National Treatment and American Foreign Policy – The Evolution of National Treatment Approaches in International Trade

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The National Treatment Clause, Article 1102 of the North American Free Trade Agreement, protects foreign investors from discrimination, including expropriation of their investments. This national treatment approach – equal treatment of foreign investors and local investors by states – was developed to encourage investment in Europe after the Second World War. Over the course of fifty years, the approach has evolved to provide foreign investors with protections over and above those provided to domestic investors. This article discusses the evolution of national treatment approaches, from affording foreign investors equal treatment to ensuring new investment conditions in international trade.

Keywords: international trade, investment, NAFTA, national treatment
Introduction

One major condition for American support for the Rome Treaty was a European guarantee of “national treatment” for the European subsidiaries of American multinational corporations – that is, the assurance that an American-owned subsidiary would be treated equally with the national firms of the European countries. The importance of this policy … for the European expansion of American corporations cannot be overemphasized.

Robert Gilpin

This quotation from Robert Gilpin hints at the historical foundations of legal theory surrounding national treatment. After the Second World War, multinational corporations based in the United States found an opportunity to invest in European national restructuring. However, due to protectionist policies of the host European states, the United States required assurances that its corporations would have equal access to valuable contracts. Thus, a national treatment political-legal policy was founded on the premises of reciprocity and non-discrimination for U.S. investment projects in the face of European protectionist corporate interests. One important aspect of this policy was institutional neutrality. Independent institutions would allocate resources or adjudicate disputes without bias toward state-controlled enterprises or national industry, upholding the investment rights of foreign corporations equally with those of domestic corporations. The American objective was to create a system where foreign investment could take place based on principles of fair and open competition between the foreign-owned enterprises and the local enterprises. The European states would gain American innovation and resource management while furthering their national agendas for redevelopment.

This article chronicles how approaches to national treatment have evolved over the past fifty years. These approaches have been influenced by socio-political events that have led to new and emerging legal conditions that affect American investment in foreign states; in particular, they have been influenced by cases where a host country realizes the profitability of the investor-owned enterprise and expropriates the investment. The legal remedy that has emerged in response to such cases is the creation of legal expropriation standards and their inclusion in international trade agreements. The future of national treatment will depend upon a state or states imposing conditions on trade that will ensure corporate justice and on the host states accepting those conditions to further capital investment.
An Evolving Standard of National Treatment

National treatment is a political value that is manifested to a greater or lesser extent in the legal relationship between a host state where the investment occurs and the foreign corporation that has invested there. The host sovereign state, as a political entity, executes policy to advance the welfare of the state. To this effect, governments may intervene in free economic transactions or in the workings of institutions in order to serve the social public agenda. Requests for national treatment seek to mitigate the effects of such intervention on the legal/social relationship between the foreign investor and the host state. National treatment is thus compromised when the state directly intervenes with private enterprise in a way that discriminates against the foreign investor.

The following case study provides an example of such a state intervention, specifically, unjust expropriation of a foreign direct investment. In 1971 the Allende government in Chile expropriated the assets of the (American) International Telephone and Telegraph, Inc. (ITT) company, a profitable firm that extracted and processed copper, an important natural resource for Chile. The government faced political pressure to self-manage its natural resources, and thus it expropriated the assets of the corporation. The political objective was to assert state sovereignty over the natural resource producing the greatest source of national revenue. The profits gained would fund national development projects as well as secure the Chilean Governments’ political future. The Chilean government’s compensation to ITT was deemed drastically inadequate – a classic example of obsolescent bargaining theory.

The government of Chile breached national treatment by not permitting ITT a judicial forum in which to advocate its right to continue its operations and create a return on investment. In response, the Nixon Administration in the United States amended its working definition of national treatment to include just compensation in the event of expropriation. The absence of a judicial forum in which to seek just compensation for expropriation led to changes in other provisions related to national treatment. The United States would no longer permit foreign investment in a state that did not respect the principle of fair compensation in cases of expropriation; further, the United States also created a forum to settle related disputes.

Issues related to national treatment in cases of expropriation compensation are far from resolved. Venezuela has a long history of state intervention with American oil companies. In 2005, the Chavez government was commencing policy to expropriate up to a 51 percent share in the investor oil companies, in effect nationalizing these foreign institutions. The chance that the Chavez government would compensate the
When a host country expropriates the assets of foreign investors (affecting return on investment) without just compensation, the country that is home to the investing corporations will impose legal conditions of investment. International trade agreements presently address this concern by imposing domestic expropriation standards. The appropriateness and scope of these standards demonstrate an evolution of national treatment standards.

**NAFTA**

Article 1102 of the North American Free Trade Agreement (NAFTA), titled “National Treatment”, provides that treatment no less favourable than that accorded to domestic enterprises shall be accorded by sovereign signatory states with regard to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of private investments made by foreign investors. Further, the agreement holds that a state cannot require an investor of another party to the treaty, by reason of its nationality, to sell or otherwise dispose of an investment in the territory of the first party. In addition, Article 1110 states that

> [n]o Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”) …

Even the exceptions provided in the NAFTA do not excuse state compensation for expropriation of investor assets. According to the same article, expropriation is permitted under the following circumstances: for a public purpose; on a non-discriminatory basis; in accordance with due process of law and Article 1105(1); and on payment of compensation in accordance with the agreement. If there is a finding of expropriation, compensation is required, even if the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1). Therefore, the more arbitrary or discriminatory the measure that takes an investor’s business without providing compensation, the more likely that there is a breach of Article 1110.

