USMCA: Investment Provisions

The United States-Mexico-Canada Agreement (USMCA) is a proposed free trade agreement (FTA) that, if approved by Congress and ratified by Canada and Mexico, would replace the North American Free Trade Agreement (NAFTA). USMCA would retain NAFTA’s market-opening measures while adding or updating provisions in areas such as digital trade, intellectual property rights, and worker rights. The proposed agreement would make notable changes to NAFTA’s investment provisions—mainly qualifying basic investor protections and limiting the degree to which foreign investors can bring complaints against their host states under the investor-state dispute settlement (ISDS) mechanism. ISDS claims with Canada would be phased out entirely; those with Mexico would be more restricted than under NAFTA. Given the significant changes proposed and the importance of U.S. investment ties with Canada and Mexico, USMCA’s investment provisions are an active part of congressional debate over the USMCA.

NAFTA’s Investment Provisions

Enacted in 1994, NAFTA removed investment barriers, ensured basic investment protections, and provided mechanisms for the settlement of disputes over commitments in the agreement. Since NAFTA entered into force, the stock of foreign direct investment (FDI) between the United States and its NAFTA partners has increased dramatically, although it is difficult to determine whether the increase was the result of NAFTA or other factors (Figure 1). In 2018, Canada and Mexico ranked fifth and thirteenth, respectively, as destinations for U.S. FDI and second and twenty-first as sources of FDI in the United States.

In response to criticism that NAFTA’s investment protections were too broad, subsequent U.S. trade and investment agreements clarified certain provisions and added new transparency requirements. The proposed USMCA would continue some of these trends. Additionally, the proposed USMCA would place new limits on access to ISDS mechanisms. In general, these changes limit the kinds of claims that foreign investors are able to bring in response to domestic regulations.

Definition of an Investment

USMCA’s investment chapter defines “investment” more broadly than NAFTA and echoes the language of more recent U.S. FTAs. Whereas NAFTA enumerates what qualifies as an investment, the proposed USMCA defines an investment as an asset that an investor owns or controls that has the characteristics of an investment such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. It then enumerates a nonexhaustive list of examples that could include enterprises, stocks, bonds, derivatives, intellectual property, licenses, or other tangible or intangible property.

Investor Protections under USMCA

The proposed USMCA contains many of the same core investment provisions as NAFTA, but with new qualifications and provisions that reflect more recent U.S. trade and investment agreements. New limits are placed on what provisions are eligible for ISDS, compared to NAFTA and past U.S. FTAs.

Minimum Standard of Treatment (MST). Like NAFTA, the proposed USMCA would require that each party accord covered investments “treatment in accordance with customary international law.” However, the proposed agreement would add new clarifications, stating that the concepts of “fair and equitable treatment” (due process) and “full protection and security” (police protection) do not require treatment in addition to or beyond the minimum standard treatment of aliens under customary international law. Previously, some ISDS tribunals had suggested otherwise. The proposed USMCA would further clarify that an action, such as the implementation of a new regulation, would not be a breach of MST simply because it was inconsistent with an investor’s expectations.

National Treatment and Most-Favored-Nation (MFN) Treatment. Like NAFTA and other U.S. FTAs, the proposed USMCA would include nondiscrimination provisions, requiring that each country accord the investors and investments of another country treatment no less favorable than that it accords, in like circumstances, to its own investors or the investors of any other country throughout the lifecycle of the investment. However, the proposed USMCA adds further language noting that whether treatment is accorded in “like circumstances” depends on the totality of the circumstances, including whether the treatment at issue distinguishes between investors or investments based on legitimate public welfare objectives.

Expropriation and Compensation. Like NAFTA, the proposed USMCA states that expropriation may only occur...
for a public purpose and must be done in a nondiscriminatory manner, with prompt, adequate, and effective compensation, and in accordance with due process of law. While indirect (also known as regulatory) expropriation is still included, the proposed USMCA affirms that nondiscriminatory regulatory actions designed to protect legitimate public welfare objectives would not constitute indirect expropriation except in “rare circumstances,” similar to language in more recent U.S. FTAs. USMCA would also place new limits on the enforceability of this provision through ISDS.

