The European Union's New Powers on Foreign Direct Investment: Implications for International Business and Global Economic Stability

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ABSTRACT

The Lisbon Treaty has given EU institutions power over foreign direct investment (FDI). The Commission has indicated that it will use these powers to develop an EU wide FDI policy. FDI policy consists of measures to protect investment, restrictions that apply to FDI and measures to promote investment including incentives. Initially, the new EU FDI policy is likely to be confined to the protection of investment and, more specifically, the gradual replacement of member states' bilateral investment treaties (BITs) with EU wide treaties. By leaving investment incentives and restrictions within the control of member states for the time being, the Commission is taking a pragmatic approach that seeks to minimize resistance from member states to its new powers. While some hurdles will need to be overcome, EU wide protection of investment can be argued to result in benefits for international businesses both inside and outside of the EU as well as for the EU itself. Further, an EU wide policy has the potential to pave the way for a global investment agreement which would create a more certain global environment for FDI and hence contribute to global economic stability.

Keywords

Europe; New trends in international investment; Globalisation

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1.0 Introduction

The European Commission has long sought exclusive competence over foreign direct investment (FDI) to complement its power in trade matters. The Lisbon Treaty has finally delivered this by including foreign direct investment in the EU's common commercial policy. Since the first drafts of the Lisbon Treaty emerged over two years ago, there has been debate about the approach that the Commission is likely to take to these powers. For example will it confine the exercise of these powers to matters related to investment protection or take a broader view that seeks to take greater control over the incentives that the various states offer to investors and seek to harmonize the restrictions that individual states still maintain in relation to certain classes of FDI?

Communications from the Commission during 2010 suggest that it will be confining the exercise of its powers to investment protection matters and will be adopting a gradual approach to the replacement of the member states bilateral investment treaties (BITs). By leaving the matter of incentives and restrictions largely as they are for the time being, the Commission is adopting a pragmatic approach that will minimize resistance from member states to the exercise of its new powers.

This paper explores the current system of regulation of FDI in the EU, some of the problems that have arisen and how a more centralized FDI policy might resolve these. It argues that EU wide protection of investment policy would have benefits not only for international business firms from outside of the EU but also for EU based firms and the EU itself. Further, given that EU member states are party to more than half of all investment treaties world wide, the process of bringing about an EU wide foreign investment policy could prompt a more global agreement on foreign direct investment. If this was able to be achieved, it could result in bringing the international regulation of foreign direct investment into line with the globally based international legal regime for trade as exists through the World Trade Organization.

A new EU wide foreign investment policy could therefore play a considerable role in promoting greater predictability and stability in the global regulatory environment for foreign direct investment and as a result enhance global economic stability. It could be argued that it is in the wider interest of all international businesses to support and help bring this about.

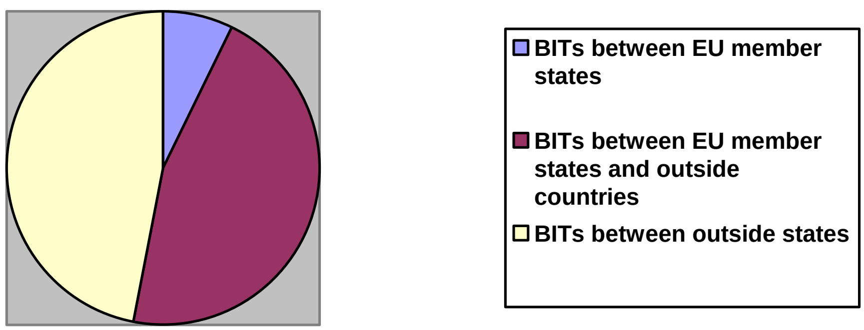
2.0 The European Union's Regulatory Regime for Foreign Direct Investment

The main component of the international regulatory regime for foreign direct investment is the vast network of bilateral investment treaties entered into between countries world wide. In recent years this has been supplemented by investment provisions in multilateral and free trade agreements. At last count there were 2676 bilateral investment agreements and some 273 free trade agreements world wide (UNCTAD, 2009).

