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Implications of the Transatlantic Trade and Investment Partnership (TTIP) for Investment Flows Between the European Union and the USA

Abstract

The Transatlantic Trade and Investment Partnership (TTIP) is a controversial subject, but at the same time it is perceived to be the most comprehensive international agreement on free trade and investment protection. Among the topics that evoke criticism on the part of different social groups is the investor-state dispute-settlement (ISDS), as well as its legal consequences for the EU Member states. A less discussed issue is the potential implications of the agreement on the state of economic co-operation between the European Union and the USA in the field of investment flows, with special reference to foreign direct investment (FDI). The aim of this paper is to present the discussion related to the ISDS and examine some of the economic, political and legal implications of TTIP provisions for FDI flows between the EU and the USA. The proposals of the European Commission to change the investment protection system might be treated as an attempt to make the system of arbitration more transparent and convincing to societies, and safer for states. The effects of the TTIP agreement for FDI between both partners might be dependent on the scale of trade creation and diversion effects, and the mirror effects of investment creation and diversion under a free trade area.

Keywords: *Transatlantic Trade and Investment Partnership (TTIP), investor-state dispute-settlement (ISDS), foreign direct investment (FDI), USA, UE*

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1. Introduction

The Transatlantic Trade and Investment Partnership (TTIP) negotiated between the USA and the EU is a controversial subject. Among the topics that evoke criticism on the part of different social groups is the investor-state dispute-settlement (ISDS), as well as its legal consequences for the EU states. A less discussed issue is the potential implications of the agreement on the state of economic co-operation between the European Union and the USA in the field of investment flows, with special reference to foreign direct investment (FDI). In this context some questions arise, namely:

- What are the arguments for and against the ISDS provisions?
- Would investment protection issues change the policy of both partners towards FDI?
- Would agreement's provisions influence the current state of FDI flows between the negotiating partners? and
- To what extent might creation and diversion investment effects be expected as a result of the creation of a free trade area?

The aim of this paper is to answer these questions and to examine some of the economic, political and legal implications of TTIP provisions for FDI flows between the EU and the USA.

2. Main provisions of Transatlantic Trade and Investment Partnership (TTIP)

The idea of a creation of a free trade agreement between the USA and the EU has a longer history than just the current efforts aimed at establishing the TTIP. The negotiations on Transatlantic Free Trade Agreement (TAFTA) failed in the 1990s, but the idea of such an agreement remained desirable to politicians on both sides in the decades that followed (Watts 2016, p. 88). The negotiations on the Transatlantic Trade and Investment Partnership (TTIP) were launched on July 8, 2013. Between July 2013 and October 2016, fifteen Negotiating Rounds were held, concentrating on the main issues to be settled. The official report of both negotiating parties of January 2017 optimistically states that: *“Our negotiators have made significant strides since 2013, identifying landing zones for certain issues, finding common ground on other important issues, and clarifying the remaining differences”*. (U.S.-EU Joint Report, 2017). Nevertheless, the future of the of TTIP is uncertain under the current political conditions.

The proposal of the TTIP agreement includes three main elements, namely:

- market access, which means removing customs duties on goods and restrictions on services, gaining better access to public markets, and making it easier to invest;
- improved regulatory coherence and cooperation by dismantling unnecessary regulatory barriers, such as the duplication of bureaucracy;
- improved cooperation when it comes to setting international standards (EC, 2015).

The EU has declared that progress in improving conditions for trade and investment will not be made at expense of the EU basic values, i.e. high standards in the areas of the environment, health and safety, protection of privacy, as well as workers' and consumer rights (EC, 2015, p. 6). It is pointed out that the negotiating parties, while opening some sectors through 'positive' or 'negative' lists, retain their right to maintain or introduce non-discriminatory legislation, related for instance to:

- standards of treatment for patients;
- capital requirements for banks;
- qualification requirements for certain professions; and
- universal service obligations (EC 2016, p. 4).

Nevertheless, these declarations have not allayed public fears in Europe, which are expressed in different ways (See photo 1).



Photo 1. 'No TTIP', Alicante/Spain, March 2016

Source: Author's photo.

