

# Heading towards a battle of the BITs

## CENTRALISATION

THE EU'S LISBON TREATY HAS KICK-STARTED THE PROCESS OF CENTRALISING FDI STRATEGY, WITH IMPLICATIONS FOR THE MANY BILATERAL INVESTMENT TREATIES IN PLACE TO PROTECT EXISTING DEALS. THIS IS GOOD NEWS FOR SOME, BUT BAD FOR OTHERS, WRITES IANA DREYER

Each time a new EU treaty is signed, more decision-making powers go from the individual member states to Brussels. And, within Brussels itself, more decision-making powers go from the Council of Member States and the European Commission to the directly elected European Parliament. But these transfers of power never occur without the usual tussles as reluctant member states, emboldened commissioners, and newly empowered members of the European Parliament (MEPs) enter the power scramble.

The Lisbon Treaty – intended to make the EU ‘more democratic, more transparent and more efficient’ – has been in force for only a few months, and now it is the turn of European FDI deals to start the process of handing over power. In particular, European bilateral investment treaties (BITs), which provide for investment protection mechanisms, are becoming a point of contention.

How come? Although the EU is a single customs territory with exclusive rights to negotiate and sign international trade agreements – be it World Trade Organisation deals or bilateral free trade agreements (FTAs) – the right to sign treaties regulating foreign investment with third countries has traditionally been jealously guarded by member states. They have pursued their own policies to suit their individual economic strategies



Illustration by John Holcroft

or to maintain privileged relationships with powerful partners. But times have changed.

With the rise of challenging economic powers such as China or Russia and other crucial emerging markets, Europeans have felt the need to pool power to convince their partners to open their markets for more investment and to ensure their assets are adequately protected. For those outside the EU, it will become easier to deal with one single partner on FDI, especially in the services sector, rather than navigate 27 different entities that are supposed to be one single market, but are often a patchwork of diverging regulations.

### The implications of EU power

So, how revolutionary is this new power to sign deals on FDI? What does it mean in practice? And how are the boundaries of powers

between member states versus Brussels likely to play out when it comes to BITs in particular?

The architects of the Lisbon Treaty intended to allow the EU not only to sign investment liberalisation deals, but also so-called ‘post-establishment’ agreements regarding the protection of investments, an area already covered by BITs. The EU’s 27 member states have signed about 1700 BITs, of which about 1450 are in force.

Under the new treaty, it is likely that the process leading to a future BIT will operate in a similar way to the 2007 US-EU Open Skies agreement. Here, the EU agreement replaced and superseded all other bilateral agreements on flight rights signed between individual member states and the US. But before the Brussels machinery comes up with its own BIT, the first major challenge is to clarify the legal status of all the already-

existing BITs. For both practical and political reasons, these cannot just be brushed aside in one stroke.

The EU Commission, the body that negotiates trade deals, is drafting a proposal on how to ‘grandfather’ all of these agreements, ie: to integrate member state BITs into EU law. But this arrangement might require adjustments to certain treaties. Furthermore, the political process surrounding grandfathering will not be as straightforward as some might have hoped.

The EU Commission is likely to put conditions on treating certain BITs as compatible with EU law. In previous legal battles with Austria, Sweden and Finland, the Commission has used the European Court of Justice’s opinions to make these countries change BIT clauses or abandon BITs that allowed unlimited transfer of profits across borders.

Under EU law, special circumstances, such as a balance-of-payments crisis or financial sanctions against a third country, should permit restrictions on profit transfers. The EU Commission might dig out more clauses to make a point about compatibility with EU law. Some member states will be reluctant to let their external FDI policies be determined by Brussels and will certainly pick a fight. Some experts predict that the parties to the process might resort to the European Court of Justice to clarify Brussels versus the member states’ powers on the matter.

### Battle of the BITs

Now enter the EU Parliament. Since December last year, it has equal powers to the Council of Member States to decide on trade and investment policy. Certain MEPs, mostly on the left side of the political spectrum, have already signalled that they will want to put conditions on grandfathering BITs. Not all member state BITs cater for investor-to-state arbitration proceedings, but a growing number do. For ideological reasons, some MEPs oppose the principle of investor-to-state dispute settlement, so the matter might become politicised. Certain MEPs will insist on conditioning grandfathering on the introduction of environmental, ethical or labour clauses.

Given the still very patchy power configuration among the

different institutions under the new treaty, it is unclear how this ‘battle of the BITs’ will play out. But the track record of the European Parliament indicates that MEPs are ultimately reluctant to derail a process that involves a lot of previous consultations with the technocrats from the EU Commission across the street and the member states’ delegates. The European Parliament is not as vociferous as the US Congress, for example, on trade and investment policy. But MEPs will leave their imprint in the BIT grandfathering process.

All this means that we are still some way from seeing a model ‘EU BIT’, as some have been predicting, or an equivalent of the NAFTA (North American Free Trade Agreement) Chapter 11 and its bilateral investor-state dispute settlement mechanism, in the next EU bilateral trade agreement. The EU will move slowly. This year, at least, will be a year of legal clarification. But this does not mean nothing is moving on the FDI deal front in Brussels’ negotiations with its partners.

Investment has been sneaking in slowly in EU negotiations with external partners. When the EU gained powers in the 1990s to negotiate liberalisation of services, ‘establishment’ – or ‘investment’ to the layman – was also included. This is why the EU has been able to table offers and ask its partners to liberalise certain services in the World Trade Organisation or its FTAs.

In its latest FTAs, the EU, anticipating the Lisbon Treaty, has moved beyond services. In the Economic Partnership Agreement with the Caribbean (Cariforum), which was signed in late 2008, free investment in most non-services sectors – with a few exceptions – is the basic principle. As a general rule on establishment, the agreement prohibits numerical quotas, monopolies, exclusive rights or economics needs tests, output limitations, limitations on foreign capital participation, restrictions on branching, and forced joint-ventures.

In services, however, there are a number of exceptions, not least because many EU services sectors themselves are highly regulated. Investment liberalisation is conditioned on some ethical

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standards such as the prohibition of bribes, and subjected to a rather long list of environmental and labour clauses that apply to the entire agreement.

### The shape of things to come?

In its latest deal, the EU-South Korea FTA, which was signed in October last year, but which the member states and the European Parliament have still to ratify, very similar investment clauses apply. They are strengthened by a new dispute settlement mechanism that allows for legal arbitration to solve disputes, as opposed to the traditional recourse to bilateral diplomacy. But the agreement falls short of proposing investor-state dispute settlement, and thus does not provide the same legal bite as many US FTAs, for example.

The EU-South Korean agreement is currently being resisted in some corners of the European car industry and by some member states eager to protect jobs in the current recession. Whether and under what circumstances it will be ratified is likely to determine the Brussels Commission’s future boldness in proposing a model EU BIT or push for investor-state dispute settlement in future FTAs.

The body has high ambitions. It wishes notably to include strong investment clauses in its talks with Russia, Europe’s major challenge when it comes to investment protection. Brussels also wants to talk investment with China, and be bolder on the matter with the countries it has launched free trade deals with, namely Canada and Singapore. But it will probably not be able to advance rapidly. It will need to work step-by-step over several years. ■

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