The principal aim of the bilateral investment treaty system is to set forth standards of treatment of foreign investors by the state in which the investment is made. Thus, one finds in most bilateral investment treaties provisions that a host state will not expropriate an investment without compensation; that they will treat the investor fairly and equitably; that full protection and security will be provided to the investment; that they will not discriminate against foreign investors from the treaty country and that they will treat foreign investors in the same manner as local investors in that industry.

Member countries of the European Union figure prominently in the international bilateral investment treaty regime. Figure 1 compares the number of BITs between EU member states themselves, the number of BITs between EU member states with countries outside of the EU and the number of BITs between countries not members of the EU.

Figure 1
Significance of European Union member states in the International Investment Treaty Regime



Sources: Dreyer, I. (2010). Heading Towards a Battle of the BITs; De Mestral, A. (2010). Is a model EU BIT possible – or even desirable?; United Nations Conference on Trade and Development. (2009). Recent Developments in International Investment Agreements. 2008 – June 2009

An important conclusion that may be drawn from Figure 1 is that if the EU was to act as a block it could exert considerable influence over the possible evolution of the international investment regime into a more global one (as exists in the case of trade through the World Trade Organization) rather then the current patchwork of treaties between individual countries. As yet, no attempt to secure a globally based international legal regime for foreign direct investment has been successful despite attempts to reach such an agreement in the 1940s when countries were negotiating the Havana charter, in the 1970s at the Paris conference on international economic cooperation (Juillard, 2001) and in the late 1990s when an attempt was made by the OECD to initiate a multilateral agreement on investment. The most recent initiative, which was an attempt to include investment in the WTO system of agreements, failed at Cancun in 2003 (Bungenberg, p.4).

Although EU member states account for more than half of the entire BITs world wide they figure much less prominently as defendants in investment disputes. Disputes arise where an investor alleges that the state in which the investment has been established violates one of the principles set out in the BIT between the home state of the investor and the host state. Most disputes are heard by an arbitral tribunal established in accordance with the provisions of the particular treaty between the states involved. The International Centre for the Settlement of Investment Disputes (ICSID) is a common choice as the body to establish tribunals to hear disputes. Table 1 sets out the number of known claims against each of the EU member states arising from bilateral investment treaties as well as the EU and world total.

Table 1
Number of known claims against EU member states arising from Bilateral Investment Treaties

EU Member Country	**Number of Known Claims arising from BITs**
Austria	0
Belgium	0
Bulgaria	1
Czech Republic	16
Cyprus	0
Denmark	0
Estonia	3
Finland	0
France	1
Germany	2
Greece	0
Hungary	6
Ireland	0
Italy	0
Latvia	2
Lithuania	2
Luxembourg	0
Malta	0
Netherlands	0
Poland	10
Portugal	0
Romania	7
Slovakia	5
Slovenia	2
Spain	1
Sweden	0
United Kingdom	1
Total EU	**59**
World Total	**357**

Source: United Nations Conference on Trade and Development. (2010). Latest Developments in Investor - State Dispute Settlement.

It can be seen that the vast majority of the claims (54 out of 59) have been made against newer states of the European Union. Of these, 29 have proceeded to a hearing before an arbitral tribunal with 11 having been decided in favor of the investor, 10 in favor of the state with 8 cases having been settled (UNCTAD, n.d.). These statistics reveal that the host state has been successful in approximately 50 % of the decided cases and the investor in the remaining 50%. This parallels world wide figures for the success rate of claims under bilateral investment treaties.

