Beware of TPP's Investor–State Dispute Settlement Provision

By Joseph Stiglitz | 03.28.16

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While advocates promote the Trans-Pacific Partnership (TPP) as a "free trade" agreement between the United States and 11 Pacific Rim countries, the most economically significant provisions are not cuts to trade barriers. Instead, the key element is TPP's investment chapter, which gives foreign investors the right to sue governments in private international arbitration when they feel their newly created property rights are violated (a process known as investor–state dispute settlement, or ISDS).

The alleged goal of ISDS is to increase security for investors in states without an adequate "rule of law." But the fact that the U.S. is insisting on the same provisions in Europe, where legal safeguards are as strong as they are in the U.S., suggests another motive: the desire to make it harder to adopt new financial regulations, environmental laws, worker protections, and food and health safety standards.

While defenders of ISDS sometimes claim that it prevents discrimination against foreign firms, foreign firms have sued—and won—even when they are treated no differently from domestic firms. In fact, these provisions discriminate *in favor* of foreign firms: A foreign firm can sue the U.S. government in private arbitration for cash rewards if it thinks government actions violate the new rights and privileges granted by TPP, but domestic American firms have no such recourse in U.S. courts. Two arbitrators can, in effect, undermine decisions of Congress and the president, ordering billions of dollars in payments for their lost investment value and guesstimated lost profits.

Under TPP, foreign investors could sue over pretty much any law, regulation, or government decision. The agreement guarantees a "minimum standard of treatment," a vague standard that corporate-friendly arbitrators have interpreted liberally in past decisions, inventing obligations for governments that do not exist in the actual text of agreements or host countries' laws.

In an earlier case using NAFTA's similar provisions, arbitrators ordered Canada to pay American waste disposable company S.D. Myers $5.6 million because the country prohibited the export of toxic industrial waste—exports that were banned by international treaty that applied to Canadian and foreign firms alike. The company's lawyer boasted, "It wouldn't matter if a substance was liquid plutonium destined for a child's breakfast cereal. If the government bans a product and a U.S.-based company loses profits, the company can claim damages."

The list of egregious decisions under similar agreements is growing. In an example playing out now, the energy company TransCanada will challenge President Obama's decision to reject the Keystone XL pipeline, demanding $15 billion in compensation under NAFTA's investment provisions. Relative to NAFTA, TPP would expand both the substantive rights afforded to foreign investors and the types of government actions subject to compensation claims.

The U.S. Trade Representative (USTR) says, not to worry: *so far* we have not lost a case. This is not because we can't lose; Canada, with all of its world-class lawyers, has lost many cases. So far most U.S. trade agreements that include ISDS enforcement involve countries with little foreign investment here, but this will change dramatically if Japanese and Australian firms, which both have large investment footprints in the U.S., gain access to TPP's investment measures, or if we enact a similar deal being negotiated with the European Union.

But which country wins or loses is partly beside the point. TPP's rules could reverse the fundamental "polluter pays" principle—i.e., those that do damage should pay remediation. Instead, governments may end up paying businesses not to pollute. From toxic waste to toxic financial products, TPP would institute rights to investor compensation for nondiscriminatory government actions in the public interest. The threat of adverse rulings would deter government actions necessary to protect the public, as is happening in New Zealand and other countries that have halted new tobacco warning label rules as they wait to see how cigarette company investor–state suits pan out.

U.S. negotiators claim TPP includes new safeguards by stipulating nothing "shall be construed to prevent a Party from adopting, maintaining or enforcing any measure" appropriate to ensure "environmental, health, or other regulatory objectives." But the same provision renders that pledge useless with language limiting the application of this provision to policies "otherwise consistent with" the terms of the investment chapter. Even if these new terms and other safeguards *were* meaningful in terms of protecting the right to regulate, the agreement's obligation to provide "most favored nation treatment" to foreign investors means that an investor could "import" more favorable investor guarantees from other agreements, thus sidestepping so-called safeguards.

TPP partners presumably understand these obfuscations. That's why several governments insisted on having the ability to dismiss investor challenges of tobacco control measures. But what about the safeguards for any other areas of public interest regulation—say, instituting a carbon tax, bargaining for lower drug prices under Medicare, or preventing the next crisis with new financial regulations? Big pharmaceutical and fossil fuel companies are already enthusiastic ISDS users. TPP would be the first U.S. trade agreement to grant financial firms the right to dispute financial regulations with "minimum standard of treatment" claims. We should be reining in Wall Street risk, not giving banks more ways to avoid regulation.

The USTR would undoubtedly dispute this interpretation of TPP, but it is based on broad consultation with experts across the world. In past agreements, complexities and ambiguities such as these have provided ample scope for arbitrators to rule repeatedly in favor of corporate interests over the public interests. TPP has clearly not fixed these problem problems.

To be clear, the United States has a critical role to play in promoting an open international trade and investment system. But who benefits from such efforts depends entirely upon the *specific* rules included in the agreements. Under TPP, there would not be more investment in the U.S.; if anything, the provisions are designed to shift investment *out* of the U.S. The real effects would be on basic safeguards for health, safety, the environment, and even the economy.