Kluwer Arbitration Blog

Debating ISDS

Simon Lester (Cato Institute) · Saturday, June 20th, 2015

Thanks to the Kluwer Arbitration Blog editors for this chance to weigh in on the ISDS debate. I have been a frequent critic of the existing ISDS system, but I take a different approach than many other opponents. For me, the discussion should focus on two main issues, one related to access to international rights protections and the other related to substantive obligations:

1. Why do foreign investors have recourse to enforceable international law to assert their rights, whereas virtually no one else does?

2. What should the scope of international investment law obligations be?

In this post, I will highlight these two issues, and I look forward to hearing the responses of ISDS supporters.

On the issue of who has access to enforceable international law, it is widely acknowledged that international law is a fragmented system. However, it is nonetheless possible to step back and evaluate it as a whole, to see how various groups are treated. When you compare international investment law to other areas, such as human rights, it is clear that foreign investors have been given a fairly effective enforcement mechanism, whereas ordinary citizens generally have not (one or two regional rights treaties aside). We should ask why that is. On its face, this situation does not seem, well, "fair and equitable."

Some have argued that international investment law is a progressive force that can be used as the basis for expanding rights to others. That is a principled position. However, in practical terms, it is not likely that this will happen anytime soon, if ever. The rights of foreign investors are a one-off grant; there is no movement to extend these rights to others. Thus, supporters of the system need to accept that the current system gives rights to some and not others, and that is not likely to change.

Is there a justification for giving special rights only to foreign investors? If this were the 1950s, when newly independent countries were asserting their sovereignty and nationalizing the investments of foreign companies, there might have been a better case for it. In a situation where certain national governments are targeting foreign investors, the idea of a neutral international tribunal to adjudicate the issues could have some merit.

But today, the situation of foreign investors is very different. Except in fairly rare circumstances, governments are not targeting foreign companies on the basis of nationality. (And if they were, a

non-discrimination provision alone could address the problem. I will discuss the substantive obligations further below.) In fact, the bigger problem with governments and foreign investors is probably the large subsidies governments keep offering to lure them in. To take an example, even as the United States and the European Union battle at the WTO over the subsidies each provides to Boeing and Airbus, respectively, U.S. state governments are offering subsidies to that foreign competitor Airbus!

Of course, it is certainly true that governments treat investors, and citizens more generally, badly sometimes. In many countries, even the more advanced ones, the absence of rule of law can be a serious problem. But it is hard to make the case that most countries are targeting investors because they are *foreign*. The truth is, governments treat a lot of people badly; mostly this means treating their own people badly, but foreign investors do sometimes get caught up in this general problem.

The strange thing about ISDS is that it addresses only a small subset of this problem of bad government treatment, in that it only addresses the problem as it pertains to foreign investors. What is particularly odd about it is that foreign investors are often in a much better position to defend their rights than are domestic investors or ordinary citizens. There are certainly a range of foreign investors, and not all are big multinational companies. However, in order to engage in investment outside of your country, significant resources are usually required. By contrast, domestic investors are often small companies, such as dry cleaners or pool maintenance companies. As it stands now, though, it is only foreign investors who get the protections under international law, not domestic investors, or ordinary citizens for that matter.

There are arguments for addressing gaps in the rule of law through international treaties, either with an international standard or a requirement to incorporate such standards in domestic law. But the ISDS approach of providing such protections *only for foreign investors* undermines the rule of law as much as it promotes it. It is akin to saying in a domestic constitution that the only rights we will protect are those of wealthy property owners.

Turning to the substantive obligations, the discussions of what international investment law requires often blur together some very different rules. Sometimes defenders of the system portray it as only about prohibiting discrimination against foreign investors; other times they focus on the issue of expropriation of physical assets. If these were the only obligations, ISDS may never have made headlines in the first place.

In truth, the biggest issues are the international investment law rules on regulatory expropriation and on the minimum standard of treatment, including fair and equitable treatment. My sense is that some defenders see these as very narrow obligations, which would only affect a small percentage of government actions, those which cross a very high threshold of bad behavior. In practice, however, some broad interpretations of these provisions have created opportunities for litigators to challenge a wide range of government actions and inactions.

While some critics worry about the “regulatory chill” that may result, my fears are broader than that. It seems to me that we have given foreign investors an opportunity to challenge just about any government behavior that they do not like.

Of course, that does not mean that investors will win every challenge. But to me, the win-loss record is not the most important thing. The more interesting issue is what kinds of challenges are being brought, and what impact they are having on governments. When I see claims made against

governments who decide to withdraw subsidies, it raises concerns.

Note that it would not be very difficult to fix the problems of overbroad legal obligations. In the context of regulatory expropriation, a number of agreements have added language to make clear that nondiscriminatory regulation will almost never violate this provision. Something similar could be added to the minimum standard of treatment provisions. Or, a general exception for legitimate social policies could be included. This would not be unprecedented, as some agreements already have a provision like this. The resistance to adding such language in U.S. and EU investment obligations is somewhat baffling, although I suppose the obvious explanation is that business groups are lobbying hard against it.

I have tried hard to engage with supporters of the existing ISDS system on these issues, on twitter, on various blogs, and via e-mail. It has been difficult to get much of a response. Usually when I raise the issue of the broad scope of fair and equitable treatment, for example, they disappear from the debate, leaving me wondering what their position is. If ISDS is about the treatment of *foreign* investors, why isn't a non-discrimination provision enough? And why have an international legal system that requires fair and equitable treatment, and compensation for expropriation, for foreign investors, but not for anyone else?

I appreciate the opportunity from the editors of this blog to raise some of these issues, and I look forward to hearing any responses from ISDS supporters.

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