDS protections that are so vital for securing a free and open multilateral investment environment in NAFTA partner countries.

The National Association of Manufacturers and more than one hundred other American business groups have urged the Trump Administration to ensure fair treatment by foreign governments by maintaining and improving ISDS enforcement and the protection of U.S. property overseas.<sup>7</sup>

Without ISDS, it would be easier for foreign allies to discriminate against the products and services that American workers manufacture and export to Canada and Mexico.

Although Americans' trust in government has reached all-time lows, NAFTA has been one government-to-government agreement that has served them well. Maintaining transparent, independent, and neutral arbitration mechanisms in trade agreements for resolving foreign investment disputes—and protecting Americans' property rights and their right to the rule of law—is one way to restore that trust.

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6. News release, "Warren Urges U.S. Trade Rep to Remove ISDS Provisions During Next Round of NAFTA Negotiations," Office of Senator Elizabeth Warren, September 19, 2017, [https://www.warren.senate.gov/?p=press\\_release&id=1844](https://www.warren.senate.gov/?p=press_release&id=1844) (accessed October 12, 2017).

7. Letter to Robert Lighthizer, Rex Tillerson, Gary Cohn, Wilbur Ross, and Steve Mnuchin from various industry associations, August 8, 2017, <http://www.nam.org/Issues/Trade/August-8--2017-Business-Letter-on-ISDS-in-NAFTA/> (accessed October 6, 2017).

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