3. The investment pillar of TTIP

As far as **investment** is concerned, at least three main issues arise in the context of TTIP negotiations, i.e. market access commitment, national treatment commitment, and standards of investment protection and the issue of resolution of investment disputes. The last issue has stirred up strong public concerns in Europe. The ISDS is perceived to:

- limit the policy space of governments, making them be reluctant to introduce regulations that might expose them to challenges and financial claims on the part of foreign private parties;
- impose restraints on rights of governments to enforce or maintain legislation in the public interest (the concept of ‘regulatory chill’) (Bronckers 2015, Pyka 2015)
- be capable of being used by investors to challenge health, environmental and social regulations on the grounds that they suffer from arbitrary and abusive treatment and/or are victims of ‘indirect expropriation’ (the case of Phillip Morris International against Australia), (Pardo 2014)
- be a mechanism which enforces obligations for host countries only (a ‘one-way instrument’) and affects core government functions (Bottini 2016).

Apart from the above-mentioned concerns, the hitherto existing ISDS procedures are perceived as deficient. They are characterized by a lack of transparency, inconsistencies in arbitral awards, high costs of procedures, and the existence of both parallel and frivolous claims (Pardo 2014).

In addition, problems relating to the unforeseeability of judgments, slowness of legal proceedings, and questions concerning the impartiality of judges are discussed in the context of public reservations about the mechanism of ISDS (Menkes 2016).

Anticipating the public concerns, the European Commission (EC) suspended negotiations on the investment pillar of TTIP in 2014 and, following wide public consultations, worked out a proposal in this field. The legal basis for such an activity of the EC is the Lisbon Treaty, which conferred competence for the protection of investments to the EU. This is perceived as an unprecedented opportunity for a profound reform of the traditional approach to investment protection and the associated ISDS system (EC 2015a).

In its so-called *Concept Paper*, the EU identified four areas for further improvement, to wit:

- 1) protection of the right to regulate;
- 2) the establishment and functioning of arbitral tribunals;
- 3) the review of ISDS decisions through an appellate mechanism;
- 4) the relationship between domestic judicial systems and ISDS (EC 2105a).

On 16 September 2015, the European Commission presented a new proposal on investment protection, which included a proposal to set up an Investment Court System (ICS) (EC 2015b). The ICS would replace the existing investor-state dis-

pute-settlement (ISDS) in all ongoing and future EU investment negotiations, including the TTIP negotiations. The ICS would consist of a first instance Tribunal and an Appeal Tribunal. Both these institutions would be composed of individuals appointed as “judges” by the contracting parties and subject to strict ethical standards. The qualifications of judges should be comparable to those required for the members of permanent international courts, such as the International Court of Justice and the WTO Appellate Body. The new Appellate Tribunal would operate on principles similar to the WTO Appellate Body. In order to limit unjustified cases, the ability of investors to take a case before the Tribunal would be precisely defined. Targeted discrimination on the basis of gender, race, religion, or nationality, expropriation without compensation, or a denial of justice would give investors grounds to institute such a procedure. The new system should guarantee governments’ right to regulate.

This proposal was tabled for discussion with the United States and made public on 12 November 2015 (EC 2015c). One of the changes made to the 16 September proposal consisted of an additional improvement for small and medium-sized enterprises. They would benefit from faster proceedings and would enjoy privileged treatment in comparison with large transnational corporations.

Negotiations on investment protection resumed in February 2016. However, the reports on the state of play of the TTIP negotiations, published by the EC after the 13th, 14th and 15th rounds of negotiations, did not show any substantial progress in this field (EC 2016a, 27 April, EC 2016b, 15 July, EC 2016c, 21 October).

The EU declared, in a report of October 21, 2016: *‘On investment rules, the discussions focused on common provisions (definitions; performance requirements; compensation for losses; expropriation; transfers; senior management and board of directors; denial of benefits) with the aim of further clarifying the respective drafting choices and policy objectives, and identifying further areas of conceptual convergence. (...) On investment dispute resolution, some progress was made in those parts of the respective text proposals on which both sides have similar conceptual and textual approaches, or in identifying shared objectives and possible future drafting solutions’* (EC 2016c).