**Investor-State Dispute Settlement**

To provide investors “due process before an impartial tribunal,” NAFTA enabled foreign investors to take host governments to binding arbitration over alleged violations of investment commitments in the agreement. The proposed USMCA eliminates ISDS with respect to Canada and places new restrictions on its use with respect to Mexico. The new restrictions limit what kinds of alleged violations investors may bring before ISDS tribunals. The changes, however, would not disrupt pending ISDS cases under NAFTA and allow new claims under NAFTA rules for three years from the date of NAFTA’s termination.

**The United States and Canada**

Three years after the proposed USMCA goes into effect, ISDS mechanisms under NAFTA between the United States and Canada would be phased out. Absent an independent agreement, U.S. or Canadian investors alleging a violation of USMCA by their host government would only have recourse to domestic courts or other dispute resolution mechanisms. Under NAFTA, the bulk of disputes brought before ISDS tribunals have involved Canadian or U.S. claimants. Canadians initiated 16 of the 17 ISDS cases against the United States (Figure 2).

**The United States and Mexico**

**New Limitations.** The proposed USMCA retains ISDS with respect to Mexico but investors could only bring claims alleging a breach of national treatment, a breach of most-favored-nation treatment, or for direct expropriation. Claims alleging a violation of national treatment with respect to the establishment or acquisition of an investment (the so-called “right to invest” provision), claims alleging a violation of the MST, and claims alleging indirect (or regulatory) expropriation, all of which made up the bulk of ISDS claims made under NAFTA, would no longer be covered. Such claims could still be dealt with through USMCA state-to-state dispute settlement measures.

**Exhaustion of Local Remedies.** Unlike in NAFTA and other U.S. FTAs, USMCA would require investors to “exhaust local remedies” by first filing their complaints in the courts or administrative tribunals of the host state and waiting 30 months before initiating arbitration (unless such action would be “obviously futile or ineffective”).

**Exceptions for Energy and Infrastructure.** The above limitations would not apply to covered government contracts with the oil and gas, power generation, telecommunication, transportation, and infrastructure sectors. Claimants in the sectors may use ISDS for a breach of any provision of the agreement and need not exhaust local remedies.

**Procedure and Transparency.** The proposed USMCA includes updated provisions on panel selection, transparency, and would require compliance with the International Bar Association Guidelines on Conflicts of Interest in International Arbitration and would forbid arbitrators from acting in another capacity in any other pending arbitration under the agreement.

**Figure 2. NAFTA’s ISDS Record (No. of Disputes)**

![Graph showing NAFTA's ISDS Record](image)

**Source:** United Nations Conference on Trade and Development.

**Summary and Issues for Congress**

NAFTA’s provisions removed barriers to investment and established core protections to ensure nondiscriminatory treatment, among other objectives, with the goal of increasing trade and investment across North America. The proposed USMCA includes many of those same protections but with qualifications in line with more recent U.S. trade and investment agreements, as well as new limitations.

The biggest change from NAFTA and recent U.S. FTAs is the curtailment of ISDS. Supporters of NAFTA’s ISDS mechanism argue that it provides investors a neutral and effective venue for resolving disputes with their host states. Under this view, NAFTA’s ISDS mechanism encourages investment, particularly where investors might otherwise worry about the effectiveness of local courts in dealing with specialized investment issues and discriminatory treatment without impartial recourse. Opponents, however, have raised concerns that NAFTA’s ISDS mechanism (i) provides procedural rights to foreign investors that are unavailable to domestic investors and (ii) discourages states from implementing health and environmental regulations, among other concerns.

Robust ISDS provisions have been a part of U.S. trade agreements for decades, and investor protections have been long-standing U.S. trade negotiating objectives. Congress may wish to consider whether the proposed USMCA represents a discrete departure from past U.S. policy or a new paradigm for future trade agreements.

**Further Reading**


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