



## What Opportunities Do the New EU International Investment Agreements Offer for Developing Countries?

### Summary

The issue of how foreign direct investment (FDI) can contribute to sustainable development processes is becoming increasingly important for many developing countries. For a long time now the issue from a development policy point of view has no longer been around how to increase the quantity of investment inflows. The quality of FDI and the contribution they make to environment-friendly and inclusive growth processes is just as important. This is accompanied by a desire on the part of many developing countries to more strongly regulate their investment inflows in order to increase their positive effects on development. This shift in focus is not just a consequence of the disillusionment that many developing countries have experienced given the minor economic benefits stemming from the liberalization of their investment regimes in the 1980s and 1990s. It is also a result of the economic success of emerging countries which frequently do not implement these recommendations for liberalization one-on-one. Furthermore the coherence of investment agreements also has to play a greater role in light of new systemic risks such as global finance and climate risks and increased interlinking between different areas of policy.

Against this backdrop, the role and substance of international investment agreements (IIA) have been subject to intense discussion in recent times. IIAs were traditionally negotiated as tools to protect from western companies' FDI in politically unstable developing countries.

This one-sided focus for IIAs is no longer appropriate today: the global investment regime is in a period of change which calls the traditional North-South logic behind IIAs into question. It is no longer just North American, European and Japanese companies that invest abroad but also their Chinese, Brazilian and Indian competitors. The need for better consideration of public and private interests in IIAs is also growing in industrialized countries as a result of the increase in reciprocal investment flows.

Against this background the European Union (EU) has implemented a far-reaching institutional reform of its Common Commercial Policy as a result of the Lisbon Treaty: negotiating European IIAs now falls under the overall competency of the EU and no longer just the Member States.

This merging of trade and investment policy making at EU level provides new starting points for future IIAs to be drafted in a more development-friendly manner. Development policy actors should pay greater attention to this policy area in order to increase the potential for FDI to promote sustainable development processes. The formal options for pressing for greater coherence between investment and development policy have increased as a result of Lisbon. In order to use this room to manoeuvre more effectively developing countries need additional support to increase their negotiating capacities.

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The Lisbon Treaty, which came into force on 1st December 2009, brought an expansion of the EU's Common Commercial Policy to include FDI. Article 207 of the Treaty on the Functioning of the European Union (TFEU) stipulates that the overall responsibility for entering into trade and investment agreements now lies with Brussels. The impact of this reform of the Common Commercial Policy on third countries and on developing countries in particular has up to now largely been ignored in the political and academic debate. This brief discusses how developing countries will be affected by the EU's new international investment policy and what policy recommendations can be deduced for German and European development policy.

### Developing countries and the international investment regime

FDIs are protected by a dense network of more than 3,000 IIAs which are mostly bilateral. The EU is one of the central actors in the global IIA system. The 27 Member States of the EU have entered into more than 1,100 bilateral IIAs. The first agreement was signed by Germany and Pakistan in 1959. During the period of decolonization and the controversial debate on a New World Economic Order within the United Nations, foreign investors were no longer able to rely on traditional international customary law protection. IIAs were intended to fill this gap. Against the backdrop of this historical constellation, industrialized countries entered into IIAs with developing countries that established comprehensive protection standards for foreign investors and provided them with the option to sue host countries before transnational arbitration courts.

This one-sided focus for IIAs as tools for promoting foreign investments must be subject to critical assessment from a development-policy perspective. Such a narrow historically-rooted understanding of IIAs is no longer appropriate in today's era of globalization and interdependence of different policy areas. IIAs are certainly first and foremost a tool for protecting investment flows to developing countries. More recent econometric studies have shown that establishing a transnational and binding legal framework through IIAs can lead to increased FDI inflows. However, IIAs are only one determining factor among many that influence the volume and direction of investment flows. Furthermore IIAs limit the scope for host countries in implementing regulatory measures that are intended to encourage the contribution that FDI makes to environment-friendly and inclusive growth processes. Furthermore, the financial transfer clauses contained in IIAs can limit the scope for host countries in the event of acute macroeconomic crises.

This limitation of host countries' policy space is of course intentional to a certain degree in order to encourage investments. However, the large number of investor-state dispute settlement proceedings over the last decade show that the standards contained in IIAs, which are often formulated vaguely and in an open-ended manner, are inter-

preted very widely by transnational arbitration tribunals. One example is the principle of fair and equitable treatment. This IIA standard clause allows foreign investors to make a claim against virtually any political measure adopted by the host country, including those that are taken in the public interest. It is not surprising therefore that a large number of claims from foreign investors before transnational arbitration courts are based on this broad standard.

