ASIAN TRADE CENTRE

POLICY BRIEF

NUMBER: 18-05 October 2018

KEEPING INVESTOR PROTECTIONS IN RCEP

RCEP officials are considering a deeply problematic change in the investment chapter—the restriction of investor protections to only certain sectors.

This is an issue for firms in Asia.

Investor state dispute settlement (ISDS) should be viewed as a catastrophic insurance policy. If all goes well, it might never be used at all. But if things go very badly, it is critically important to have in place.

To start, note that governments always have the right to regulate in the interests of public health, as well as animal and plant health. This right is enshrined in the multilateral trading system under the World Trade Organization (WTO) and has been carried through in every preferential trade agreement since then.

There is nothing in RCEP or any other trade agreement that will fundamentally undermine the government's sovereign right to ensure the safety of its citizens.

No government would ever agree to an agreement that would abrogate this right.

Second, a good ISDS clause does ***not*** give companies the right to sue governments over being given an "unfair advantage." Solid ISDS provisions run to 30-60 pages and spell out, as specifically as possible, exactly what constitutes an example of government expropriation of rights under which a foreign investor could consider launching an ISDS suit.

The basic issue that ISDS is trying to address is the following: Governments sometimes seize property (expropriate) for the public interest. The clearest example is when the government decides to build a road through a shop. In many countries, the rules that govern what happens in this situation are murky. Investors may suddenly find their property seized without warning or without receiving fair compensation for the loss of the shop.

ISDS is designed to make clear provisions around expropriation. A good clause explains in detail what sort of conditions must be in place when a government decides to act.

Note that ISDS does not prevent the government from acting—if the road must be built through the shop, the government has the right to do so.

Instead, ISDS rules spell out how firms are to be notified about this decision, how they will be compensated, and what they can do if they want to appeal what they think is an arbitrary decision or an unfair amount of compensation.

A firm can, of course, use local courts. But the reason why a *foreign* investor might want to use an outside arbitrator to resolve a potential dispute with the government is that an investor may not always be confident that the court system in the other country will rule fairly in a dispute.

Remember that the issue is whether or not the government has followed the proper procedures. Not every judge in every country will be willing to find against its own government.

An investor cannot simply claim to be losing revenue somehow because other products get an "unfair advantage." ISDS does not say anything about making or losing money.

Globally, there are more than 3,000 different bilateral investment treaties (BITS) as well as hundreds of free trade agreements. Of these, more than 90 percent contain ISDS provisions. The total number of disputes using ISDS is quite limited, particularly given the volume of foreign investment covered by this welter of treaties.

What makes this relatively small number of disputes even more impressive is that the earlier versions of ISDS were much broader than later ones. In other words, the earlier ISDS rules were quite expansive, allowing investors to use the arbitration system comparatively easily. Yet, most businesses do not resort to an outside system but continue to use the domestic court procedures to resolve disputes.

In part this stems from a lack of certainty about how any given arbitration case will be resolved which adds an element of risk to a decision to sue. Plus, most investors would prefer to remain in their host country and recognize the chilling effect that suing the government tends to have on their business operations. Hence, few investors are likely to sue, even if their case would probably be ruled in their favor.

Recent trade agreements have narrowly defined the scope of potential lawsuits. This is the main reason why ISDS provisions have grown in length over time, as governments have tried to strike a more appropriate balance between their right to regulate and the right of investors to ensure that their investments are not unfairly seized.

It is fitting that RCEP should think hard about a fair balance between government and firm interests. But by limiting the scope of ISDS to specific sectors, firms are no longer given the protections that are needed in such a diverse region.

Such restrictions by sector set a poor precedent for the future. As RCEP is writing rules for trade for the region, it provides legitimacy for sectoral exclusions from rules, regulations, and standards of all sorts in the future.

Prohibitions by sector for goods and services that are otherwise covered by RCEP is a worrisome trend.

While some governments might argue that they are unlikely to expropriate assets and unfairly compensate firms for their losses, investors cannot be certain that such promises will hold true across all 16 RCEP markets absent commitments in the trade agreement.

RCEP officials should not carve out sectors from catastrophic insurance provided by ISDS—or any other elements of protection—in this trade agreement.

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