An analysis of the issues involved in the decided cases suggests that many of them involved cases where foreign investors had made investments in industries that had been privatized after the collapse of communism in Eastern Europe. A large majority of them (38 out of 54 cases) involved investors from other EU member countries and were brought under the bilateral investment treaty between the EU country from which the investor came and the EU country where the investment was made. The cases have involved foreign investments in media; the finance sector; telecommunications; electricity generation; a steel mill; an oil refinery; management of airport terminals and duty free outlets. The amounts awarded to successful foreign investors vary with the highest known award being some US$270 million against a host state.

This paper will argue in the following section that the European Commission is of the view that there is no need for bilateral investment treaties between member states. As noted earlier there are 191 of these. All but two are between older member states of the EU (the original 15) and the newer member states. One of the main reasons for this view is that there is potential for conflict between EU law and bilateral investment treaties.

3.0 The new EU powers to regulate foreign direct investment

Up until the coming into force of the Lisbon Treaty, power in relation to foreign direct investment matters was divided between the European Union bodies and the member states. In practice, this meant that when negotiating with third countries, the European Union would deal with matters relating to the access and establishment of firms from third countries in the EU market whereas member states continued to regulate the conditions that would apply to foreign firms once they set up business within that state. This division arose in part because of the EU’s powers in relation to the negotiation of matters related to external trade (such as trade in services and trade related investment measures) and, in part, because of the EU's authority in relation to the right of establishment and power over capital movements into and out of the EU. Subject to these overriding EU powers, member states retained the right to have their own regulations that applied to the conduct of both foreign and domestic investors within their state. Thus, the authority to negotiate investment agreements (BITs) with third countries that related to the treatment and protection of the investor once in the host state remained within the power of each EU member state.

It can be argued that Commission has long sought to extend its powers to include foreign direct investment matters. There are essentially two reasons that could be advanced for this. The first is that the Commission wanted greater powers to conclude free trade agreements that include investment provisions. The EU currently has free trade agreements with Chile, the Caribbean countries and South Korea (Dreyer, 2010). It is in the process of negotiating free trade agreements with the Mercusor countries of South America, the Gulf Cooperation Council and ASEAN (Bungenberg, 2008, p. 9) as well as several individual countries including Canada, India and Singapore. Although the Commission could conclude such free trade agreements in the past, those agreements were not able to enter into force until ratified by each of the EU member states because of the lack of EU exclusive competence in relation to treatment and protection of investors. This not only delayed the negotiation process but also led to the possibility of inconsistencies between free trade agreements and bilateral investment treaties (Bungenberg, 2008, p.13). In the years leading up to the Lisbon Treaty, the Commission became more active in relation to foreign investment regulation. In 2006, the Commission issued a document (later adopted by the Council) that set out the minimum provisions on investment for inclusion in free trade agreements (Bungenberg, 2008, p.11). This could be argued to be an attempt by the commission to establish some EU wide uniformity in foreign investment protection.

A second reason to explain the Commission's desire for control over foreign direct investment arose out of conflict between EU law and the bilateral investment treaties of member states. There have been a number of instances of this conflict. Perhaps the earliest concerns a dispute between the Commission and Austria, Finland and Sweden regarding provisions in their bilateral investment treaties that allowed foreign investors free repatriation of capital. The Commission contended that this provision was in conflict with EU laws that required an exception to the free movement of capital in cases of an emergency. The cases against Austria and Finland were decided by the ECJ in 2009 in favor of the Commission. Other examples of conflict between EU law and bilateral investment treaties have included two cases commenced by investors against Hungary and one case against Romania where the state's obligations under its bilateral investment treaties conflicted with is obligations under EU law.

The Commission originally sought to address this conflict in a note sent in 2006 by the Commission to the Economic and Financial Committee of the European Union in which the view was expressed that in a single market there was no need for bilateral investment treaties between member countries of the EU (Antell et.al. n.d.; Alexandrov et.al, n.d.). Member states were consulted at the Economic and Financial Committee of the Council concerning the Commission's view but, after such consultation, it was concluded that most member states did not share the Commission's opinion (Antell et.al. n.d.; Vis-Dunbar, 2009).