The EU proposals related to reform of the hitherto existing ISDS mechanism have produced critical responses. The arguments of experts are as follows:

- The newly negotiated EU-Canada Comprehensive Economic Trade Agreement (CETA) and the Agreement with Singapore include both investment protection and an investor-state arbitration clauses. The controversy around TTIP can threaten the ratification of these agreements;
- The EU countries entered without fuss into nearly half of the 3000 bilateral investment treaties that exist in the world, with arbitration provisions as a standard feature;
- The EU proposal could be dismissive of the rules already in place, ‘... exacerbating public fears of the investment arbitral system, rather than reducing them.’ (Bishop 2015, p. 7);

- The EC has unwittingly reinforced concerns about ISDS. Some of the changes the Commission has proposed weaken both the substantive protection for investors and the mechanism the UN system created to enforce these protection measures – The Mauritius Convention on *Transparency in Treaty-based Investor-State Arbitration*- (Chase 2015, p. 226–227);
- It would be beneficial for European investors if the TTIP included ISDS, because the US legal system alone is not a dependable safeguard for foreign investors, as demonstrated in the *Loewen case*.¹ (Lorz 2014);

The EU proposal to set up an Investment Court System (ICS) has encountered critical opinions expressed by two totally different organizations, i.e. the Society of German Lawyers (Deutscher Richterbund 2016) and Greenpeace organization (Greenpeace 2016).

Generally, the Society of German Lawyers rejected the proposal as having neither a legal basis nor being necessary. According to the statement of the Society, the creation of ICS would deprive domestic courts of the possibility to protect foreign investors. Particular objections to the proposal are related to, among others, the definition of investment. The document uses too wide a definition of investment, comprising also bonds, shares in enterprises, intellectual property rights, and moveable property. As a consequence, different types of legal regulations can be used to judge investors' claims (civil, social, tax law regulations etc.).

The Society of German Lawyers has also expressed serious doubts about the competence of the EU to establishment the Investment Court System, as there is no legal basis for such far-reaching changes in the legal systems of the EU and the Member States. Hence, the Investment Court would be located outside the existing institutional and legal systems of the EU. The Society does not see any necessity for creating a special court for foreign investors, because the EU Member States should guarantee the same legal treatment of all entities in their economies. Apart from the above-cited objections, there is also some fear that the independence of judges cannot be guaranteed (Deutscher Richterbund 2016).

Greenpeace, in its *Position Paper*, states that '*...the new Proposal substantially fails to address and mitigate our concerns on the detrimental impact of ISDS mechanisms on the protection of public interests, such as health and the environment, and on the fair and non-discriminatory access to justice*' (Greenpeace 2016, p. 1).

According to Greenpeace, under the EU proposal:

- Foreign investors would still benefit from greater rights than domestic investors;
- ICS tribunals will not be composed of 'professional judges' because at the same time they could be arbitrators in ISDS cases under other international investment agreements; hence there is a possibility of conflicts of interest;

¹ *The Loewen case*: Case No ARB(AF)/98/3, International Centre for Settlement of Investment Disputes, Washington, D.C. 2003.

- The ICS will not be subject to the judicial scrutiny of EU supreme and constitutional courts, hence inconsistency of the ICS's case law and that of EU courts could occur; and the jurisdictions of EU and national courts will be limited because a special regime to solve foreign investors' claims would be established;
- The EC has failed to protect the EU and Member States' right to regulate in the public interest (Greenpeace 2016, p. 1–3).

The arguments presented by these two organizations seem to be reasonable. Currently, the idea of a permanent Multilateral Investment Court is under public consultation in the EU.² It would replace the bilateral Investment Court Systems included in the recent EU trade and investment agreements. Simultaneously, this idea is being discussed in several third countries and international organisations dealing with investment, such as UNCTAD, the OECD, UNCITRAL and the World Bank (EC 2016d, EC 2016e, EC 2016f, EC 2017).

