Why true free traders should push for a TTIP without investment protection

Sebastian Dullien is professor at HTW Berlin – University of Applied Sciences and Senior Policy Fellow at the European Council on Foreign Relations

Much has been written about the potential benefits of the transatlantic trade and investment partnership (TTIP) under negotiation at the moment. In Brussels circles, TTIP has long been hailed as a potential means to boost European growth in times of deep crisis and austerity without having to spend any additional euro from European or national budgets.

Opponents have rallied against TTIP. Civil society organisations have called the treaty a 'corporate power grab' and have started to mobilise resistance, which has resulted in more than 100,000 critical contributions to the public consultation process from citizens. According to some of the critics, TTIP will destroy jobs, lower incomes, and tie the hands of elected governments in regulate health, labour, and environmental standards – in fact, it will create a race-to-the bottom.

Upon closer examination, both positions are distorting the truth. Speakers from the European Commission often add up the potential benefits of TTIP over the 'working life of an average household' in order to make the economic benefits look impressive. What is in effect quite a marginal increase in annual per capita GDP, 0.3 percent (in the case of the EU, this would amount to about €100 annually), can easily turn into a much more impressive €10,000 or greater, if one looks at a household of four and several decades of potential working history.

Civil society also overstates the anti-TTIP case. The rare studies that actually foresee a large number of jobs being destroyed or a drop in income rely on very specific assumptions and economic models and should be treated as outliers. Some safety regulations and standards from the United States are even superior to European standards. There is no indication that the harmonisation of standards would lead to a race-to-the bottom in European consumer protection.

However, the NGOs have a point when it comes to the hotly disputed investment protection provisions and the so-called investor-state-dispute settlement (ISDS) which is supposed to be included in the treaty. Some of the existing ISDS provisions in other treaties are so outrageous that it is easy to understand the claims of a 'corporate power grab'. ISDS usually allows companies to sue a government for compensation if they feel that they have been directly or indirectly expropriated. 'Indirect expropriation' can include all kinds of regulations that hurt a company's expected profits. Companies can usually sue without having to first go through the national court system.

Disputes are then decided by international arbitration panels. The dispute process is often criticised because panels are put together in an ad hoc fashion and it is possible for a panel member to have (quite recently) worked as a lawyer for the company concerned, or that s/he will represent the company shortly after the panel has ruled. And under many treaties, appeals are not allowed.

Also, ISDS provisions can create an uneven playing field between national and international corporations and can put small- and medium-sized companies at a disadvantage. Under ISDS provisions, international companies can resort to more advantageous international arbitration rules, while nationally owned companies have to go through the national court systems. Moreover, the legal cost of bringing a suit before international arbitration panels can easily run into millions of dollars, so they are not really an option for small- and medium-sized companies involved in a dispute about their (usually) small-scale investment.

Most ISDS provisions, while calling for 'fair and equitable treatment' for investors, do not define what a legitimate public interest is. Therefore, the panels are allowed a broad interpretation of when 'fair and equitable treatment' of an international investor is violated.

A number of recent cases have made headlines because they are seen as examples of a government's legitimate policy space to regulate being constrained. One prominent case is the suit brought by the tobacco company, Philip Morris, against the Australian government, which passed a law in 2011 banning the use of tobacco logos on cigarette packets. Philip Morris has also sued the Uruguayan government under a separate investment protection treaty after Uruguay increased the size of health warnings legally required on cigarette packaging.

Critics of the ISDS system claim that even if awards in favour of big corporations are not granted, policymakers' fear of them can lead to 'regulatory freeze'. As an example, they cite New Zealand, which ditched plans to follow Australia in limiting tobacco logos on cigarette packages after Philip Morris claimed damages against the Australian government.

It is often claimed that all these issues could be remedied by wording ISDS provisions carefully, by making procedures more transparent, and by changing the rules for panel appointments and proceedings. However, it is highly questionable whether such measures could really solve the problem.

The Canada-EU Comprehensive Economic and Trade Agreement (CETA), for example, is often referred to as a potential blueprint for TTIP rules. But CETA still defines investment very broadly, including bonds and bank deposits in the definition. Including these instruments risks severely limiting policy space in the future. For instance, if bonds were included in investment protection provisions, debt restructuring like that involving Greece in 2012 would be problematic, even if the agreement tries to carve out exceptions for orderly debt restructuring.

Even an agreement like CETA does not create firm and clearly defined rules that strike a balance between the interests of investors and the host country's legitimate interest in public regulation. Instead, CETA relies on a broad 'fair and equitable treatment' clause.

