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VIA EMAIL:
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Hon. Harry Reid, *Minority Leader, U.S. Senate*
Hon. John Boehner, *Speaker, U.S. House of Representatives*
Hon. Nancy Pelosi, *Minority Leader, U.S. House of Representatives*
Hon. Orrin G. Hatch, *Chairman, U.S. Senate Committee on Finance*
Hon. Ron Wyden, *Ranking Member, U.S. Senate Committee on Finance*
Hon. Paul Ryan, *Chairman, U.S. House of Representatives Committee on Ways*
Hon. Sander M. Levin, *Ranking Member, U.S. House of Representatives Committee on Ways and Means*

Where Progressive and Conservatives Agree on Trade:
Current Investor-State Dispute Settlement model is bad for the United States

It is not often in current policy debates that scholars from the left and the right agree on a point of principle—from myself, for one, to the Cato Institute and the editorial board of *The Economist.*[i] Such is the case with a policy known as "investor-state dispute settlement," or ISDS, proposed to be written into the Trans-Pacific Partnership, the Trans-Atlantic Trade and Investment Partnership, and already contained in a host of other international agreements to which the United States is now party.

There is much confusion about ISDS, but plain and simple: ISDS is about rewriting the rules of how our economy works, tipping the balance of power in favor of big businesses at the expense of workers and the public here and in partner countries.

ISDS is not just in trade agreements like the Trans-Pacific Partnership (TPP) in Asia-Pacific and the Trans-Atlantic Trade and Investment Partnership (TTIP) with the European Union. A series of bilateral investment treaties, or BITs, under negotiation between the United States and partners—India and China, to name two of several—will also implement the same model private arbitration mechanism, just without the complementary trade provisions.

TPP will not be the last time that Congress hears about ISDS, but if Congress passes Trade Promotion Authority it may be the last best chance they have to change this situation for the next six years—because once an international agreement is inked, it is very hard to change.

Allow me to explain several points on which I find substantial misunderstanding about the economic impact of ISDS in U.S. trade agreements. In addition, I also explain how excessive intellectual property protections will harm consumers and taxpayers and hamper innovation, and how the relatively toothless enforcement of labor and environment protections in trade will not create the high standards trading regime we all want.

1. **ISDS is about changing the rules of how our economy works to lock in regulatory boundaries**

Proponents argue that ISDS measures are needed to protect the rights of U.S. and other foreign investors in partner countries. Few would argue that investors should not be secure and made whole in their expectation that governments would not literally expropriate assets. But if that were the problem, we already have the solution: insurance against this risk provided by the World Bank Group's Multilateral Investment Guarantee Agency, and the United States' Overseas Private Investment Corporation.

That U.S. negotiators insist on including the same model ISDS agreement with Europe in TTIP as it does with developing Asia-Pacific in TPP reveals that ISDS is not really about protecting property rights--these countries have every bit as good a "rule of law" and system of property protections as the US—but about something else. After all, Europe's legal institutions—on par with ours in terms of their development of the rule of law—already provide protections for property rights adequate to create a regional economy that is larger than the United States. The problems they are facing today have *nothing* to do with deficiencies in property rights protections.

Most fundamentally, *if there were something wrong with their system of property rights protection, why should it be changed only for foreign firms. If there were something wrong with their system of dispute adjudication, why should that be changed only for foreign firms, and only for this particular class of disputes.*

Something else *must* be going on here; and what that something else is clear: this is about *rewriting the rules of the economic game*—in ways that strengthen corporations at the expense of the rest of society.

We don't have the details of the wording of the proposed provision, but the USTR has provided no hint that the provisions that they intend to include would be meaningfully different from those currently contained in existing agreements. One of the problems with these agreements is the ambiguity of language, which leaves enormous discretion to private arbitrators making decisions of enormous consequences for public policies, with no appeal. There is no built-in way to "correct" a misinterpretation of the "law" that is inconsistent with broader public policy, or the intent of the negotiators, other than the enormously difficult task of renegotiating the treaty itself.
These are not hypothetical questions for our trading partners. What the prior experience with ISDS suggests is that the practice locks in regulatory boundaries, by subjecting any

changes to laws or rules by Federal, state, or local government to challenge by foreign investors:

- Uruguay and Australia are being sued for a tobacco warning regulation in response to a suit from Philip Morris
- Canada backed down on a similar tobacco warning label regulation in response to a suit from Philip Morris under Nafta.
- Canada also now faces suit over a Quebec province ban on hydraulic fracturing gas exploration under the bedrock of the St. Lawrence River.
- Germany, which democratically chose to cut itself from nuclear power following the 2011 Fukushima disaster, now faces an investor suit from a Swedish company alleging $4.7 billion in damages.