Against this background a lively debate has arisen in recent years on a new focus for IIAs. A series of claims from foreign investors against members of the North American Free Trade Agreement (NAFTA) have prompted them to specify investment standards in greater detail in order to prevent regulations in the public interest from being interpreted widely as "creeping expropriation". Australia even goes as far as to ban arbitration clauses from IIAs completely and refers investment disputes to national courts. Alarmed at claims brought against the *black economic empowerment* policy enshrined in its constitution, South Africa has introduced a renunciation of liberal IIAs. There have been similar developments in India and Latin America.

This dynamic in international investment law points to the fact that many countries are searching for a rebalancing of the private interests of investors and the public interests of host countries. Even international organizations such as the United Nations Conference on Trade and Development (UNCTAD) have called for IIAs to be drafted in a more development-friendly manner for quite some time.

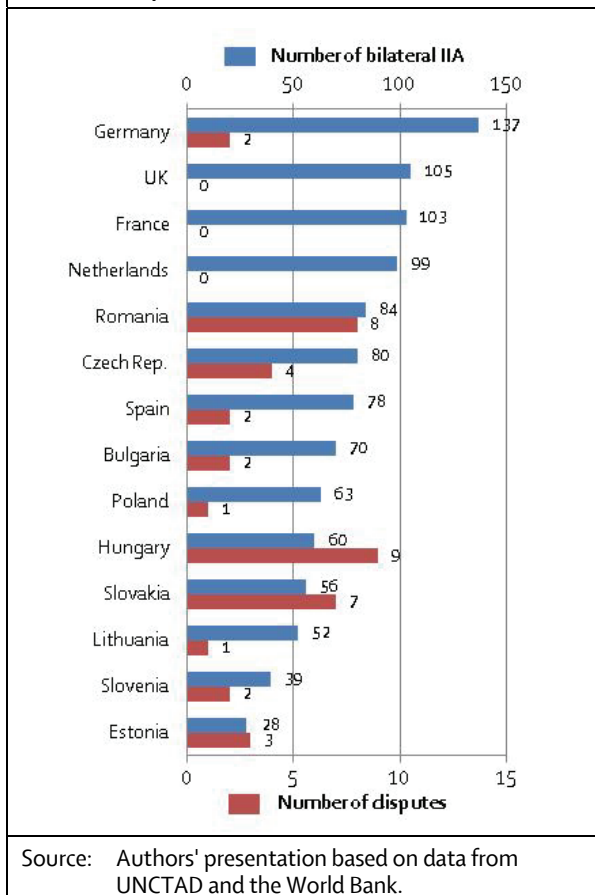
### The EU's new international investment policy

With the Lisbon Treaty this dynamic now also includes the EU, with a dual shift in competencies which is significant from a development policy point of view: firstly, by including direct investments in the Common Commercial Policy, Article 207 TFEU leads to a vertical shift in competencies which has far-reaching consequences. Any future IIAs which are negotiated on behalf of the EU or by an individual Member State fall within the requirement to comply with Article 21 of the Treaty on European Union (TEU). This article requires that the external actions of the EU should *inter alia* encourage sustainable development in developing countries with the aim of reducing poverty. The bilateral IIA policies of the Member States did not have a normative reference framework of this kind before Lisbon.

Secondly, there is a horizontal extension in competencies that leads to a more important legislative role of the European Parliament. The "ordinary legislative procedure" now also applies to the Common Commercial Policy. It is no longer just the European Council which decides on the adoption of legal acts and trade and investment agreements as a representative of the Member States, but ultimately the European Parliament in the final instance. As a result of this formal role it is expected that the Parliament will also have a greater influence on ongoing negotiations

for IIAs and will push for these agreements to be drafted in a more development-friendly manner in accordance with Article 21 TEU. This has already become clear over the past two years in the discussion on the "Regulation establishing transitional arrangements for bilateral investment agreements between Member States and third countries".

**Figure 1: Number of bilateral IIAs and proceedings for dispute resolution for selected EU Member States**



An intensive and controversial debate on the institutional design of international investment policy in the EU has developed with the entry into force of the Lisbon Treaty. As is so often the case, the EU's forces were absorbed first of all in the issue of how to redefine the balance between the Commission, Council and Parliament. Issues related to designing the actual content of policies only arose later. The primary goal was to create legal certainty for European investors. Hence, the issue of how to proceed with the existing IIAs of the Member States was at the centre of this debate.