As compared to national law, provisions in recent treaties still tilt the balance of power away from governments and towards global corporations. For example, the German constitution includes a clause protecting private property. In cases of expropriation, the constitution calls for compensation. This compensation must take into account the private owner's interest as well as society's legitimate interests. The compensation principle in CETA is different: under the treaty, compensation is set based on the market value of lost profits – which constitutes an absolute investor protection without any concern for the public interest.

Of course, in principle, one could reform these rules further to make them closer to something that could be sold to the general population as being fair and compatible with democracy as they know it. The German minister of economics and chairman of the Social Democratic Party, Sigmar Gabriel, has introduced a proposal calling for setting up a formal 'investment court' with a permanent secretariat, professionalised judges, and the potential for appeal.

However, it is not clear whether these ideas can be implemented in practice and especially whether they could be realised in time to get TTIP through the US Congress before the start of the next

"True free-traders should be able to see the political limitations of ISDS and, therefore, should aim for what is feasible – a limited TTIP with all tariffs removed and some harmonisation of standards, leaving open the potential for more in the future"

presidential election campaign. First, what constitutes a justified regulatory step (one that would not warrant compensation even if an investor's profits were hit) would have to be defined in detail. To date, this has never been done. Secondly, investment protection treaties are extremely complicated legal documents. It can easily happen (and it has often happened in the past) that wording slips through that later allows clever corporate lawyers to exploit a well-intentioned treaty. And unlike national law (in which things like this also happen regularly), a treaty cannot be easily changed by a vote of parliament.

At the same time, it would be a pity to see TTIP failing completely or being delayed indefinitely. While the overall effects of any conceivable transatlantic trade agreement are rather small, they might be substantial for single countries and single sectors. It is true that average tariffs in transatlantic trade are below 3 percent. Yet, due to their very different economic and export structures, some EU countries face very high tariffs on their top exports.

For example, while tariffs on Bulgaria's top exports to the US – mainly tobacco – average more than 10 percent, tariffs on Luxembourg's average a mere 0.28 percent. Even between countries with similar per capita incomes, existing rates of tariffs are quite different: while tariffs on France's exports average 0.69 percent, tariffs on Germany's average 1.65 percent; whereas tariffs on Portugal's exports (which include bed linen, on which

there are tariffs of up to 20 percent) average 4.62 percent, tariffs on Slovenia's exports average only 0.66. Abandoning TTIP completely would mean preventing some of the crisis countries from gaining a much-needed export boost through higher sales to the US.

The logical solution would be to give in to the NGOs and ditch the ISDS provisions from the TTIP negotiations. It could always be revisited later by negotiating a bilateral – or even multilateral – investment protection agreement with sensible rules, setting up a standing international court for investor-state-disputes.

This strategy would also make sense because the actual economic effects from including ISDS into TTIP can be expected to be very close to zero. Economic literature struggles to find any significant effect of investment protection treaties on actual investment flows. In the case of transatlantic investment flows, the effects can also be expected to be extremely low to non-existent because of the fact that in both the EU and the US, the rule of law is strong and the judiciary is independent – so that most experts reckon that they really do not need investment protection between them.

One argument made by proponents of including ISDS in TTIP is that it would improve the bargaining position with regard to China, which so far has been very careful on the wording of investment protection treaties that it is prepared to sign. However, this argument is not entirely convincing. Why should China change its position of carefully protecting its own economic interest before signing an investment protection treaty just because the US and the EU have signed a bilateral deal?

Free-traders in Brussels are also voicing concern that giving in to NGOs' demands of scrapping ISDS in the transatlantic negotiations would hand them an easy victory and just give them an incentive to move on to fight against the next aspect of TTIP, until they have succeeded in dismantling the entire negotiation process. According to this narrative, it is better to hold the ground on ISDS and only budge as a final option.

This political economy argument seems questionable, though. There are real, not just perceived problems with ISDS. Simply trying to ignore the NGOs' concerns will not convince the public once it has been alarmed. Including ISDS in the treaty negotiation guarantees a permanent rallying point for NGOs. Already, the inclusion of ISDS in the TTIP negotiations has caused a public outcry never experienced in Europe before in the discussion of any trade agreement. It is safe to assume that, had TTIP been limited to the removal of tariffs and other conventional trade barriers, only a very small share of the population would even know what TTIP is.

To put it more bluntly: if you are against transatlantic free trade, the best way to prevent significant liberalisation is to insist on the inclusion of ISDS in a TTIP agreement as a sine-qua-non. True free-traders should be able to see the political limitations of ISDS and, therefore, should aim for what is feasible – a limited TTIP with all tariffs removed and some harmonisation of standards, leaving open the potential for more in the future. ■