The proposal for establishment of a permanent Multilateral Investment Court is aimed at avoiding the failures of former projects. The Multilateral Investment Court should have both first instance and appeal tribunals. Judges should be tenured, highly qualified, and obliged to adhere to the strictest ethical standards. The Multilateral Investment Court would rule on disputes arising under future and existing investment treaties. What seems to be important is that the Multilateral Investment Court would only apply where an investment treaty already explicitly allows an investor to bring a dispute against a State, and would not create new possibilities for an investor to bring a dispute against a state. The parties in dispute would be prevented from choosing which judges should rule on their case. The Multilateral Investment Court would provide for effective enforcement of its decisions and be open to all interested countries to join (EC 2016e).

4. Recent trends in investor-state dispute-settlements (ISDS)

There have been some observations related to usage of ISDS procedures (UNCTAD 2016, pp. 104–107; UNCTAD 2015, pp. 112–117; Lorz 2014). The main facts are as follows:

- The cumulative number of known ISDS cases grew in the years 1987–2016, reaching the level of almost 700 (as of 1 January 2016).
- 107 countries have been respondents to one or more known ISDS claims.
- Developed countries have been the main ISDS users, responsible for 80% of all claims.

² The consultation was open until 15 March 2017.

- The relative share of cases against developed countries has remained at about 40 per cent.
- Intra-EU disputes accounted for approximately 19% of all cases globally.
- The most frequent home States of claimants were (based on total known cases as of the end 2015): USA (138), i.e. 20% of the total, the Netherlands (80), the UK (59), Germany (51), Canada (39) ... Italy (30)... Turkey (19), Cyprus (18).
- The most frequent respondent States were: Argentina (59 cases), Bolivarian Republic of Venezuela (36), Czech Republic (33), Spain (29), Egypt (24), Canada (25)...Poland (20), Ukraine (19), India (17).
- In most cases the International Centre for Settlement of Investment Disputes (ICSID) was used as the arbitral forum.

As for Poland's experiences with ISDS procedures, the state was the respondent in some cases in which the decisions of an international arbitration were beneficial to it (for example: '*Schooner Capital vs Poland*', '*Minnotte and Lewis vs Poland*'). In other cases, however, decisions were taken in favour of investors (for example: '*Saar Papier Vertriebs GmbH vs Poland*') (Menkes 2016, pp. 149–167).

In general, some new ISDS cases in the global economy concerned public policies, including environmental issues, anti-money laundering and taxation. ISDS claims also affected sustainable development sectors. The amounts sought by investors ranged from USD 8 million to about USD 2.5 billion, but information regarding this issue is scant. Awards in favour of the investor were justified mainly by improper individual decisions by the executive authorities, and only in a small fraction of cases by legislative measures.

Investors most frequently challenged four types of State conduct in 2015 (UNCTAD 2016, p. 106):

- Legislative reforms in the renewable energy sector (at least 20 cases);
- Alleged direct expropriations of investments (at least 6 cases);
- Alleged discriminatory treatment (at least 6 cases);
- Revocation or denial of licenses or permits (at least 5 cases).

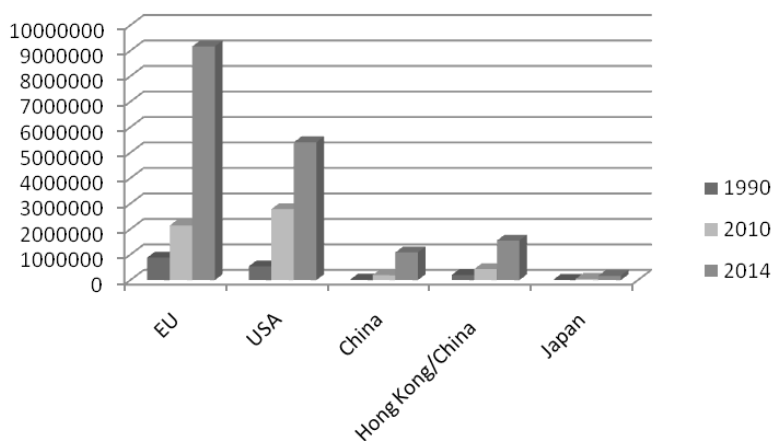
All this information suggests that the problem of investment disputes cannot be neglected. The EU proposals for creating a transparent, reliable system of dispute settlement could appease social emotions related to this topic.

