Commentary

Does U.S. and EU Foreign Investment Need "Protection"?

By Simon Lester
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European negotiators will be in DC next week for the third round of talks on the Transatlantic Trade and Investment Partnership (TTIP). While much of the media focus for these negotiations is on trade issues, foreign investment will be covered in the talks as well. One of the most important, but least well understood, aspects of the foreign investment-related portions of the talks is the idea of rules for "protecting" foreign investment. While one might think that foreign investors such as BMW or Google are powerful companies that can assert their rights effectively, even when they are outside their "home" country, current international investment agreements treat them as ninety-eight-pound weaklings who are likely to be pushed around by mean foreign governments when they go abroad. In the TTIP negotiations, the US and EU will be considering provisions that "protect" these and other foreign investors. These talks provide a good opportunity to rethink the rules.

In many of their other trade and investment agreements, the US and EU have pushed hard for investment rules that provide for "investor state dispute settlement" (ISDS), in order to "protect" companies who invest abroad. While many international agreements only allow for states to make claims against each other, under ISDS, foreign investors can bring claims against states directly in an international tribunal. Such rules have been part of international economic policy in the US and Europe for many years. But should these rules be extended to the TTIP? More specifically, should we use international agreements to "protect" U.S. and EU foreign investment in this way?

In answering these questions, a key issue is, protection from what exactly? Looking at the existing rules in other agreements, there are three main kinds of government behavior that are at issue here (that is, from which investors supposedly need protection):

- Discriminatory treatment of foreign investors and investments;

- Expropriation of foreign investments; and

- Treatment that is not "fair or equitable."

Let's consider each of these separately.

The idea of nondiscrimination in international economic relations is probably the least controversial of these. It is a long-standing component of the world trading system, and simply means that each party promises to treat foreigners the same way it treats its own nationals.

The other issues are more difficult. Expropriation of private assets, once very common, has gone out of favor in recent decades, although it still occurs occasionally. But the international expropriation rules also cover *regulatory* expropriation, which means that government regulation is sometimes so extensive that it can be deemed the equivalent of an actual expropriation. In U.S. constitutional law, there is a similar concept known as "regulatory takings." A wide range of regulatory actions can be challenged on this ground. While a nondiscrimination principle is clearly about international economic relations, putting regulatory expropriation (and actual expropriation) rules in a treaty is more akin to elevating domestic constitutional law principles to the status of international law.

Finally, provisions related to "fair and equitable" treatment similarly take domestic legal principles to the international arena. While they have been interpreted differently by different international tribunals, in general terms they seem to encompass the "due process" concerns seen in domestic legal systems.

The origin of such "protections" has its roots in U.S. and EU investment in unstable, undemocratic developing countries many decades ago. It was thought that the court systems of these countries could not address improper government behavior, and thus international remedies would be useful. And to some extent, these countries were eager to adopt the rules, so as to give assurances to, and encourage, foreign investment.

The big change that has happened recently is the expansion of the international investment system to wealthy democracies. But even if rules were useful for the older investments in unstable regions, it is not clear why they are needed for investments in stable democracies, who have effective domestic mechanisms to prevent government abuses.

This takes us to the TTIP. The two parties both have mature, stable, and well-developed legal and political systems. In this situation, what "protections" does foreign investment need beyond what is already provided in domestic law? The analysis may vary depending on the particular obligation.

There is a case to be made that mutual promises of nondiscrimination are useful. At times, there are emotion-based concerns about foreign takeovers of domestic assets in both the US and EU. The French expressed dismay about a possible takeover of yogurt maker Danone; Americans were concerned about a takeover of pork producer Smithfield Foods. Perhaps a legal obligation of nondiscrimination could prevent backsliding towards nationalistic impulses.

With regard to the other principles, though, it is difficult to see what is added. These principles already exist, in one form or another, in U.S. and EU domestic law. What is the value of a separate process exclusively for foreign investors?

Just as importantly, it seems clear that something is lost with these provisions. They have become a lightning rod for criticism of international economic agreements, and make these agreements much harder to get through the domestic political process. That means core free-trade objectives such as lowering tariffs are harder to achieve.

For years now, these provisions have been carried over from agreement to agreement with only minor refinements. A US-EU agreement will have such a big impact in terms of the amount of investment covered that it merits a rethinking of these issues. In recent years, there has been an explosion of litigation under these investment rules, as foreign investors (and their clever lawyers) have taken advantage of the vague legal obligations to make ever-more-creative claims. The large amount of US-EU cross-border investment — almost 4 trillion dollars — will provide many new opportunities for this.

In the final analysis, there are two main considerations with regard to whether U.S. and EU foreign investment needs extra "protection" in the TTIP. First, if a U.S. (or EU) company chooses to make an investment abroad, why should the U.S. (or EU) government go to bat for it at all? In the past, we used "gunboat diplomacy" to protect our companies. Now we use international lawyers. But why should we do anything? These companies have chosen another jurisdiction for their investment, which is fine. Companies should invest in whatever location makes the most economic sense. But in that situation, it is not clear why the investment is "ours" to worry about anymore. When multinationals invest all over the world, are they really "ours," or are they now just global entities?

And second, when the place of the investment is the EU or US, which have plenty of their own protections in domestic law, international law seems largely duplicative. International investment rules are an opportunity for lawyers to bring additional claims, but are not necessary for "protection" of foreign investment. Without some evidence that more is necessary, perhaps US-EU investment rules should be limited to a basic promise to treat each other's investors equally, let governments settle disputes between themselves, and leave the international constitutional protections out of it.

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