ISDS not only opens the United States up to such suits, but it will impede our trading partners from aligning their labor, environment, and consumer and public safety standards to the high level that we need while making it easier for U.S. companies to move investment abroad.

Note that in these cases, there is no allegation of discriminatory treatment. Uruguay wanted to protect its citizens from the health hazards of smoking regardless of who produced the cigarettes. This is nothing short of a *regulatory takings measure,* in which corporations would be compensated for a loss in *expected profits* from a change in a regulation—even a regulation (as in the case of cigarettes) which simply stops the corporation from harming people and imposing costs on society—including budgetary costs on the government.

Of course, in effect, existing regulations are "grandfathered in." But we simply can't tell when we will discover some new health or environmental hazard.

The consequences of this change in the rules and responsibilities of investors is best seen through another real world example. Consider asbestos: for years, companies produced a cancer-causing product and through public civil law were forced to pay settlement to their victims. But if the ISDS rules had been in place, and the offending companies had been owned by a foreign firm from a country with which we had an investment agreement, the asbestos manufacturers would have been able to sue the government for imposing new laws attempting to regulate asbestos manufacturing. The US taxpayer would have been asked to pay the firm *not* to produce the death-inducing product.

Policymakers don't yet know what the next "asbestos" is, but they should retain their autonomy to address those issues when they arise. The regulatory actions which we, as a country, might wish to take in the future include, of course, not just those related to health, safety, worker and consumer protection, but also even to the economy: before the 2008 crisis, we didn't realize the full consequences of some of the financial products and practices. The investment agreement could inhibit our ability to institute the necessary regulatory changes necessary even to protect the economy.

(While among economists there is in general considerable support for a more narrowly drafted provision that would protect us *just* against discrimination, even here, there are concerns. Developing countries legitimately want to ensure that foreign investors increase the human capital of their employees. There is a large theoretical and empirical literature pointing out that foreign capital behaves differently than domestic capital and movements in such capital have different effects; there needs to be a special set of regulatory provisions for cross-border capital flows—even the IMF has recognized this. Repeatedly, the United States government has cited security concerns for limitations in foreign ownership in certain assets. Even to protect US interests, there should be a provision that is much more carefully crafted than those in existing agreements.)

The investment agreement raises, moreover, fundamental Constitutional issues, which have not yet been given an adequate airing. Except for regulatory measures which affect interstate commerce, responsibilities lie with the States. But the investment protections written into U.S. agreements extend to *all* actions taken by states and local govenments. While these provisions do not necessarily proscribe the imposition of regulations, they impose a cost on US taxpayers for any loss in *expected profits* as a result. While the clear intent of the Constitution was to cede full authority for such regulation (other than, for instance, that affecting interstate commerce) to the States, the clear intent of these trade agreements is to use the Treaty Authority to limit the power of states and localities to regulate.

2. Yes, the United States has never lost a case…yet

This much is true—the United States has never lost an arbitration ruling. But it is not terribly reassuring as this may not always be the case in the future.

The U.S. record owes largely to the fact that most of the countries with which the U.S. has such an agreement are developing countries with little investment in the United States or capacity to mount such challenges, rather than to "safe guards" USTR negotiated to protect U.S. interests. The asymmetry of the relationships can be seen in the fact that the government of Uruguay is relying on the generosity of former mayor Michael Bloomberg, Microsoft founder Bill Gates, and other benefactors in their arbitral defense against claims by Philip Morris that non-discriminatory health warning labels diminished their Uruguayan profits.

But the U.S. also regularly loses challenges at the World Trade Organization as well as regulatory takings suits in federal courts, so just by the law of averages we should not expect the perfect U.S. batting average on investor-state disputes to last.

This will be different when European and Japanese companies with much larger stakes in the U.S. economy, more resources, and more international business savvy get access to this extra-judicial means in the United States. Such suits and boundaries on legislative and regulatory autonomy will undoubtedly be forthcoming if the United States keeps expanding

ISDS, with uncertain outcomes. Already, around the world the number of investor-state dispute cases is growing according to UN data, with businesses bringing nearly 60 cases a year, up from 10 cases at the end of the 1990s.

