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**Research Report**

## Is USMCA really "the new gold standard" of investment protection?

Columbia FDI Perspectives, No. 281

**Provided in Cooperation with:**

Columbia Center on Sustainable Investment (CCSI) - A joint center of Columbia Law School and the Earth Institute, Columbia University

*Suggested Citation:* Sacerdoti, Giorgio (2020) : Is USMCA really "the new gold standard" of investment protection?, Columbia FDI Perspectives, No. 281, Columbia University, Columbia Center on Sustainable Investment (CCSI), New York, NY

This Version is available at:

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Columbia Center  
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## Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues

No. 281 June 29, 2020

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### **Is USMCA really “the new gold standard” of investment protection? \***

by

Giorgio Sacerdoti\*\*

In his January 2020 *Perspective*, Orlando F. Cabrera C. submitted that the new investment protection regime established by the US and Mexico under the United States–Mexico–Canada Agreement (USMCA) represents “a new gold standard to enforce investment protection” that other countries should consider following.

I disagree for two reasons. The first relates to the political genesis of the new discipline. The second is due to its content, both substantively (level of protection granted) and procedurally (instances in which recourse to direct arbitration against the host country is open).

In both respects, Chapter 14 of USMCA reduces drastically (and in my view erratically) the protection afforded to investors compared to NAFTA Chapter 11. Direct arbitration is restricted to US-Mexico relations, in practice in favor of US nationals investing in Mexico. Moreover, it is fully available for breaches of all of the substantive standards provided in the treaty only to investors having entered “covered governmental contracts” with either host country. Canada opted out from this mechanism altogether, as advocated by its civil society in light of the many cases in which US investors had successfully challenged Canadian restrictive measures under NAFTA, mainly enacted by provinces.

Chapter 14 is the result of a novel development. The more limited protection compared to NAFTA does not reflect acceptance of the persistent criticism of the investment regime, specifically investor-state dispute settlement (ISDS), expressed by certain developing countries circles (and UNCTAD), civil society (the “no-globals”) and some think-tanks in the north. The origin is the Trump administration’s novel theory that international treaty protection granted to US investors abroad encourages the delocalization of US companies to the detriment of US workers, and hence is incompatible with its “America First” policy.

In this political context, Canada found no resistance from the US in removing ISDS. As to Mexico, the NAFTA-level procedural protections for US investors (i.e., full ISDS) have been maintained only for the big business sectors that advocated it most energetically, had the best

political connections and are least affected by the “American-jobs-first” policy because of their capital-intensive character.

Cabrera describes well the two distinct protection regimes established under USMCA: “First, general investors can claim breaches only to national treatment, most-favored-nation treatment (only at investment’s post-establishment phase) and direct expropriation. Second, the ‘Covered Government Contracts’ provisions allow investors that have concluded governmental contracts and related activities in oil and gas, power generation, public telecommunications, public transportation, and certain public infrastructure to claim breaches to the above three standards ... plus the minimum standard of treatment ..., transfers, performance requirements, senior management, and indirect expropriation.” Based on the statistics he provides, the most protected investments appear to be the most capital-intensive and environment-unfriendly sectors (oil and gas). The least protected is manufacturing, which is the most labor-intensive and hence the most important to fight poverty, unemployment and workers’ exploitation in a developing country such as Mexico. As reported by Cabrera, “the US and Mexico decided, through the general investment section, to allow narrower enforcement of protections to the largest FDI flows from the US to Mexico. Between 1999 and 2016, manufacturing accounted for 49% of US FDI inflows.”

It is difficult to understand how such a “double-standard” regime, based on purely political choices rather than a rational social-economic evaluation of the benefits of FDI protection, can be considered a “gold standard.”

In relation to the substantive standards of national treatment, most-favored-nation treatment and treatment according to the minimum standard of international law (which includes, under Article 14.6, fair-and-equitable treatment and full protection and security), there has been nominally no substantial innovation compared to the definition of these protections in NAFTA in 1994. However, as mentioned above, USMCA grants full access to direct arbitration in Mexico-US relations only to investors that have concluded “Covered Government Contracts” in certain sectors. Other, “normal” or “general” investors can resort to arbitration only in cases of alleged breach of the national or most-favored-nation treatment obligations, i.e., in case of discrimination.<sup>1</sup> The rationale for affording effective protection on a discriminatory basis, depending on the mega-sector involved, is difficult to understand.<sup>2</sup>

Where, then, to search for a “gold standard” in recent international investment agreements for how foreign investors should be treated, balancing their protection with host countries’ legitimate interests? It seems that the most innovate substantive standard is found in the detailed and restrictive definition (compared to the open-ended definition of “traditional” BITs) of fair-and-equitable treatment in Article 8.10.2 of the [EU-Canada Comprehensive Economic and Trade Agreement \(CETA\)](#). Moreover, in both CETA and the recent [EU-Mexico FTA](#) (and to respond to criticisms addressed to ISDS), investor-State arbitration has been replaced by a permanent Court System. Thus, not even Mexico has followed USMCA’s foreign investment protection regime.

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<sup>1</sup> See [Annex 14-D \(Mexico-US Investment Disputes\)](#), and [Annex 14-E \(Mexico-US Investment Disputes Related to Covered Government Contracts\)](#). State-to-state panels under [Chapter 31](#) are not competent to deal with disputes arising under Chapter 14 (see Article 31(2)(c)).

<sup>2</sup> In contrast, the reasons for the tobacco industry's exclusion from ISDS in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership are obvious.

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