The future of EU international investment policy – What clues to take from NAFTA 2.0?

What can the latest revision of the North American Free Trade Agreement (NAFTA) between Canada, Mexico and the United States tell us about the potential future of EU international investment policy? **Robert Basedow** *suggests that NAFTA 2.0 indicates the love story of OECD economies with investment protection agreements and investor-state dispute settlement (ISDS) mechanisms appears to be coming to an end, which could have clear ramifications for the EU given ISDS has been a controversial issue in previous EU trade agreements.*

Investor-state dispute settlement (ISDS) remains a highly controversial issue in the European public debate. ISDS provisions in trade and investment agreements empower foreign investors to sue host countries for monetary compensation in case of expropriation before private ad hoc tribunals. ISDS was invented in the 1960s to encourage firms to invest in developing countries with weak legal systems and biased domestic courts. The mechanism should provide an enforceable minimum level of property protection across borders and thereby contribute to growth and development in host and home economies of investors. Despite the arguably good intentions behind the inception of ISDS, the mechanism has become highly contentious. In particular in the context of the negotiations on the Transatlantic Trade and Investment Partnership between the USA and EU, millions of Europeans citizens, politicians and NGOs have voiced their concern that ISDS may erode the rule of law and democracy.

Following this public opposition and the election of Donald Trump as US President, the EU and the USA have paused the TTIP negotiations. Nonetheless, the EU remains currently formally committed to negotiate comprehensive trade and investment agreements with ISDS provisions with twelve partner countries around the world. Opinion 2/15 of the Court of Justice of the European Union further complicates the situation. The Court found that the EU was exclusively competent under the Treaty of Lisbon to negotiate and conclude agreements with third countries regulating foreign direct investments, but cautioned that ISDS provisions continued to come under shared competence with the Member States. Trade and investment agreements with ISDS provisions would thus require mixed ratification through the European Parliament and all Member State parliaments. Mixed ratification, however, seems politically challenging in the current political climate.

Policy-makers in Brussels and Member State capitals currently reflect on the future course in EU international investment policy. First, the EU may refrain from negotiating agreements with ISDS provisions in the future. Second, it might re-empower the Member States to negotiate agreements with ISDS provisions to sidestep the heated political debate in Brussels. The EU has indeed recently authorised several Member States to negotiate such agreements inter alia with Iran arguably to evade the European political debate. Third, it might also continue its reform efforts to replace ad hoc ISDS through a multilateral investment court with more transparent, legitimate and accountable structures and processes.

In short, EU international investment policy has hit a fork in the road and there are many question regarding the EU's future approach to investment protection and ISDS. I propose to look at recent and significant developments in US international investment policy to get some clues for possible future developments in EU policy.

NAFTA 2.0

US President Trump recently presented the re-negotiated text of the North American Free Trade Agreement (NAFTA), which shall be known in the future as the US-Mexico-Canada Agreement (USMCA). NAFTA entered into force in 1994 and was in many domains – and notably in international investment policy – a defining international treaty. It contains ISDS provisions and is one the most heavily used treaties for that matter. Investors started using NAFTA as early as 1997 to bring claims against Mexico, Canada and lastly even the USA.

In consequence, the NAFTA countries started carefully managing the treaty and updated it to limit financial and political risks arising from ISDS. They for instance increased transparency under ISDS and specified the substantive protection provisions to limit the interpretative leeway of arbitrators and to better ring-fence states' right to regulate. Other countries – and arguably the EU – followed suit and emulated NAFTA approaches in their trade and investment agreements. It is thus fair to say that NAFTA was in many regards a global pacesetter for international investment agreements and policy. What then can we learn from NAFTA 2.0?

NAFTA 2.0 contains two major changes with regard to investment protection and ISDS. First and foremost, the USA and Canada have agreed that their bilateral investment relationship shall not be subject to ISDS anymore. So-called legacy investors – investments placed between 1994 and the ratification of the new NAFTA – will have a grace period of three years to bring claims after the new treaty enters into force. New investors and projects, however, will not have access to ISDS in the future. This constitutes a major policy shift. The US and Canadian firms are heavily invested on both sides of the border and US-Canada investment relations produced no less than 41 arbitration claims over recent years.

The second major change relates to US-Mexico investment relations. The USA and Mexico agreed to maintain the possibility of investors having recourse to ISDS in their bilateral relationship. Access to ISDS, however, is heavily circumscribed. Investors for instance are required to seek justice through domestic courts for thirty months before they can launch an ISDS proceeding. What is more, investors cannot invoke a breach of the infamous 'fair and equitable treatment' standard to claim compensation but can only bring claims on the basis of expropriation. Both changes erect de facto high legal hurdles for investors. It needs to be mentioned though that some sectors – such as public services or energy – will enjoy special treatment. NAFTA 2.0 will not significantly alter the current situation.

Lessons for EU international investment policy

What conclusions can we draw from NAFTA 2.0 for the EU's future approach to international investment policy and the global investment regime? On the one hand, the trend towards the conclusion of investment agreements with ISDS provisions between capital-exporting developed democracies seems to be stalling. In the 1990s and 2000s, ever more countries concluded these agreements even if their legal systems provided a high level of investor protection.

The USA – historically a major proponent of ISDS – seems to be reconsidering this and adopting a more measured and functional approach. Rather than including ISDS by default into its agreements, it seems to be more carefully assessing its costs and benefits in light of the partner country. This turn in US policy raises further questions over US willingness to join a multilateral investment court with a global membership as proposed by the EU.

On the other hand, NAFTA 2.0 continues on the trajectory of detailing investor rights and limiting investor access to ISDS. This trend started under the old NAFTA and has been gaining momentum in recent years. In the light of the political climate in Europe, it seems reasonable to assume that the EU will follow suit and further restrict investor rights and ISDS under future agreements. Overall, NAFTA 2.0 suggests that the love story of OECD economies with investment protection agreements and ISDS seems to be coming to an end.

Please read our comments policy before commenting.

Note: This article gives the views of the author, not the position of EUROPP – European Politics and Policy or the London School of Economics. Featured image credit: Council of Canadians (CC BY-NC-SA 2.0)

About the author

Robert Basedow – *LSE*
Robert Basedow is Assistant Professor in International Political Economy at the LSE's European Institute.

Date originally posted: 2018-10-11

Permalink: http://blogs.lse.ac.uk/europpblog/2018/10/11/the-future-of-eu-international-investment-policy-what-clues-to-take-from-nafta-2-0/

Blog homepage: http://blogs.lse.ac.uk/europpblog/