5. The position of the EU and the USA in the global foreign direct investment

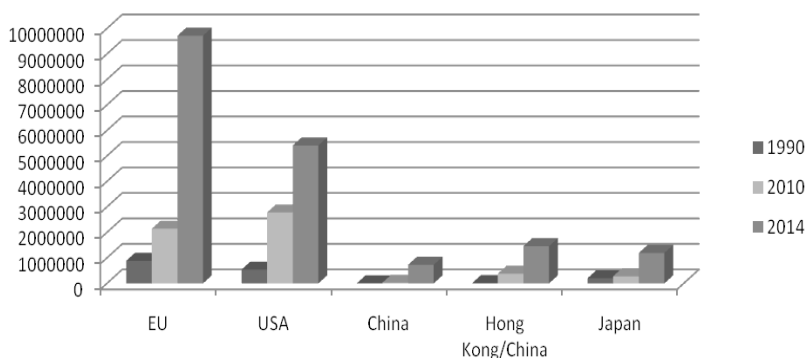
The EU and the USA have the leading position in the both global FDI inward and global FDI outward stocks. **The EU** accounted for **35.2%** and **40.3%** of the global inward and global outward stock respectively in 2014. In turn, **the USA** accounted

for **20.8%** and **24.4 %** of the global inward and global outward stock respectively (UNCTAD data base and own calculations). The comparison with main competitors shows that the dominant position of the EU and USA in the global economy is unquestionable. China and Hong Kong/China accounted together for 10.2% of the global FDI inward stock and 8.5% of the global FDI outward stock, and Japan – for 4.6% of the global FDI outward stock. Foreign direct investment in Japan is traditionally of less importance (UNCTAD data base and own calculations).

Both the EU and the USA have been **net exporters of capital** in the form of FDI, except for the USA in 2010. Graphs 1 and 2 illustrate the position of the analyzed partners in international business in comparison with their main competitors in the years 1990–2014 .



Graph 1. FDI inward stock, the EU, USA and their main competitors, 1990–2010–2014, USD Million
 Source: UNCTAD and own elaboration.



Graph 2. FDI outward stock, the EU, USA and their main competitors, 1990–2010–2014
 Source: UNCTAD and own elaboration.

6. Geographical distribution of FDI outward stocks of the EU–28 and the USA

FDI outward stock of the EU–28 were located mainly in **the United States** at the end of 2014, i.e. **34.5%** of the total. The main EU–28 holders of FDI stocks in the United States were the United Kingdom, France and Germany. The second main destination of the EU outward stocks was **Switzerland**. This country accounted for 11% of the EU outward stocks and the main activity of European investors was financial intermediation. The third main partner for the EU–27 was **Brazil**, with a 6% share of EU–28 FDI outward stock, having overtaken Canada. In Asia, the main location for EU–28 outward FDI stocks were **Hong Kong, Singapore and China**, together accounting for almost half of the EU–28's FDI positions in Asia at the end of 2014 (Eurostat 2016).

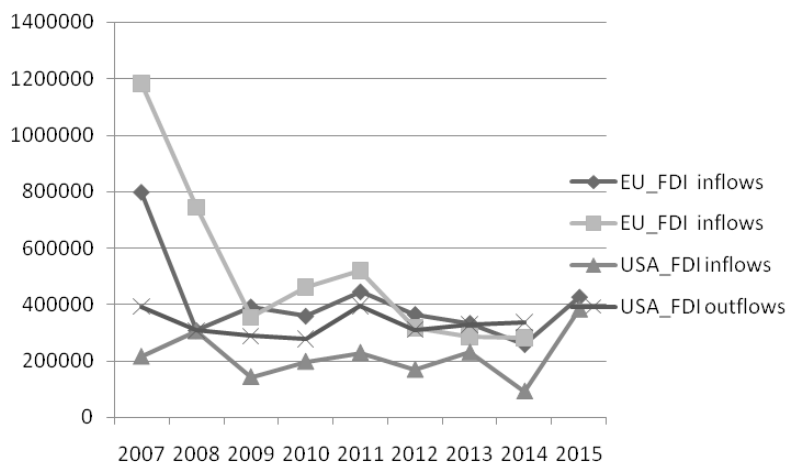
The main locations for **the US FDI outward stock** at the end of 2012 were **the EU**, accounting for **44%** of the total, **Canada** – accounting for 7%, **Latin America** – for 6%, **Japan** and **Switzerland** – each accounting for 3% (OECD 2014 and own calculations).