Both of these concerns have now been addressed by the Lisbon Treaty which, in Articles 206 and 207 of the Treaty on the Functioning of the European Union, gives exclusive competence to EU institutions over foreign direct investment by including foreign direct investment in the EU's common commercial policy. One commentator has noted that this may well be the most significant extension of power given to EU institutions by the Lisbon Treaty (Woolcock, 2010, p. 22).

However, foreign Direct investment policy not only includes measures for the protection of FDI but also the incentives that various countries provide to attempt to attract it and any restrictions that they might impose on certain classes of FDI or FDI generally. Accordingly if there is to be a central EU foreign investment policy, the question arises as to whether it will be confined to protection matters only or encompasses these other aspects of FDI policy as well.

4.0 The Commission's approach to the exercise of the new EU powers re FDI

The Commission has produced three documents during the course of 2010 which together give an indication of the direction it will be taking in relation to the EU's new exclusive competence on foreign direct investment (European Commission 2010(a); European Commission 2010 (b), European Commission 2010 (c). The message behind these documents is that the Commission will be taking a cautious and pragmatic approach to its new found powers.

The Commission has stated that in the longer term all of the bilateral investment treaties of the member states will be replaced by EU wide treaties (European Commission 2010 (c), p. 6 – 7). In the meantime, as a transitional arrangement, the Commission has put forward a proposal for a regulation that will have the effect of keeping in force the more than 1,000 treaties of entered into by member states (European Commission 2010 (a). However, it is made clear that member states are no longer empowered to negotiate or enter into new treaties unless empowered to do so, presumably by the Commission (European Commission 2010(b).

The Commission has indicated that the priority for the negotiation of EU wide investment agreements will take place within the context of negotiating bilateral and multilateral free trade agreements with those countries that attract most investment from EU firms. The Commission has specifically singled out the proposed agreements with Mercusor, Canada, Singapore and India as perhaps the first of the new EU wide agreements to contain investment provisions in the context of comprehensive economic and trade agreements. It has also made specific mention of China and Russia as two other individual states that are considered as priorities for EU wide investment agreements (European Commission 2010 (c), p. 7).

The Commission's statements to date have largely ignored its previous concerns about the 191 internal BITs between member states. The only reference to these is that any restrictions on capital and payments must be consistent with EU law. This signals that member countries' BITs that contain provisions contrary to this would now be overridden by EU law - at least as far as those provisions are concerned. However the broader issue of possible problems of conflicts between intra EU BITs and EU law has not been dealt with as yet.

The Commission's gradual and pragmatic approach to the replacement of the member states existing BITs and its priority for negotiations with key EU investor destination countries and regions are likely to minimize resistance from member states. Prior to the formulation of the commission's policy proposals in 2010, some observers questioned whether it would be easy to secure agreement between the European Parliament and Council on matters as contentious as foreign investment policy (Bungenberg, 2008, p.13; Dreyer, 2010). While members of the European Parliament are in theory not representing their home state, it would be naive to assume that they are not lobbied by vested interests from their own country. It has been pointed out above that there is likely to be interests within member states that opt for maintaining the status quo as much as possible rather than centralizing foreign investment policy at the EU level. The members of the Council who will decide the Council position on any legislation related to foreign investment matters will also find it difficult to avoid lobbying by interests seeking to maintain the status quo. Accordingly, the approach taken by the Commission appears to have borne these potential difficulties in mind.

However, the Commission's approach is not without problems. While its is useful to have targeted specific countries and regions for new EU wide investment protection agreements, some countries might not wish to renegotiate immediately and may decide to wait until their current treaties with individual member states expire. Consequently the possibility for yet further complications in the EU system of bilateral investment treaties exists with some member states' treaties remaining in force while others expire and are replaced by bilateral and multilateral investment treaties at the EU level.