The compromise found in the meantime of the Transitional Regulation mentioned above states that the Member State agreements will remain in force and should only be superseded by EU IIAs gradually. Furthermore the Transitional Regulation provides that Member States may also continue to negotiate bilateral IIAs with the Commission's approval. These agreements must be compatible with EU law and must therefore comply with Article 21 TEU. Entering into bilateral IIAs is particularly important for Member States

that, unlike countries such as Germany and the Netherlands, have not yet set up a comprehensive IIA network (blue bars in Figure 1). As a result it can be expected that the EU will negotiate trade and investment agreements over the next few years first and foremost with countries which are important economically, such as Canada, Singapore, India and China. In parallel, the Member States will conclude bilateral IIAs with less developed countries which nevertheless will have to comply with EU law.

### Implications for developing countries

The restructuring of the Common Commercial Policy already mentioned has the following implications for developing countries and development policy making: firstly, with the Lisbon Treaty international investment policy making reaches the multi-level governance system of the EU. If IIAs were often negotiated by Member States before Lisbon as purely technocratic tools with the public predominantly excluded, the debate has now become politicized. The European Parliament has an important and pivotal role in this regard in bringing the interests of the stakeholders in development policy into the political process.

Secondly, the opportunities for a more consistent investment policy have increased with the restructuring of the Common Commercial Policy. Investment rules will mainly be negotiated as part of free-trade agreements in future. Debates on encouraging FDI by industrialized countries, improving the negotiating capacities and *special and differential treatment*, which have shaped the trade policy discourse in a similar form for decades, may also make their way into investment policy. The free-trade agreement between the EU and the Caribbean countries (CARIFORUM) is a step in this direction. These tentative steps towards integrating development policy needs in trade and investment agreements are significant, particularly when measured against existing IIA practices of Member States.

Thirdly, in the discussion in the European Council the interests of the traditional exporters of FDI such as Germany and the Netherlands will be balanced with those of eastern European importers of FDI. Eastern European countries already had painful experiences as a result of several disputes with foreign investors (red bars in Figure 1). A balanced international investment policy also appears to be in the interests of the European Commission, which favours a policy similar to that adopted by NAFTA countries. This rebalancing will also have a positive impact on developing countries due to the reciprocal nature of IIA's provisions and will in turn expand their policy space.

Fourthly, developing countries can also benefit in future from a more uniform international investment policy, as they now only need to negotiate one agreement which applies to all 27 Member States of the EU. This centralization on the part of the EU spares the negotiating capacities of the developing countries. However, this burden will only be relieved in a few years

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as the negotiations with industrialized and emerging nations are the current priority for the EU.

There are also challenges surrounding the options for drafting EU IIAs in a more development-friendly manner. On the one hand the power asymmetry is greater where developing countries negotiate with the EU directly rather than with just one Member State. The current debate around the Transitional Regulation has shown that the traditional exporters of FDI among the Member States are pushing for high protection standards to be adopted in future EU IIAs. It is important to bring the legitimate interests of European companies in having effective legal protection in developing countries in line with the interests of the host countries. Balancing the interests in this way does not have to be a zero-sum game. One example of this would be exempting speculative short-term investment flows from the list of investment forms protected by IIAs. European companies that are interested in a long-term investment could still rely on comprehensive legal protection with an investment definition of this kind. A further example is the adoption of provisions for the promotion of investments which would benefit both investors as well as the host countries. Reference to sustainability standards such as the OECD Guidelines for Multinational Enterprises could also be an important innovation. By participating in a large number of multi-stakeholder forums which develop such standards, European companies are showing that they are no longer solely insisting on their rights but are also accepting the responsibilities they have towards the host countries.

Integrating market access clauses in future EU IIAs presents an additional challenge. Empirical studies have shown that these types of clauses are particularly suited to encouraging investment flows into developing countries within the

framework of free-trade agreements. However, with this host countries give up their rights to regulate access to FDI with this. It is important for the host countries to consider precisely which sectors should be opened up in view of national development strategies.

### Recommendations for development policy

The EU's new international investment policy presents new challenges for development policy actors who have paid little attention to this policy area in the past. Development ministries in the Member States along with the Directorate-General Development and Cooperation-EuropeAid should press for a more consistent international investment policy on the level of the Member States and the EU. The formal possibilities for this were improved in the Lisbon Treaty, but these can only be used where they are combined with concrete proposals for drafting IIAs in a development-friendly manner.

The departure from pure protection agreements as described above means that negotiating IIAs with the EU have become more complex. Developing countries require support on how to draft IIA with the EU in a more development-friendly manner. Funds should increasingly be made available via multilateral organizations such as UNCTAD in view of the lack of capacities among European donors in this policy area.

Beyond influencing the EU's new international investment policy, European donors should search out to their partners in emerging countries such as South Africa, India and China. Trilateral cooperation projects lend themselves to providing support for developing countries in view of the increasing importance of the emerging countries' outward FDI, and the large number of south-south IIAs that they enter into with other developing countries.

### Literature

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