The Daily Dish

Un-Sticking NAFTA Renegotiation

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Eakinomics: Un-Sticking NAFTA Renegotiation

The effective deadline for renegotiation of the North American Free Trade Agreement (NAFTA) in time to be ratified in 2018 is only two weeks away. One sticking point in the negotiations is the future of the Investor-State Dispute Settlement (ISDS) provisions. ISDS is a procedure in which investors can pursue arbitration with governments that discriminate against foreign suppliers or deny foreign investors their right to due process, seize property without just compensation, or restrict the movement of capital within their borders. In an ISDS case the parties enter an arbitration process in which the case is decided by a panel of legal experts. ISDS gives companies at home and abroad the security to invest internationally.

In NAFTA, the ISDS provisions have proven to be an important feature. According to United Nations data, firms have sued either Mexico or Canada 43 times since 1997, a bit over two cases a year. The total damages sought in those suits exceed $10 billion, averaging over $250 million per case. Clearly these are important cases. Canada is the more likely target of a suit — with 26 cases over the years that total over $8 billion. Mexico faced the remaining 17 suits totaling over $2 billion in damages.

The United States advocated for including the ISDS provisions in the original NAFTA deal. At present, however, the Trump Administration is pushing to have the ISDS excluded from a modernized NAFTA. Reportedly, it considers the ISDS an inappropriate subsidy to U.S. investments outside the United States. Unfortunately, that is turning the economics on its head. The point was not to subsidize anything, but rather simply to level the playing field between the legal environment in the United States and the strength of legal systems elsewhere. Undoing that leveling would serve to misallocate capital investments, reduce returns, and ultimately harm the competitiveness of U.S. firms. Some suggest that getting rid of ISDS would be good for American workers; i.e., forcing firms to invest more in the United States somehow aids U.S. labor. But that is clearly not the case if those investments and jobs aren't internationally competitive or if they disguise the need for better education and skills in the U.S. workforce.

Including ISDS in NAFTA is good policy. It is even better if it reduces the difficulty of meeting the deadline for a deal.