**Institute for International Economic Policy Working Paper Series**
**Elliott School of International Affairs**
**The George Washington University**

# Trade Imbalance: Juggling the Needs of Investors and the Public Interest in TTIP

**IIEP-WP-2014-8**

**Susan Ariel Aaronson**
**George Washington University**

**Rob Maxim**
**George Washington University**

**June 2014**

Institute for International Economic Policy
1957 E St. NW, Suite 502
Voice: (202) 994-5320
Fax: (202) 994-5477
Email: **iiep@gwu.edu**
Web: **www.gwu.edu/~iiep**

<u>Trade Imbalance: Juggling the Needs of Investors and the Public Interest in TTIP</u>

By Susan Aaronson, Ph.D., and Rob Maxim, GWU[1]

Albert Einstein taught us that insanity means "doing the same thing over again and expecting different results." Although investor-state provisions have become increasingly controversial in both the US and the EU, the two trade behemoths plan to include such provisions as they negotiate a free trade agreement (the Trans-Atlantic Trade Agreement, or TTIP) in Washington DC this week. They argue that such provisions will encourage investment across the pond and enable TTIP to serve both as a building block, as well as the "gold standard," for other agreements.

Because governments compete for investment, policymakers vie to create an investment friendly environment. Governments enter into investment agreements to reassure investors that their rights will be protected if the government expropriates a property or takes regulatory or budgetary actions that effectively reduce the value of an investment. Investor-state provisions allow investors to challenge and seek compensation for, such actions. Investors are allowed to jump over the domestic legal system, and seek arbitration by a panel of three independent arbitrators. Hence, investor-state provisions make perfect sense when the host country has an ineffective or corrupt judiciary. But it is unwise to include these provisions in a free trade agreement among the US and the 28 nations of the EU. The EU and the US have transparent, effective legal systems with lots of experience adjudicating issues of investor protection.

Moreover, investor-state provisions can have unanticipated side effects for the rule of law. In Europe, Canada, Mexico, and the United States, foreign investors are increasingly taking advantage of these provisions to challenge budgetary or regulatory decisions that could reduce the value of their investments. In these cases, investors have argued that governmental actions are the equivalent of indirect expropriations or regulatory takings. As a result, some critics see investor-state disputes as a covert means of undermining democracy. Moreover, these detractors note that these provisions provide foreign investors with rights that domestic investors don't have.

In 1997, the US company Ethyl sued Canada under NAFTA's investment provisions, arguing that Canadian restrictions on a gasoline additive called MMT

---

[1] Susan Ariel Aaronson is Associate Research Professor, GWU and the Minerva Chair at the National War College. Rob Maxim is Research Associate, Global Economic Governance Project, GWU.

were the equivalent of an indirect expropriation. The Canadian government justified the restriction because scientific studies had shown that burning MMT posed a risk of nerve and brain damage in humans, especially in children. Meanwhile, the province of Alberta sued the Canadian federal government through the country's domestic legal system, and a Canadian federal-provincial dispute settlement panel ruled that the restriction violated Canadian law. Soon thereafter, Canada and Ethyl settled the claim. The Canadian government withdrew its restrictions on MMT, issued a statement that MMT did not pose a health threat, and then paid US$13 million in compensation to cover Ethyl's arbitration costs. The Canadian example shows that domestic courts can and do balance investor interests with the public interest.

In recent years investors have also used IIAs to challenge government environmental regulations, anti-smoking laws, and financial crisis policies as the equivalent of expropriations. When foreign investors bypass domestic court systems that are widely seen as effective, transparent, and legitimate, they can undermine the rule of law. Yet according to both the US Government and the European Commission, trade agreements are supposed to enhance the rule of law and make the policy environment more predictable.

US and EU negotiators should reconsider the investment provisions in TTIP, making it clear that firms should not be allowed to challenge budgetary or regulatory decisions as expropriations. Moreover, investors should rely on domestic courts rather than arbitral bodies to challenge what they see as expropriations and to receive compensation. All investor-state disputes and decisions should be made public; and the agreement should set reasonable time limits as to when investors can make claims (e.g. up to 18 months after an expropriation).

US and EU negotiators know that in the real world, no one size fits all. While investor-state provisions don't belong in TTIP, those provisions may well belong in other investment agreements. Nonetheless, in a world where nations compete for investment, policymakers must carefully balance the needs of investors with the public interest. To do otherwise would be crazy.