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NAFTA Update A Step Backward For US Investors

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The current U.S. policy on international investment is, quite simply, moving backwards. U.S. investors are justly concerned that they will soon lose the robust international law protections and dispute resolution mechanisms that they have accessed for years. The investment chapter of the recently signed, but not yet ratified, U.S.-Mexico-Canada Agreement[1] is at the forefront of this trend.

Will the retrenchment in investor-state dispute settlement, or ISDS, continue to be the general policy of the Trump administration, and result in the watering down of all such protections and dispute resolution alternatives in future trade agreements? What are the wider business implications of this change? Should this trend be stopped now before it spreads further?

In summary, under the USMCA:

- The new investment chapter represents a 180-degree change in policy direction. The approach taken in the USMCA represents a retreat to the world before the U.S.' first bilateral investment treaty, or BIT, was signed with Panama in 1982.

- U.S. investors in Canada will have no ability to make direct claims against Canada for failure to follow basic and fundamental obligations to treat investors fairly and in a nondiscriminatory manner, or for compensation in cases of direct or indirect expropriation.

- The vast majority of U.S. investors in Mexico will see access to dispute resolution procedures limited as well, requiring that they first go to a local court. Once there, their protections will be limited.

- A few sectors have been promised better treatment. The oil and gas (but not mining), power generation, telecommunications and transportation service industries will not have to go to a

Mexican court first, and will have access to the same traditional protections and standards of treatment that were given in the North American Free Trade Agreement.[1] But the new USMCA investment chapter may ultimately provide little help to the investors in those sectors, because of its limited scope of application to defined "covered government contracts" and other limiting factors.

In contrast, when NAFTA came into effect on Jan. 1, 1994, the investment chapter at the time was considered the gold standard in international investment protection. NAFTA provides international dispute resolution through arbitration for U.S. investors in Mexico and Canada. Investors are protected against expropriation without compensation, discrimination and arbitrary treatment — basic international protections every U.S. investor should expect from a host government when investing abroad.

NAFTA was consistent with U.S. model BIT practice. Today, the U.S. has negotiated over 40 such BITs and free trade agreements, with strong investment chapters. Almost every country in the world has signed such treaties, with over 3,000 similar treaties in existence.[2]

U.S. investors are also the largest beneficiaries of this international investment treaty system, having been claimants in over 225 disputes against foreign governments for breaches of international law protections.[3] The next largest claimant group is investors in the United Kingdom, with 112 such claims. Canadian investors have been claimants in 54 cases. It is notable that the U.S. government has been respondent in 30 such cases, and has never lost once. Any arguments that such policies have worked against U.S. interests are simply unsustainable on their face.

But what is the basis for this dramatic shift in U.S. policy direction? U.S. Trade Representative Robert Lighthizer has justified it on the basis of purposefully discouraging U.S. investment abroad, on the premise that the change will purportedly encourage companies instead to return and invest in the U.S. Lighthizer's political motivation may have been to ensure, at the end of the day, stronger bipartisan support in Congress for ratifying the agreement. But we think the systemic costs of narrowing ISDS protections so drastically are greater than the short-term benefits of attracting a few votes of support.

We would argue that Lighthizer's justification for curtailing ISDS protections ignores key U.S. business realities. The American Chemistry Council, an industry trade group, has expressed fundamental concerns about the investment provisions in the USMCA, even though the group supports the agreement's ultimate passage in its current form.[4] Ed Brzytwa, the council's director for international trade, noted in a Dec. 4, 2018, blog post that while "USMCA is poised to support chemical manufacturing growth in many ways," it is also true that U.S. chemical manufacturers have traditionally relied strongly on ISDS in their investment decisions:

- U.S. chemical manufacturers do not invest in foreign markets simply to ship products back to the U.S. They are in overseas markets because they need to be close to their customers and to take advantage of having proximity to locally-produced feedstocks. Moreover, opening foreign markets creates demand for exports of innovative products from the U.S.

- For a highly-regulated sector such as chemicals, it is safer and more efficient to build and invest in manufacturing facilities locally, as a way to minimize shipping and to protect people and the environment.

It appears that Lighthizer understands well that ISDS provides the benefit of legal certainty through protections and dispute resolution to U.S. investors who invest in Canada and Mexico, and thus encourages such foreign investment. This is something that U.S. investors agree is a positive factor.

However, in the current political climate, encouraging and protecting foreign investment through meaningful remedies such as ISDS is viewed as a negative. By effectively eliminating NAFTA chapter 11, the logic is that there would be no protections or remedies for U.S. investors, thus taking away what Lighthizer perceives as an added policy incentive to invest in Canada and Mexico. Adopting an "America First" attitude toward investment, Lighthizer argues that without the recourse to ISDS provided to companies overseas, firms would be more inclined to invest in the U.S.

The problem is that, as in the case of the chemical industry, companies need to be near their foreign suppliers and markets. Many U.S. investors are not investing abroad to move jobs from the U.S., but the nature of their industries are such that they can only do their business abroad.