Turning to the other aspects of foreign investment policy, it seems reasonably clear that the Commission will be confining its attention to the investment protection aspects of foreign investment policy while leaving it to member countries to continue to undertake their own investment promotion measures including the offering of incentives. There has also been no mention of harmonizing restrictions that individual member countries place on FDI.

At the present time, member states within the EU actively compete with each other for incoming investment (Guimon, 2010). They do so not only by those provisions within their bilateral investment treaties that seek to protect the foreign investor but also by offering a range of investment incentives administered by each member state. While the granting of investment incentives by member states is subject to provisions of the EU's powers regarding state aid to industry, member states are quite creative in working within the law to devise incentives to entice investors into selected industries and regions that are seen as priorities for development. While there are arguments in favour of an EU wide investment promotion agency (Guimon, 2010), it is likely that the Commission has considered that any moves to restrict the activities of investment promotion agencies within member states and any extension of EU powers in relation to investment incentives would be strongly resisted.

The Commission may also have arrived at the conclusion that some agencies within member states would also have been likely to resist attempts by Brussels to loosen restrictions that member states currently maintain in relation to foreign direct investment. Many member states currently have restrictions in place that require screening of certain classes of investment, limitations as to the extent of foreign equity in certain industries and operational requirements such as those that restrict the extent to which foreign personnel can be employed in entities in their state (Kalinova, Palerm & Thomsen, 2010). While there is a general right of establishment within the EU (which also applies to firms outside of the EU once they have a presence in one EU member state), EU member states are currently permitted to maintain restrictions in some sectors provided those restrictions can be justified on such grounds as public policy, public security and public health. The report by Kalinova, Palerm & Thomsen (2010) shows that EU member states' restrictions are minor compared to those that exist in many other countries with all EU member states being less restrictive than other major countries including the United States, Japan, Canada, Russia and China. However, restrictions that do apply are highly country specific and accordingly any attempt to harmonize them may have encountered some opposition by interests within host states that argue for their maintenance.

The most recent communication from the Commission has also taken into account the need for effective dispute resolution under international investment agreements. It has stated that dispute resolution procedures should be transparent, should promote consistency and predictability and has suggested ICSID as the appropriate forum (European Commission 2010 (c), p.10).

However the Commission's proposals here are not without some difficulties. First there is the difficulty that the use of ICSID to resolve an investment dispute requires the country of the investor be a member of ICSID. Because the EU is not a 'state' in international law then it would not be possible to have EU based bilateral investment treaties that provide for dispute resolution between investors and host states using the ICSID mechanism without an amendment of the IMF statute that governs ICSID (Bungenberg, 2008, p. 21). This would require the agreement of all parties and this may not be easy to secure. In any event, given that ICSID awards tend to be publicly available, many states might consider that some other more private mechanism for the resolution of disputes would be preferable.

Following on from this, regardless of whether ICSID arbitration or some other arbitration mechanism is used to resolve disputes, any award against the EU may well have to be paid by the EU. The question has been raised as to how the EU would then recover the money from the state where the offending action against the investor took place (De Mestral, 2010). Given that many cases in the past have involved changes in policy and given that many policy areas (such as tax policy) remain with individual EU member states, then the problem of the EU being liable for the action of host states over which it has no control may be a very real issue. In its most recent communication the Commission has noted that any award against the EU under an EU wide treaty would be the responsibility of the Commission. It has noted that recovering any damages from a member state might require reliance on currently available instruments or alternatively new legislation.

5.0 Implications for International Business of an EU wide policy

There are a number of benefits of an EU wide foreign investment policy for international businesses from outside the EU, from within the EU itself and more broadly for the global investment regime. Many of these parallel the benefits that have accrued as a result of the common trade policy.