The above quoted data show that the EU and the USA constitute important partners to each other in the field of capital movements in the form of FDI. Investment protection measures should be a subject of common concern for them. Among the EU Member States, **the Netherlands, the United Kingdom, Luxembourg and Ireland** are the most attractive for US FDI investors. They accounted for **82%** of FDI outward stock located in the EU. US FDI outward stock in the new EU Member States amounted to **1.2%** of that located in the whole EU (OECD 2014 and own calculations).

7. Dynamics of FDI flows into and out of the EU and the USA

Annual FDI flows into and out of the analyzed regions during the crisis and post-crisis periods show a decrease in foreign direct investors' activities in the years 2009–2014 (see Graph No 3). UNCTAD's preliminary estimates indicated that FDI flows to developed countries bounced back sharply in 2015, nevertheless, the outlook for 2016 was perceived as '*cloudy*' (UNCTAD 2016).

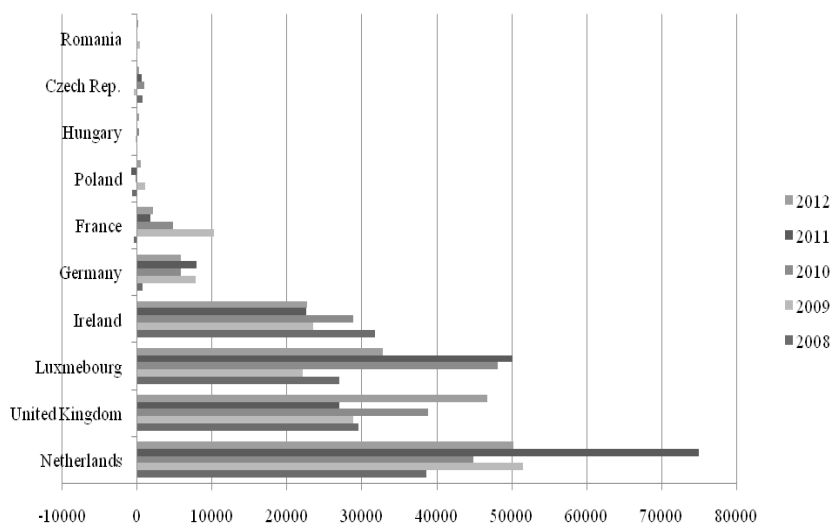
The bilateral FDI relationships between the EU and the USA, measured using FDI intensity indexes, show that investment connections between the partners were relatively strong in 2012 (with FDI intensity indexes higher than 1). Nevertheless, there is a potential for intensification of FDI between these partners (Czarny, Folfas 2016, pp. 31–46).



Graph 3. FDI flows into and out of the EU and the USA, 2007–2015, USD Million

Source: UNCTAD data base and own elaboration.

US direct investors showed differentiated interests in their investments in particular EU countries in the years 2008–2012 (see Graph 4). American investors preferred the so-called ‘old EU Member States’ and traditional partners (the Netherlands, the United Kingdom, Luxembourg, Ireland). US FDI in France and Germany was relatively moderate and US FDI flows into the new EU Member States were negligible. In the latter case some divestment occurred as well.



Graph 4. US outward FDI in the selected countries of the EU, 2008–2012, USD Million

Source: OECD data base and own elaboration.