Some obvious categories are mining and natural resources, construction and infrastructure (which includes transportation, energy, public works and tourism). The latest set of statistics from the International Centre for Settlement of Investment Disputes (ICSID arbitration makes up about 70% of the total number of ISDS cases) indicates that these sectors make up over 60% of the ISDS caseload in 2018.[5] Manufacturing is only a small percentage of the investments under dispute. Again, Lighthizer's rationale is simply inconsistent with the facts.

Under the USMCA, the United States' investment policy is moving from the gold standard to no standard. U.S. investors in Canada and Mexico are rightly concerned. U.S. investors in other overseas markets should also be concerned. Their investment protections might be in the crosshairs next.

Implications of Weakened Investment Protections for U.S. Business Abroad

At the very least, the narrowed set of options for investment protections in the USMCA causes greater global uncertainty for U.S. investors. On top of the existing uncertainties caused by Trump's trade policies, including the use of national security tariffs under Section 232 of the Trade Expansion Act of 1962 on steel and aluminum, the weaking of protections for U.S. investment abroad raises broad questions:

- What alternative approaches to agreement-specific ISDS will be available to U.S. investors? Some may be able to take advantage of networks of existing BITs, depending on how their investments are structured and legal rights are conferred, but this may not always be the case.

- As the U.S. pursues the weakened approach to investment protection policy in new free trade agreements (and revises existing FTAs accordingly), how do U.S. companies assess their vulnerabilities? Do they simply accept greater risks and hope for the best? What are their optimal mitigation strategies?

- The hoped-for result that U.S. investors will simply repatriate operations back to the U.S. in the face of these increased uncertainties is unrealistic. It does not reflect the realities of how U.S.

companies do business today, or how they structure their global operations, whether they are manufacturers or global services providers.

- A maxim of U.S. economic and trade policy in the past was, “Where U.S. investments go, exports will follow.” U.S. foreign direct investment abroad was seen as another way to project U.S. economic influence abroad, and to open foreign markets to U.S. goods, services and business practices. It is in the U.S. interest for markets around the world to welcome U.S. investments, along with our brands and innovations.

- Retrenching from protecting U.S. investors’ interests abroad could well lead to ceding a larger share of foreign markets to competitors such as China. Already, U.S. companies are reporting vigorous competition from Chinese firms in markets where they had strong presences only a few years ago. This trend will undoubtedly continue.

Moreover, the limited ISDS provisions negotiated in the USMCA may raise serious questions about the political support that may be forthcoming from congressional Republicans for the completed trade pact once the agreement proceeds to Congress for ratification, perhaps as soon as this summer under the White House’s preferred timetable.

In March 2018, when the USMCA was still under negotiation, 103 Republican lawmakers warned U.S. negotiators that eliminating or weakening NAFTA’s original ISDS provisions could endanger eventual Republican support for the agreement. Ranking Ways and Means member Rep. Kevin Brady, R-Texas, continues to raise concerns about the limitations on ISDS as he assesses USMCA outcomes.

The U.S. business community is also wary of the precedent established by the ISDS provisions in the USMCA for future U.S. investment interests. They view maintaining strong investment protections equivalent to those the U.S. has favored in the past as essential to safeguarding U.S. investors’ rights during the preestablishment phase, providing a consistent and predictable minimum standard of treatment, and for protecting against instances of indirect expropriation.

They know that such strong standards of investor protection, once eroded, will be hard to win back. U.S. investors are prepared to fight vigorously to maintain such standards in existing agreements, and to make the case that these standards are essential to supporting U.S. exports and the ability of U.S. companies to sell to and support their customers, both at home and abroad.

U.S. investors need the strong support of U.S. economic, trade and foreign policy behind them. The drastic change in U.S. policy on ISDS in the agreement represents a misstep whose broader business and commercial implications need to be carefully considered.

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[1] See Chapter 14, https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/14_Investment.pdf.

[2] https://investmentpolicyhub.unctad.org/IIA.

[3] https://pitad.org.

[4] https://urldefense.proofpoint.com/v2/url?u=https-3A__www.americanchemistry.com_Policy_Trade_US-2DChemicals-2DIndustry-2DSupports-2DPassage-2Dof-2DUSMCA.pdf&d=DwIGaQ&c=Anw7wKLFSGyH7zEzIqo-zgMRy5HE-AH-SibmOy3H7xE&r=7M-4lKPwsmSB6Mmbs6I-a5UsDmIPt576Y3zWMV3TRPY&m=sdqtPihzt-jHAJzhEnbgpNi-VTVKyWXLLeINcx0WnX8&s=bBk8W1IZk65vEaK6zEBAFbdEbHhE0YFICAHn9S24Xeg&e=.

[5] The ICSID Caseload, Statistics (Issue 2019-1), https://icsid.worldbank.org/en/Pages/resources/ICSID-Caseload-Statistics.aspx.