International investors from outside of the EU wishing to do business throughout the EU area may benefit from reduced transaction costs if they need only to be familiar with the bilateral investment treaty between their home country and the EU rather than at present having to take into account the nuances of up to 27 different bilateral investment treaties that may exist between their home state and various EU member states (Hjalmroth & Westerberg, n.d., p. 27; Dreyer, 2010). A single EU wide standard of treatment would also facilitate cross border activities within the EU by international firms because, under an EU wide bilateral investment treaty with their home state, there would be one uniform standard of protection for their investments (Guimon, 2010).

Initiatives such as the EU wide public company and the forthcoming regulation to allow EU wide private companies would benefit international firms from outside of the EU to a greater extent if complemented by an EU wide foreign investment policy particularly if such a policy was able to harmonize, on an EU wide basis, the remaining individual member state restrictions that exist on foreign investment. An EU wide foreign investment policy would also avoid problems of conflicts between EU laws on the one hand and bilateral investment treaties on the other as have arisen in several cases being pursued against EU member states as noted in Section 3.

There would also be considerable benefits for international business firms headquartered in the EU. The EU has much greater negotiating power than each of its individual members and, accordingly, when new bilateral investment treaties are being negotiated it has a better chance of obtaining the best level of protection for EU firms investing abroad (Hjalmroth & Westerberg, n.d., p. 22; Bungenberg, 2008, p.14). The negotiation of new investment treaties provides the opportunity to remove inconsistencies that currently exist within the group of bilateral investment treaties that EU member states have with outside countries (Hjalmroth & Westerberg, n.d., p. 21). This creates more certainty for international business investing both from and into the EU. As noted in Section 3, the EU is also in the process of negotiating multilateral trade deals with groups of countries outside of the EU. At present each trade deal must be ratified by member states thereby delaying the process. Competence to conclude these agreements at the EU level may increase not only the EU's negotiating power in securing favorable terms in those agreements but bring them to conclusion more speedily thereby benefiting EU firms that are able to take advantage of them.

The EU itself would also benefit in a number of ways. First, there is a view that some EU firms may well be moving outside of the EU to make an investment back into the EU because of the better protections for investment that exist in the treaties that individual countries have with some external states compared to the protections that exist within the EU itself (Bungenberg, 2008, p.15). An EU wide foreign investment policy could be framed in such a way as to reduce the advantages for firms going offshore to invest back into the EU. Of course, this advantage would be even greater if a global agreement on investment regulation could be reached as discussed in more detail below.

Despite these benefits it needs to be acknowledged that there may be some costs for some multinational firms. First, international business firms that have the resources to do so are aware of the differences in investment protection that exist between countries within the EU. They are also aware of the differing levels of incentives that exist between EU member countries to attempt to attract investment into industries and regions of each country. The knowledgeable multinational firm is able to take advantage of this competition to secure benefits for itself in terms of incentives and the level of protection for its investment. Such firms may well lose these advantages if there was an EU wide foreign investment policy where each country could not use these measures to compete for foreign investment.

It has been noted in Section 4 that the time frame for bringing about an EU wide foreign investment policy is likely to be a lengthy one. However, as momentum builds towards this goal it is possible that improved chances for a global agreement on investment will arise. With European member states being party to over 50% of all international investment agreements, some countries external to the EU might see advantages in moving towards a global agreement on investment. The EU itself may also see advantages here and try to secure the agreement of other countries because reaching a global agreement may not be that big a step forward from negotiating new individual agreements with all of the EU’s trading partners.

It may also be in the interests of international business firms to support such an initiative. In a publication dealing with international investment rule making UNCTAD has noted that “there is a risk that the system eventually degenerates into an increasingly non-transparent hodgepodge of diverging rules that countries, especially capacity constrained developing countries, find more and more difficult to cope with” (UNCATD, 2008, p. 5). An unstable system of international investment regulation reduces the potential profits of multinational firms and the benefits that greater flows of foreign direct investment could bring for the global economy in terms of potential growth and increased stability.

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