The low interest of American investors in investing in the new EU Member States might be explained by the following factors:

- The less attractive locational advantages of the new EU Member States (less developed economies than the ‘old’ ones, relatively small markets, and a more expensive labour force than in developing countries);
- Less certain conditions for investment and more potential conflicts between investors and states (the Czech Republic and Poland being among the most frequent respondent States under ISDS arbitration procedures);
- The dominant presence of investors from the ‘old’ EU Member States in the economies of the new EU Member States (for example, in Poland, 91.5% of FDI inward stocks came from other EU countries);
- The occurrence of strong investment reorganization and rationalization effects under the customs union between the ‘old’ and ‘new’ EU Member States;
- In this context, potential investment creation and diversion effects under the TTIP agreement might be moderate in the new EU countries.

8. Conclusions

1. Although the negotiations between the USA and the EU have been suspended after the most recent presidential election in the USA³, the problem of ISDS within the TTIP Agreement should be perceived in the broader context of a tendency towards modernization of IIAs and termination of some of the BITs undertaken by different countries.
2. The growing number of ISDS cases in the world economy should be treated as a rather natural process when the simultaneous growth of FDI flows and stocks are taken into account. Nevertheless, the leading position of US investors as claimants under ISDS procedures might suggest that American companies are able to protect their interests better than investors from other countries. This might fuel some public fears in Europe that states would not be able to overcome a ‘regulatory chill’.
3. The proposals of the European Commission to change the investment protection system can be treated as an attempt to make the system of arbitration more transparent, convincing to societies, and safer for states.

³ See: Decision of the President of the European Commission on the setting up of a Commissioners’ Group on Trade and Harnessing Globalisation, replacing the Commissioners’ Group on the Transatlantic Trade and Investment Partnership with the United States, AGENDA of the 2204th meeting of the Commission, 14 March 2017, European Commission Secretariat General OJ(2017) 2204 Final.

4. The potential effects of the TTIP agreement for FDI between both partners might be dependent on the scale of trade creation and diversion effects and the mirror effects of investment creation and diversion under a free trade area.
5. It could be predicted that the potential benefits of the TTIP Agreement in the field of FDI flows would be rather limited for the new EU Member States, although one might expect an enhancement of some of their locational advantages.

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Streszczenie

IMPLIKACJE TRANSATLANTYCKIEGO PARTNERSTWA W DZIEDZINIE HANDLU I INWESTYCJI (TTIP) DLA PRZEPLÝWÓW INWESTYCJI MIĘDZY UNIĄ EUROPEJSKĄ A USA

Transatlantyczne Porozumienie w dziedzinie Handlu i Inwestycji (TTIP) jest przedmiotem kontrowersji, ale jednocześnie postrzegane jest jako jedno najbardziej wszechstronnych międzynarodowych porozumień o wolnym handlu i ochronie inwestycji. Wśród tematów wywołujących najwięcej krytyki ze strony różnych grup społecznych jest procedury rozstrzygania sporów między inwestorem a państwem (ISDS), jak również ich prawne konsekwencje dla krajów członkowskich UE. Mniej dyskutowaną kwestią są natomiast potencjalne implikacje porozumienia dla ekonomicznej współpracy między Unią Europejską a USA w dziedzinie przepływów inwestycji, a szczególności bezpośrednich inwestycji zagranicznych (BIZ). Celem artykułu jest przedstawienie dyskusji dotyczącej ISDS i zbadanie wybranych ekonomicznych, politycznych i prawnych implikacji postanowień TTIP dla przepływów BIZ między partnerami. Propozycja Komisji Europejskiej, aby zmienić procedury ochrony inwestycji i rozstrzygania sporów, może być traktowana jako próba stworzenia bardziej transparentnego systemu, akceptowalnego dla różnych grup społecznych i bezpieczniejszego dla państw członkowskich. Efekty porozumienia dla BIZ między UE a USA mogą zależeć od efektów kreacji i przesunięcia handlu oraz „lustrzanych” efektów w sferze inwestycji.

Słowa kluczowe: *Transatlantyczne Porozumienie w dziedzinie Handlu i Inwestycji (TTIP), rozstrzyganie sporów między inwestorem a państwem (ISDS), bezpośrednio inwestycje zagraniczne (BIZ), USA, UE*