In its original European context, national treatment meant that the foreign enterprise was to be treated equally and without bias by government or other institutions. Under the NAFTA, national treatment is qualified, limiting the ability of a foreign state to dispose of an investment or nationalize or expropriate an investment or to undertake any activity tantamount to that effect, and effectively guaranteeing compensation for legitimate expropriation policies. Therefore, it offers special
treatment of foreign investment notwithstanding the fact this protection is unavailable to domestic investors.

Article 1130 of the NAFTA provides a method of dispute resolution under international arbitration rules, and Article 1131 specifies the authority of a tribunal for investment claims. Again, while classic national treatment provides that the foreign investor will be treated equally and fairly in the jurisdiction of foreign legal institutions, Chapter 11 of the NAFTA provides for a separate judicial jurisprudence and forum and specific conditions of national treatment for investments in Mexico or Canada. The reason for this provision is that the Mexican judicial system was known to be corrupt and non-transparent, thus negating the objectives of fair and equal treatment of foreign investors. This creation of a separate forum follows the premise that if a state judicial system does not or cannot hear and address the concerns of a minority group, that group may seek judicial remedy in a foreign jurisdiction. In this case, the minority group is the corporate interests and the foreign jurisdiction is an international dispute resolution tribunal.

The legislative objective of the NAFTA National Treatment clause is to provide just compensation to foreign investors in cases of state expropriation. This legal right is not provided for domestic enterprises. It is ironic that a legal tool created to provide equal protection to foreign investors in fact discriminates in favour of the foreign investors. All companies are equal, but some are more equal than others. If the United States can impose conditions that its companies must be given more favourable treatment than domestic enterprises with regard to expropriation, what other conditions could be invoked under the cause of national treatment?

**Premise of Normative Intervention**

United States Chief Justice Rehnquist’s article “Constructing the State: Extraterritoriality: Jurisdictional Disclosure, the National Interest, and Transitional Norms” uses an academic argument to justify the assertion that one state jurisdiction may impose conditions on other sovereign states. States are usually permitted to impose policy if the act/matter is within the borders of the state or, under the passive personality principle, the act/matter involves a national citizen. Justice Rehnquist introduces a third possible ground for jurisdictional intervention: a state may regulate outside its borders and citizens if the matter is of compelling national interest and within hostis humani generis (common enemy of humankind) – thus imposing universal justice. To elaborate, a foreign state applies regulatory justice for the common good when the host state cannot administer such justice. What constitutes universal justice, however, is a subjective decision made by the regulatory state.
The premise of normative intervention has led to further evolution of national treatment. It permits one state to impose equal to preferable treatment of its investors in another state in cases where it can be argued that such treatment is to remedy a potential breach of universal justice. When universal rights cannot be upheld in a foreign judicial system, the investor seeks a remedy from its home state. The Nixon amendment and the NAFTA both follow this argument by imposing conditions on expropriation in order to maintain and protect private property rights where justice would not (or could not) be administered.

**Where Next for National Treatment?**

Although the national treatment conditions imposed by an investor state may seem appropriate in certain circumstances, how far can such conditions extend under the cause of “universal justice”? The rise in importance of certain trading nations and trading blocs may mean that the conditions that define national treatment will evolve from dealing with the issues surrounding expropriation to a point where they include other international normative values as well.

Historically, the conditions of international trade were imposed only by those states with the diplomatic and economic capacity to do so. The United States, as a hegemonic economic trading state, continues to impose conditions on trade and investment, resulting in equal to more favourable treatment of its investors by host states. With the emergence of new trading blocs (i.e., China, India and the European Union), conditions relating to national treatment may no longer be set by the United States alone.

Labour standards are prime examples of normative values that may be applied as conditions of national treatment. As with expropriation remedies, labour standards could be liberally argued as imposing universal “humanitarian” justice. The European Union includes labour standards in accession contracts to the trading union, meaning that labour standards are a condition of trading with other European states. Making such standards a condition of national treatment could play an important role in democratization, workers’ health, wealth redistribution and living standards – essential factors of national development for the host country. However, imposing such conditions on emerging trading blocs may no longer be feasible, due to reciprocal imposition of trade conditions.
Conclusion

National treatment foreign policy was created to ensure fair, just and open investment options for national and corporate development. It has been amended to ensure that financial property interests (and thus return on investment) are protected and property rights enforced by fair and just legal institutions, thus maintaining the existence of the corporate entity. The next evolution of this foreign policy may extend the conditions of national treatment to include aspects of social development. On an economic basis, social development may be perceived as a comparative disadvantage, a slippery slope of national treatment conditions arrived at on international normative grounds. The slope may draw down to a total withdrawal of all conditions and a situation where corporations would have to carefully analyze investment risk and the institutional capacity of the host state to uphold their perceived rights.
**Endnotes**

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4. Ibid. The compensation the Chilean government paid to ITT was well below return on investment (including fixed start-up costs). As a result of private and political forces, the Chilean government suffered a political coup. Many commentators believe that ITT and the American Central Intelligence Agency were influential private forces behind the coup. For more information see also note 3 supra.

5. Ibid.


8. See *Wall Street Journal*, 25 April 2005, Editorial. See also *Business Week Magazine* (online), Chávez’ Oil-Fueled Revolution, 10 October 2005. Online at http://www.businessweek.com/magazine/content/05_41/b3954088.htm. According to the article, U.S. companies were “ordered” to create joint ventures, and oil royalties have been increased in some cases from 16.7 percent to 30 percent.

9. Ibid.

11. Ibid.
12. Ibid.
13. Feldman v. United Mexican States (2000), Final Decision ICSID Case No. ARB(AF)/99/1 at para. 98-99. Article 1105(1) provides that “[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.”
14. Ibid.
15. Ibid.
16. Ibid.
19. Ibid.

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