Moreover, it appears as if even US companies will learn how to take advantage of this new legal regime to sue the US government—simply by making investments in the US through a subsidiary located in a country which is a party to one of our investment agreements. The US is known as the most litigious economy in the world—with a disproportionate fraction of our most talented young people going into that profession. It would be a surprise if as they learn about this new way of garnering profits for themselves, they did not bring—and win—large numbers of suits.

Most importantly, one does not institute a fundamental change in our legal structure in the hope that it will work out—especially when we are bound by a treaty system which makes a change so, so difficult.

3. ISDS does not meet U.S. standards for justice and legal systems

International arbitral panels created by TPP (and other agreements to which the United States is party) do not meet fundamental U.S. judicial principles. ISDS provides recourse to a private panel of three independent arbitrators who issue rulings not subject to legal review or appeal, and based on jurisprudence that does not rely on binding precedent (*stare decisis*)—every case is essentially a new roll of the dice and a new chance for judicial activism.

More than this lack of basic legal protections and uncertainty of outcomes, there exists an inherent conflict of interests in that the arbitrators are drawn from a small pool of highly-specialized international investment lawyers, who may serve as counsel to plaintiffs in cases at the same time they sit as arbitrators in other related cases. The structure creates a cozy relationship among the arbitrators

The high cost of access to such legal mechanisms violate a basic tenet of U.S. justice: that legal institutions to resolve civil disputes are a public good to which all should have access. *Private* tribunals that effectively require millions of dollars in legal costs to use will privilege big businesses with an advantage over small businesses and other stakeholders.

Congressional assent to the parameters for ISDS in TPP or other future agreements will rewrite the economic rules in ways that undermine the high standards that we all believe should provide a foundation for U.S. trade policies. On this point, serious critics of ISDS policy currently embraced in U.S. trade agreements from both sides of the political spectrum agree.

4. Intellectual Property Rights standards slow innovation and raise prices

We should be clear that the intellectual property rights provisions, or IPR, that the USTR is negotiating are not those that have been formulated or advocated by those in the academic and scientific community. There is every reason to believe that they would impede, not promote, innovation and progress. Indeed, there is no evidence that the strengthening of IPR along the lines advocated by the USTR would lead to higher productivity—there is simply no statistical relationship with measures of productivity and innovation in the economy and such measures.[ii]

The controversy, however, related primarily to provisions related to pharmaceuticals. From what we have been able to see, the agreement will have the effect of raising prices, both because it will make the entry of generics more difficult and it will make it more difficult to introduce measures (like formularies) which promote competition. On both accounts, the price people and public programs pay for prescription medicines would increase.

Two practices that TPP would expand illustrate the point: First, ever-greening of pharmaceutical patents, the practice where manufacturers effectively extend the period of patent exclusivity by getting a new patent from making only minimal changes to an old drug. Knowing that a company can extend its monopoly IPR protections through ever-greening, provides a disincentive for competitors to enter the market, which would drive down prices and fuel innovation.

Second, TPP would lock-in restrictively high current exclusivity protections for biosimilar medicines as opposed to chemical-based pharmaceuticals. USTR is negotiating for 12 years data exclusivity for biosimilar, whereas the President's budget sought to cut exclusivity to 7 years; exclusivity for chemical-developed drugs, rather than biosimilars, now has 5 years exclusivity, even though biosimilars (at present) take only 7 months longer on average to develop. More than just keeping prices high, and excluding some people from accessing such medicines, research scientists already report evidence that excessive barriers from exclusivity are already restraining innovation as it not only keeps competitors from bringing new treatments to market, but it also restricts the ability to test new medicines for safety.[iii]

Most importantly, we live in a fast changing technological environment. Even if 12 years were the "right" number today (and even the President seems to agree that it is not), it may not be tomorrow or the year after. The trade agreement makes it enormously difficult to make changes. A twenty-first century trade agreement needs to take account of these realities—it needs to focus on cooperative measures to develop joint standards that evolve with the changing technology and economy, not imposing arbitrary numbers that may or may not be appropriate for the economy today.

