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Canada–European Union Trade Negotiations
5. Investment Protection

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Canada–European Union Trade Negotiations:
5. Investment Protection

(In Brief)

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CANADA–EUROPEAN UNION TRADE NEGOTIATIONS: 5. INVESTMENT PROTECTION

1 INTRODUCTION

While negotiations for a Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union (EU) cover more than 20 subject areas, there are nine of particular interest to Canadians and their EU counterparts. These nine topics are the most sensitive or difficult negotiating issues, or the source of the greatest estimated impacts should CETA negotiations succeed, or the areas of the more controversial elements. This paper discusses investment protection.[1]

2 CANADA–EUROPEAN UNION INVESTMENT RELATIONSHIP

Canada's economic relationship with the EU is weighted heavily towards foreign direct investment (FDI). The EU is Canada's second-largest trading partner both in goods and in services, and is also Canada's second-largest source of, and destination for, FDI. However, the EU accounts for a far greater share of Canadian direct investment – both inbound and outbound – than it does of Canada's trade in goods or services. In 2009, the EU accounted for 8.3% of Canada's total merchandise exports and 12.4% of merchandise imports. The EU's share of Canada's total service trade was higher, with 18% of Canada's total service exports going to the EU in 2008 (the most recent year for which data are available) and 17% of Canada's total service imports coming from EU countries. In terms of FDI, however, 25% of the total stock of Canadian direct investment around the world was located in the EU in 2009, while EU countries were the source of 30% of all FDI in Canada.[2]

One reason why direct investment is an important aspect of the Canada–EU economic relationship is that FDI can be an effective way to circumvent some of the tariff and non-tariff barriers that inhibit trade between the two economies. In some cases, Canadian companies have found it easier to establish direct operations in the EU than to produce goods in Canada and ship them across the Atlantic Ocean.

3 NEGOTIATION ISSUES

Although successful CETA negotiations would likely erode some of the barriers to trade that motivate direct investment between Canada and the EU, an agreement could also result in increased investment between the two economies. In particular, removing some of the barriers to investment or providing greater investment security could create an incentive for EU businesses to increase their investment in Canada. Establishing operations in Canada allows EU businesses to meet the rules-of-origin requirements in the North American Free Trade Agreement (NAFTA) and to gain enhanced access to the US market.

The CETA is widely expected to include a chapter on investor rights. Canada's CETA negotiators have submitted a proposal to their EU counterparts, which likely follows the same template used in most of Canada's free trade agreements and Foreign

Investment Promotion and Protection Agreements (FIPAs, known as bilateral investment treaties [BITs] in most countries). Although there has been some evolution in content over the years, nearly all of Canada's free trade agreements, and all of its FIPAs, have wording and a structure similar to Chapter 11 of the NAFTA.

The purpose of an investment chapter in trade liberalization agreements is to provide foreign investors with protection against discriminatory treatment in the host country. In addition, investors are protected against the nationalization or expropriation of their assets, directly or indirectly, and are entitled to compensation should such expropriation take place. In case of a dispute over a government policy or action, an investor may make a claim against the government of the host country. In such cases, the dispute is settled by the trade agreement's dispute-settlement mechanism rather than by the domestic legal system.

Indirect expropriation is one of the most controversial elements of trade agreements that cover investment. Indirect expropriation is defined as "a measure or series of measures … that have an effect equivalent to direct expropriation without formal transfer of title or outright seizure."[3] This definition has been interpreted by some to mean that foreign companies can sue governments that implement policies or legislation that limit corporate profits. Canada's investment protection chapters have evolved in response to this criticism; for example, Annex 811 of the Canada–Colombia Free Trade Agreement explicitly states that "the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred." [4]

The EU does not always include investment protection provisions in its trade agreements. Its 2008 Economic Partnership Agreement with the CARIFORUM states[5] includes an investment chapter, but its recently signed agreement with South Korea does not.

The primary benefit of investment protection provisions in trade agreements is creating greater certainty and stability for investors in foreign countries. This need for certainty and stability is typically a concern when signing agreements with developing countries, where an unstable or underdeveloped domestic legal or regulatory environment may discourage foreign investors from entering that market. All of Canada's free trade agreements with developing countries contain investment chapters, and its FIPAs are signed exclusively with developing countries. By contrast, Canada's free trade agreements with developed countries – the European Free Trade Association (Norway, Switzerland, Iceland and Liechtenstein) and Israel – do not contain investment chapters. In the one exception to this rule – the NAFTA – the original intent of Chapter 11 was to provide Canadian and US investors with some certainty when investing in Mexico.

Canada undoubtedly prefers to include an investment chapter in the CETA to create a stable investment climate for Canadian investors in EU-member countries that are less developed. The need for investment protection provisions in countries like Germany or France is relatively low, but with such provisions in place, Canadian investors may be more confident and may seek opportunities in newer EU member states, such as Poland, Romania, Bulgaria and Hungary.

NOTES

1. Other subjects covered in this series are market access in agriculture, non-agricultural market access, trade in services, government procurement, technical barriers to trade and regulatory cooperation, intellectual property protection, labour mobility and dispute settlement.

2. Statistics Canada, "Canadian Direct Investment Abroad (Stocks)," Table 376-0051, CANSIM database, April 2010, Reproduced at Foreign Affairs and International Trade Canada, *Foreign Direct Investment Statistics*, "Outward stocks by country," Ottawa, 2010.

3. Foreign Affairs and International Trade Canada, "Annex 811 Indirect Expropriation," *Canada–Colombia Free Trade Agreement*, Ottawa, 2008.

4. Ibid.

5. The member states of CARIFORUM are Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, the Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago.