Policy brief
June 2015

IGO Instytut Globalnej Odpowiedzialności

VÉDEGYLET

tni

Central and Eastern European countries at the crossroads

Why governments should reject investment arbitration in TTIP

Most policy-makers and MEPs from Central and Eastern European (CEE) countries have, so far, supported the inclusion of investment arbitration in the Transatlantic Trade and Investment Partnership (TTIP) on the basis that investment treaties already exist and that TTIP offers better protections for states and will lead to an increase in investment. However, the evidence suggests that a TTIP that includes the Investor-State Dispute Settlement mechanism (ISDS), will fail to deliver on its promises and will worsen the capacity for Central and Eastern European countries to regulate:

1- There is no empirical evidence that including ISDS in TTIP will attract more US foreign direct investment.

2- While existing Bilateral Investment Treaties (BITs) between the US and CEE countries can be terminated at any time, signing TTIP will lock CEE countries into providing extensive rights to US investors indefinitely.

3- Signing ISDS in TTIP will likely lead to a surge in US investors challenging governments regulatory measures at international arbitration tribunals.

4- The European Union "reform" proposals for ISDS make no difference in investor protection regime and will not improve the space of governments to regulate.

5- The existence of intra-European BITs does not justify the inclusion of ISDS in TTIP.

6- The existing BITs with the US were signed at a very different time and context than today. Instead of reconfirming their commitment to a flawed ISDS system by signing on to TTIP, CEE governments should join the growing number of countries that are re-thinking their investment policy.

Taking this evidence into account, CEE policy makers should reconsider their position, and reject the inclusion of ISDS in TTIP.

The European Union (EU) is currently negotiating the Transatlantic Trade and Investment Partnership (TTIP) on behalf of its 27 member states. One component of the negotiations is a chapter on investment protection that includes the controversial Investor-State Dispute Settlement mechanism (ISDS). Giving the right to investors to sue governments at international tribunals has become a highly contested issue in recent years. The European Commission organised a consultation in 2014 on its ISDS agenda. Out of the 150,000 responses, 97% rejected the inclusion of ISDS in the Transatlantic Agreement[1].

All CEE countries that are members of the European Union (Bulgaria, Croatia, the Czech Republic, Poland, Romania, Slovakia, Estonia, Latvia, and Lithuania), except Hungary and Slovenia, have Bilateral Investment Treaties (BITs) with the United States (US). Signing TTIP with a full investment chapter means that investor protection will no longer be offered through the many BITs that CEE countries have with the US. US-based investors will, instead, be protected by the investor protection rules included in the TTIP treaty.

Most Central and Eastern European governments have, so far, supported the inclusion of ISDS in TTIP with the argument that it will provide a better version than what they currently have in their BITs with the US. For example, the government of Poland has expressed their belief that ISDS as proposed in TTIP will help to achieve a better balance between the rights of the foreign investor and the right of governments to regulate[2]. This position disregards the voices of experts such as Professor Leokadia Oreziak, a leading economist form the Warsaw School of Economics, who warned that "TTIP with ISDS chapter can lead to almost complete incapacitation of MS [Member States] democratic institutions, including governments and parliaments"[3].

The two countries that do not have BITs with the US, have also raised their concerns about including ISDS in TTIP. Referring to the European Commission proposals of reform of investment resolution, the government of Slovenia indicated that they have "substantive (...) reservations" and expressed "the document does not significantly upgrade the existing system for protecting investments and raises several questions"[4]. The Hungarian government has also expressed that their national parliament will not ratify CETA (Canada-EU Trade Agreement) and TTIP as long as these agreements include ISDS[5].

This briefing will present evidence to show that not only that the inclusion of ISDS in TTIP will not improve the regulatory space of Central and Eastern European countries, but, in fact, will undermine it further.

1

There is no empirical evidence that including ISDS in TTIP will attract more US foreign direct investment

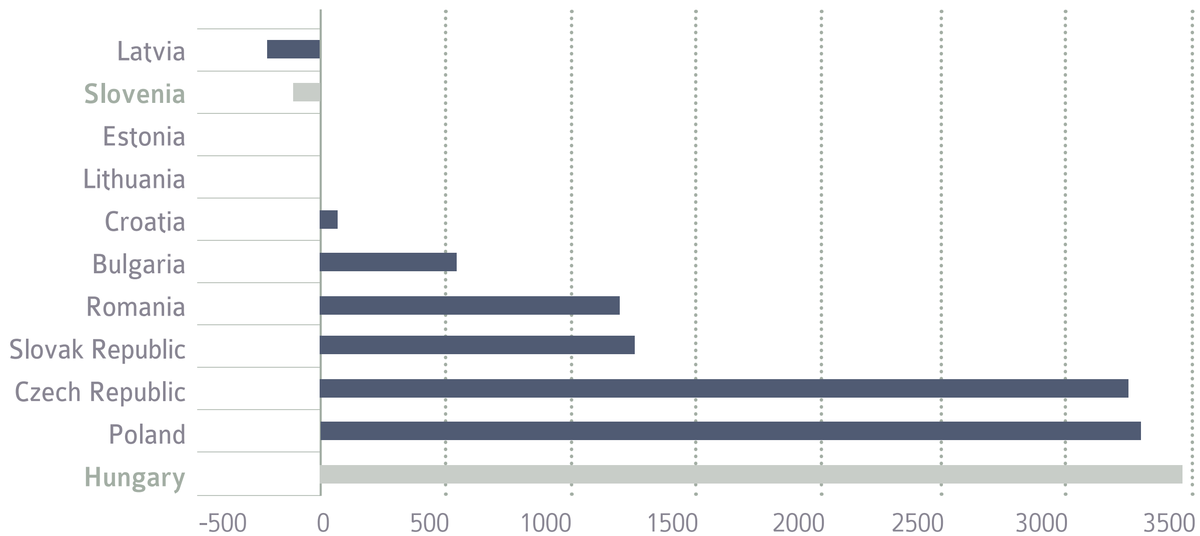
A common justification used to encourage countries to sign on to BITs is that providing investors with extensive protection will increase the flow of foreign direct investment (FDI) between two countries. The link between signing BITs and attracting increased FDI has been repeatedly questioned by academic research[6] as well as by surveys conducted among businesses[7] Furthermore, political risk insurers have indicated that the existence of BITs is not a key factor in their decision on investments[8].

This international trend is also true when looking at the data for investments made in Central and Eastern Europe by US investors. Over the last ten years, Hungary is the largest recipient of foreign direct investment from US-based investors, yet, Hungary has never signed a BIT with the US. This is even more interesting when the relative size of the Hungarian economy is taken into account, since Hungary does not have the largest economy by a wide margin.

Furthermore, it is worth noticing that most of the investment from the US to Europe goes to the Western European Member States, even though none of these countries have an investment treaty with the US. According to UNCTAD, the "FDI stock held by US investors in these nine [Central and Eastern European] countries equals one per cent of the total US FDI stock in the EU"[9].

US outward FDI 2001-2011 sum

Source: Based on UNCTAD data http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx



Even for the countries that do have a BIT with the US, the amount of FDI received from US investors between 2001 and 2011 has been marginal. On average, US investment accounts for only 2% of the total FDI inflows into CEE countries. The Czech Republic which received the highest FDI inflows from the US compared to total FDI inflows (during that 10 year period), amounted to a meagre 4.87%[10]. Even if countries fear driving investors away by rejecting ISDS, there is not that much investment to scare off. The amount of investment received from the US does not justify the risks associated with ISDS in TTIP.

2

Current BITs between the US and CEE countries can be terminated at any time, while signing TTIP will lock CEE countries into providing extensive rights to US investors indefinitely

During the 1990s, Central and Eastern European countries signed bilateral investment treaties en-masse. In most cases, this included a Bilateral Investment Treaty with the United States.

The treaties of CEE countries with the US share the same blueprint and offer the same key features and protections for investors as most BITS. They include, for instance, an initial period of validity and are automatically renewed if not terminated. If one of the parties decides to denounce the treaty, a survival clause means that existing investors, that made investments when the BIT was still active, will continue to enjoy the same protection for many years, even when the BIT is not active anymore.

In the case of Central and Eastern Europe, the nine countries that have a BIT with the US have a treaty with an initial runtime of ten years. After that period, the treaty is automatically renewed until either party decides to terminate on a one-year notice. Once the treaty is terminated, a ten-year survival clause will guarantee investors, with investments made prior to the cancellation, the same protection as offered before[11].

The last BIT with the US entered into force in 2004 with Lithuania. This means that all US-CEE countries treaties have now either met or long exceeded their initial runtime, and may thus be cancelled at any moment on a one year notice. This gives Central and Eastern European governments considerable potential to control the investment protection framework of their investment flows with the United States.

TTIP would mark the end of this control. If TTIP is ratified by the European Union (the European Parliament and the Council), a single EU member

state would not be able to decide to leave TTIP, because the agreement will become part of the EU acquis. The acquis is the body of common rights and obligations and has a binding force on all EU member states. This means that if a single EU member state wants to discontinue the extensive rights offered to investors in TTIP, it would have to leave the European Union. It is also not possible to terminate the investment protection chapter without terminating the whole agreement. Exiting from ISDS, once TTIP is signed, will be practically impossible.

Effectively, while today CEE countries can exercise their legal rights to terminate their respective bilateral investment treaties and regain control over their regulatory space, TTIP would lock Member States indefinitely into providing extensive rights to US investors.

3

Signing ISDS in TTIP will likely lead to a surge in US investors challenging governments' regulatory measures at international arbitration tribunals

Central and Eastern European countries have already been sued at least ten times by US-based investors who invoked US BITs. Investors have sought damages for at least $3.5 billion dollars.[12]

These lawsuits have attacked a number of key governmental regulations, such as supervision over the financial sector, regulation of the telecommunications sector and agricultural policy (see box below).

Box 1

US investors challenge CEE countries regulatory powers

Supervision over the financial sector

(Alex Genin, Eastern Credit Limited, Inc. & A.S. Baltoi v Estonia, ICSID ARB/99/2, 1999)

The Estonian government was sued for "acting, through its Central Bank, as a prudent and concerned supervisor in the banking sector"[13]. The Central Bank of Estonia cancelled the operating license of a Bank, arguing that it failed to provide information concerning its ultimate owners and for differences regarding the Bank's capital requirements. The owner, US citizen Alex Genin, launched a lawsuit against the government claiming 70 million USD in damages[14].

Regulation of the telecom sector

(Ameritech v Poland UNCITRAL, 1996)

During the 1990s, Ameritech provided analogue cellular telephone services through a joint-venture with Poland's state-owned telephone company. When the initial license ran out, Poland decided to put a new license out for tender instead of giving it to Ameritech. This prompted the company to initiate ISDS-arbitration under the Poland-US BIT. Even though Poland had no legal obligation to hand the license to Ameritech, the case was eventually settled for an unknown sum of money[15].

Agricultural policy and EU accession

(Cargill v Poland, ICSID / Case No. ARB(AF)/04/2, 2004)

As part of Poland's accession to the EU, the government reduced the allotment of quotas for the sweetener isoglucose, which is produced by Cargill. This was required to comply with the EU's Common Agricultural Policy (CAP). Cargill sued Poland, arguing the government discriminated against the company. It also claimed that because Poland's national isoglucose quota was below Cargill's production capacity, it amounted to expropriation of its Polish operations. The Tribunal ruled in favour of the investor and awarded $16.3 million dollars plus interest[16].

UNCTAD statistics show that lawsuits filed by investors are increasing every year. By the end of 2013, the global number of ISDS cases had reached 568; the largest number of known investment arbitrations filed were in 2012 and 2013 (58 and 56 respectively)[17].

This rise in lawsuits is driven by US based companies that are the biggest users of the ISDS system. US-based investors have initiated 127 lawsuits, 22% of all known[18] worldwide claims. The number of cases by US' investors has steadily increased each year, and is likely to continue expanding.

CEE-US BITs have been one sided. Only US investors have made use of them. No CEE-based investor has ever filed an investment arbitration lawsuit against the US during the last 20 years[19]. Also, CEE officials should not ignore the fact that the US has never lost an ISDS case.

4

The European Union "reform" proposals for ISDS make no meaningful difference in investor protection regime and do not improve CEE government's capacity to regulate in the public interest

European Trade Commissioner Malmström has recently presented a series of proposals for an "improved" version of ISDS in TTIP[20]. These proposals include allowing a choice between ISDS and domestic courts – a 'so-called 'fork in the road clause', inclusion of binding joint statements of how to interpret the provisions in the treaty, an appeal mechanism and a fixed list of appointed arbitrators, guided by a code of conduct. These measures, however, do not address the structural problems of ISDS. Investors can still undermine democracy and sue governments at private international tribunals when implementing legitimate public interest legislation in areas of health, environment, social security, human or consumer rights, financial and other domestic regulation that aims to protect citizens or the environment.[21] Foreign investors will still enjoy special rights since they can circumvent national courts. The judgment over whether legal and constitutional public policies are right or wrong will still be decided by for-profit arbitrators. Investors do not have to comply with any obligations. Governments can not sue corporations, only corporations can sue states. Finally, ISDS will continue having a chilling effect on decisions makers, who will be reluctant to regulate in the public interest for fear of arbitration disputes.

5

The existence of intra-European BITs does not justify the inclusion of ISDS in TTIP

It is true that currently European investors initiate most of the investment arbitration lawsuits against CEE governments using intra-EU BITs –these are treaties signed by CEE governments with Western European governments before they acceded to the European Union. However, the fact that US investors, so far, have made less use than the European counterparts of the possibility to sue the governments is by no means–as some government officials have claimed- a justification to include ISDS in TTIP or maintain the current US BITs. Intra-EU BITs are without doubt very detrimental to CEE countries and they should also be dealt with, but the fact that they create a bigger problem, cannot translate into the assumption that US BITs or ISDS in TTIP are beneficial for CEE countries.

Furthermore, the process of terminating intra-EU BITs has started and all the treaties will probably be terminated soon. The European Commission recently launched infringement proceedings against Austria, the Netherlands, Romania, Slovakia and Sweden demanding that the BITs between these five Member States be terminated[22]. These treaties are considered incompatible with EU law. Ireland and Italy have already terminated all their intra-EU BITs.

6

The BITs with the US were signed at a very different time and context than today. Instead of reconfirming their commitment to a flawed ISDS system by signing on to TTIP, CEE governments should join those countries that are re-thinking their investment policy.

Today's context in Central and Eastern Europe is very different from the moment when the treaties with the US were signed in the 1990s. At the time, there was little challenge to the belief that these treaties would be beneficial in terms of development and economic growth. Most international institutions like the World Bank, the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) were staunch promoters of BITs. Even the currently highly critical UNCTAD facilitated the signing of BITs at the time. The risks for governments were not discussed.

These treaties were signed by Central and Eastern European under the false illusion that they would increase development. Furthermore, at that time, CEE countries were transitioning out of the communist era; signing BITs was a way to show the world they were serious about market economy and integrating into the global investment system.

When we fast forward 20 years, it has become clear that the treaties did not live up to their promise and have instead highly constrained CEE's policy space to regulate. Today, the benefits of these treaties is under scrutiny in many countries. Their benefits are highly questionable and the flaws of the ISDS system have become evident. Countries such as Ecuador, South Africa, India and Indonesia are reconsidering their current investment frameworks.

After 40 years of state economy, local businesses in the CEE region are still in a developing phase. ISDS in TTIP can prevent governments from protecting local companies against unfair competition with multinational corporations.

Conclusion and recommendations

Governments currently have the opportunity to terminate their BITs with the US at any time, and keep control over their investment protection policy framework. The policy freedom that CEE countries presently have would be severely limited with TTIP. In addition, ISDS has come under increased international scrutiny.

Central and Eastern European countries find themselves at a crossroad regarding their investment policies with the US. One road will lead to a set of rules cast in iron that will be hard to escape and offer no improvement over the current system. In fact, it is very likely to put governments in a worse off position than the current situation. The alternative route, rejecting the inclusion of ISDS in TTIP and considering terminating their current BITs, will provide Central and Eastern Europe the possibility to regain control of their policy space to regulate and free themselves of the continuous risk of being sued for millions of euros by disgruntled investors. The concern over the cost of investment arbitration and its impact on state budgets becomes even more relevant in the current context of economic crises and austerity.

In light of the evidence, it would be wise for Central and Eastern European governments and MEPs to reconsider their position and reject the inclusion of ISDS in TTIP.

Endnotes

1 European Commission (2014) Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP) http://trade.ec.europa.eu/consultations/index.cfm?consul_id=179

2 Ministry of Economy of Poland (2015) Position on ISDS in TTIP http://www.mg.gov.pl/Wspolpraca+miedzynarodowa/Handel+zagraniczny/TTIP/Mechanizm+ISDS

3 Raś, Lidia (2015) Prof. Leokadia Oręziak o TTIP: Umowa pomiędzy UE i USA będzie korzystna tylko dla wielkich korporacji, Gazeta Prawna, 26 May. http://biznes.gazetaprawna.pl/artykuly/851265,prof-leokadia-oreziak-umowa-ttip-korzysci-dla-korporacji-isds.html

4 Position of the government of Slovenia: http://www.vlada.si/en/media_room/government_press_releases/press_release/article/the_government_on_slovenias_positions_on_the_european_agenda_on_migration_and_the_ttip_53857/

5 Position of the government of Hungary: http://www.bruxinfo.hu/cikk/20150508-magyarorszag-nem-ker-a-valasztott-birosagokbol.html; http://www.hirado.hu/2015/06/14/torlodas-eseten-a-roszkei-hataratkelohelyen-is-vizet-osztanak/; http://canadians.org/blog/hungary-says-it-wont-ratify-ceta-because-isds-provision

6 Poulsen, Lauge Skovgaard (2010) The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence, in: K. Sauvant, ed., Yearbook on International Investment Law & Policy 2009/2010 New York: Oxford University Press. http://works.bepress.com/lauge_poulsen/4/

7 European Commission, Survey of the Attitudes of the European Business Community to International Investment Rules, TN Sofres Consulting on behalf of European Commission DG Trade, 2000 http://trade.ec.europa.eu/doclib/html/111125.htm and http://trade.ec.europa.eu/doclib/html/111127.htm and Source: J Yackee, "Do Bilateral Investment Treaties Promote Foreign Direct Investment?' 51 Virginia J Int'l Law (2010) http://ssrn.com/abstract=1594887

8 Poulsen, Lauge Skovgaard (2010), see endnote 6.

9 UNCTAD (2014) Investor-state dispute settlement: an information note on the United States and the European Union, IIA Issue Notes, No. 2 http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d4_en.pdf

10 Own calculations based on UNCTAD data http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx and World bank data http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD

11 UNCTAD (2015) International Investment Agreements Navigator http://investmentpolicyhub.unctad.org/IIA

12 Ronald S. Lauder v Czech Republic (500 million USD sought); Alex Genin v Estonia (70 million USD sought); Ameritech v Poland (500 million USD sought); Cargill v Poland (130 milion USD sought); Mr. David Minnotte & Mr. Robert Lewis v Poland (35 million USD sought); Vincent J. Ryan, Schooner Capital LLC, & Atlantic Investment Partners LLC v Poland (180 milion USD sought); Noble Ventures v Romania (495 milion USD sought); S&T Oil Equipment & Machinery v Romania (180 million USD sought); Mr. Hassan Awdi v Romania (490 million USD sought); and EuroGas Inc and Belmont Resources Inc v Slovakia (1 billion USD sought).

13 Frutos-Peterson, Claudia (2001) Alex Genin, Eastern Credit Limited, Inc., and A.S. Baltoil v. The Republic of Estonia (ICSID Case No.ARB/99/2). Introductory Note https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC591&caseId=C178

14 Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil and The Republic of Estonia (ICSID Case No. ARB/99/2), Tribunal award: http://www.italaw.com/sites/default/files/case-documents/ita0359.pdf

15 IISD (2004) INVEST-SD: Investment Law and Policy Weekly News Bulletin, April 13, http://www.iisd.org/pdf/2004/investment_investsd_april13_2004.pdf

16 Peterson, Luke Eric (2008) Poland discriminated against US firm, Cargill, in sweetener quota allotment; Arbitrators reject several other claims, IAReporter, 16 July. http://www.iareporter.com/articles/poland-discriminated-against-us-firm-cargill-in-sweetener-quota-allotment-arbitrators-reject-several-other-claims

17 UNCTAD (2014), see endnote 9.

18 Many ISDS cases are not known. Tribunals have no obligation to disclose information. This number is based on known investment treaty cases.

19 There are 16 known investment treaty cases against the US. Not a single one originated by an investor from an EU Member State. Source: UNCTAD (2014), see endnote 9.

20 European Commission (2015) Concept Paper: Investment in TTIP and beyond – the path for reform. Enhancing the right to regulate and moving from current ad hoc arbitration towards an Investment Court http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF

21 S2B (2015) ISDS: Spreading the disease instead of looking for a cure http://www.s2bnetwork.org/isds-statement/

22 European Commission (2015) Commission asks Member States to terminate their intra-EU bilateral investment treaties, Press release, 18 June http://europa.eu/rapid/press-release_IP-15-5198_en.htm.

Authors: Cecilia Olivet, Pietje Vervest and Luuk Schmitz

Editor: Nick Buxton

Design and illustrations: Ricardo Santos

Acknowledgements: We thank Natacha Cingotti, Marc Maes, Marcin Wojtalik, Maria Świetlik, Roland Zarzycki, Györgyi Újszászi and Ante Wessels for insightful comments to the different drafts of the text.

Amsterdam/Poland/Hungary, June 2015

Published by the Transnational Institute, Instytut Globalnej Odpowiedzialności (IGO) and Védegylet Egyesület

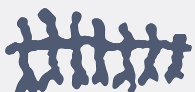
Contents of the report may be quoted or reproduced for non-commercial purposes, provided that the source of information is acknowledged.

The Transnational Institute (TNI) is an international research and advocacy institute committed to building a just, democratic and sustainable world. For more than 40 years, TNI has served as a unique nexus between social movements, engaged scholars and policy makers.

www.tni.org

Institute of Global Responsibility (IGO) is an independent non-governmental organisation (NGO) based in Warsaw, Poland. It was established in 2007 and since that time has been focusing on development policy issues, development education and cooperation with partners in the South.

www.igo.org.pl



VÉDEGYLET

Védegylet – Protect the Future has been around since 2000 and has been encouraging people to participate in local and national public affairs since then. Across Hungary Vedegylet supports local communities taking a stance against policies and developments that endanger the environment, our social and cultural heritage and which disregard our communities’ rights to participate in democratic processes.

www.vedegylet.hu