An innovation economy requires a balanced and differentiated intellectual property regime—and TPP will move us further away from this goal. We know how to move the balance in the right direction and have done so before. For instance, in the United States, we balanced the need for innovation and access to life-saving drugs with the Hatch-Waxman Act of 1984, which by 2012 meant that 78 percent of all drugs dispensed in pharmacies and health care facilities were lower-cost generics.[iv]

5. Lack of meaningful enforcement of labor and environmental standards undermine the goal of high standard agreements

Most economists agree that, while we should expect gains from specialization through trade, trade rules promoting a race to the bottom in global standards is bad for U.S. workers and business, and bad for promoting sustained and broadly shared prosperity in developing country trading partners, too. These kinds of rules unfairly shift the economic costs of global trade and investment—shifting income shares across the global supply chain, the negative externalities borne by working families from lacking pollution and workplace safety regulations—and undermine otherwise globally competitive U.S.-based businesses and workers.

What we know from public statements about the TPP is that while in some places it may make incremental improvements on select labor and environmental standards, the agreement would replicate the ineffective discretionary enforcement provisions of previous agreements going back to CAFTA, and including the more recent Peru, Colombia, Panama, and Korea deals. Though substantive obligations—what can be challenged—reportedly will inch up under TPP, the mechanism for enforcing such standards makes these obligations relatively meaningless.

We have ample evidence already that this enforcement model has proven entirely inadequate both at raising labor standards in our partner countries and at protecting U.S. businesses and jobs from unfair competition. In the case of Guatemala, the USTR took a definitive action last December—by finally filing a case against Guatemala for problems of egregious and systematic labor violations first raised with the U.S. Department of Labor in April 2008.[v] Investigations of Honduras currently underway by the Department of Labor seem to be pointing in the same direction of increased violence and worker abuses, nor does Colombia's "Labor Action Plan" appear to be yielding any better results.

To be clear, the labor standards enforcement mechanism now poised to be implemented in TPP already is not working for workers here or in partner countries. But when it comes to members of the TPP agreement, a number of specific countries raise red flags for the enforceability of standards. Vietnam, of course, has a now forty-year legacy of a political system built, in part, on denying what U.S. law says and what the world community agrees are core labor rights—the rights to free association and collective bargaining.[vi] These bipartisan principles have been part of U.S. trade law since the 1988 Omnibus Foreign Trade and Competitiveness Act—a law bipartisan law passed by a Democratic controlled Congress and signed by Republican President Ronald Reagan, and were strengthened in the May 10, 2007 agreement between a Democratic Congress and President George W. Bush.

Beyond Vietnam, questions have been raised about other TPP partners (in particular Mexico, Malaysia, Singapore, and Brunei). Some, for instance, seem to exclude specific export-oriented industries and migrant workers from protection under domestic labor laws.

Congress's responsibility to the people at bare minimum is to ensure that any new international agreements not undermine standards in the world economy. But the United States can do better by aiming to negotiate agreements that offer carrots—making access to U.S. markets contingent only to producer firms certified as meeting such standards throughout the supply chains leading goods and services to U.S. markets. If the enforcement measures in TPP are similar to those that have been leaked and to those in previous agreements, we can have some confidence that they will be relatively ineffective.

The contrast between the efforts that have been put into enforcing the interests of corporations—going beyond what I believe is a reasonable level, with procedures that give corporations the upper hand—and those used to enforce labor and environment standards says a great deal about what these agreements are really about.

6. Conclusion: Old ideas on trade ignore 21st Century economic realities

Nineteenth century economics focused on a world with fixed technology (no technological change) with full employment. It showed the advantages of taking advantage of comparative advantage. Much of the reasoning in support of the new trade agreements is based on that out-of-date model. That model ignored, too, income distribution.

In the twenty first century, technological change is paramount. Trade is affected by and affects patterns of technological change across countries. Once that is taken into account, it is no longer true that trade liberalization will increase the well-being of *both* countries.[vii]

Moreover, even those who believe in the traditional model recognize that trade liberalization leads to more inequality—and in the case of the US, this means that the winners are those who have been winning for the past third of a century, and the losers those who have already suffered stagnant incomes over this time. There is every reason to believe that these new trade agreements would simply exacerbate these trends. Today, it is recognized that inequality—and the lack of equality of opportunity—is one of the country's major problems. Policymakers should consider very carefully anything that would exacerbate inequality because of the negative long-term effect on economic opportunity. I believe that these trade agreements are likely to exacerbate inequality.

And that is especially the case today: our economy is not functioning anything like the classical nineteenth century economy. There is open and disguised unemployment. In this malfunctioning economy, there is a fundamental asymmetry: jobs are destroyed more easily than they are created. While exports create jobs and imports destroy them, our import competing sectors are far more labor intensive than our export sectors. There is a significant risk that the trade agreements will weaken an already weak labor market.

We may be able to forge a good trade agreement—a trade agreement that is good both for American workers and businesses. But we are nowhere near doing that. The agreement that the USTR seems to be rushing to complete is a one sided agreement. For Congress to give them an *almost* blank check would be a mistake. We know what they would write, and it would not be good for the country as a whole. It will take time to craft a good agreement—and it will take an open and democratic process, one in which all parts of our society participate.

The USTR sees the world of globalization as a zero sum game—a negotiation, to be done in secret, to win as much for our side (or more accurately, our corporations), giving as little as possible to the other side. One of the reasons for these agreements is to bolster our international standing. This approach of the USTR does just the opposite. It makes enemies and induces resentment—not just now, but for years to come. What we need to do is to engage in an open and transparent discussion not only with all elements of American society but also with those of our *partners.* Indeed, treating them as a true partner might seem a revolutionary idea to the USTR. I have talked to government negotiators, elected officials, and civil society leaders in our "partners." This is what they would like.

This is not the time for passing Trade Promotion Authority. This is the time for constructive engagement. Democratic processes are sometimes slow. But the outcomes are more durable, and serve all of our citizens better.

I urge you to reject TPA, and to begin a meaningful dialogue with the White House and our partners on what kind of trade regime—and what kind of world economy—we should be constructing for the twenty-first century.

Sincerely,

Joseph E. Stiglitz

Joseph E. Stiglitz, a Nobel laureate in economics, University Professor at Columbia University, and Roosevelt Institute Chief Economist, was Chairman on President Bill Clinton's Council of Economic Advisers and served as Senior Vice President and Chief Economist of the World Bank.

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[i] Daniel Ikenson, "A Compromise to Advance the Trade Agenda: Purge Negotiations of Investor-State Dispute Settlement," *Cato Institute Free Trade Bulletin,* March 4, 2014, available at http://www.cato.org/publications/free-trade-bulletin/compromise-advance-trade-agenda-purge-

negotiations-investor-state; *The Economist,* "The arbitration game," October 11, 2014, available at http://www.economist.com/news/finance-and-economics/21623756-governments-are-souring-treaties-protect-foreign-investors-arbitration.

[ii] See, for example, the recent "Symposium on Patents," in the leading *Journal of Economic Perspectives*, Vol. 27, no. 1, (2013) available at https://www.aeaweb.org/articles.php?doi=10.1257/jep.27.1.

[iii] W. Nicholson Price II, and Arti K. Rai, "Are trade secrets delaying biosimilars?" *Science Magazine*, April 10, 2015, Vol. 348 no. 6231 pp. 188-189, available at http://www.sciencemag.org/content/348/6231/188.summary?sid=0b5d79c3-97b9-4b67-9d08-62809ecce288.

[iv] GAO, "Research on Savings from Generic Drug Use," *GAO-12-371R*, Jan 31, 2012, available at http://www.gao.gov/products/GAO-12-371R.

[v] "Public Submission to the Office of Trade and Labor Affairs (OTLA) Under Chapters 16 (Labor) and 20 (Dispute Settlement) of the DR-CAFTA," April 23, 2008, available at http://www.aflcio.org/content/download/726/6600/AFL-CIO+Complaint+on+Workers%27+Rights+in+Guatemala.pdf.

[vi] Vietnam has not ratified ILO conventions on fundamental labor standards pertaining to free association, collective bargaining, and forced labor. See, http://www.ilo.org/dyn/normlex/en/f?p=1000:11210:0::NO:11210:P11210_COUNTRY_ID:103004. The rights are also recognized in the United Nations Universal Declaration of Human Rights, available at http://www.un.org/en/documents/udhr/.

[vii] Interestngly, Nobel Prize-winning economist Paul Samuelson, who forcefully articulated the argument concerning the gains from trade even before World War II, came to recognize this: see Paul A. Samuelson, "Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization," Journal of Economic Perspectives—Volume 18, Number 3—Summer 2004—Pages 135–146