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FOREIGN DIRECT INVESTMENTS IN EUROPEAN UNION ECONOMY

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Abstract *The European Union continues to be an important source and destination of foreign direct investment (FDI) in the world measured by flows and stocks. Investment is part of the EU's common commercial policy, because FDI is one of the vehicles through which each country can develop its industries. The EU's investment policy is focused on providing EU investors and investments with market access and with legal certainty and a stable, predictable, fair and properly regulated environment in which to conduct their business. The paper also provides a synthetic approach to investor-state arbitration in the Transatlantic Trade and Investment Partnership (TTIP) and Canada-EU Comprehensive Economic and Trade Agreement (CETA).*

Key words:
EU, FDI, policy measures, ISDS, TTIP, CETA

JEL Codes:
F23, F13, F38, F55

Introduction

The role of the foreign direct investment (FDI) is to transfer capital from a country to another in order to perform an economic activity in the latter. The aim of this movement is to exercise a form of *control*, more precisely to have an *impact on business decisions*. An important *source and destination* of FDI, measured by flows and stocks, was and continues to be the European Union (EU).

This transfer of capital is being supported by EU because of the positive consequences, namely economic growth, jobs creation and reducing poverty. FDI triggers the creation of new companies, new jobs both locally and abroad and also it establishes *global supply chains*. The investor has the power to decide the production location for goods and services and these decisions influence to a great extent trade, jobs and capital movements. As investment and trade are mutually dependent and counterbalancing, almost half of world trade is carried out between associates of transnational corporations (TNC) that exchange intermediate goods and services.

1. EU as host and home for FDI

In the present, BRICS economies have the leading position as the world's most important recipient of FDI, position that used to be occupied by EU. In the early 2000s, the countries of the EU were responsible for 50percent of *global FDI inflows*, whereas now the share has been reduced to less than *20 percent in 2013* (apart from intra-EU flows).

Subsequent to the global financial and economic crisis, EU FDI is now recovering.

In 2013, EU-28 outward flows were 34percent higher than EU-27 flows in 2012. In the same way, EU-28 inward flows were 12 percent above EU-27 flows in the previous year.

2013 proved to be a record year for European FDI, with the number of inward investment decisions amounting to 3,955 projects (+5 percent gain over 2012) creating 166 300 jobs (-2 percent compared with 2012).

If prior to the crisis, a FDI project created 60 jobs per project, in 2013 a similar project created only 42 jobs. Despite the fact that FDI projects reached an all-time high, however job creation could not keep up with them.

As far as EU is concerned, most of the FDI represents *a transfer of capital between EU member countries. Investment into the EU* triggers a large number of advantages such as: creating jobs, making the best out of resource distribution, transferring technology and skills, growing competition and enhancing trade. This accounts for the countries desperate *efforts to draw foreign investment*.

The fact that there is a tendency to *integrate further capital, deregulate international capital transfer and decrease transport and communication expenses,* had an impact on the companies relocation of production locally as well as abroad. Investing in a foreign country outside the EU (outward FDI) means a transfer of *economic activities towards foreign locations with the* *purpose of reducing costs, improving market access or for strategic reasons.*

Outward FDI leads to an increase of productivity, which represents a constructive and important input to the competitiveness of European companies. EU companies have struggled to establish or purchase companies outside the EU (outward FDI). Given the fact that outward FDI flows are irregular and unstable, the EU outward FDI stock is used as the most important means of EU companies' investment activities outside the EU.

In 2013, the stock of EU27 outward FDI in non-EU countries reached to USD 10.6 trillion. Investments into the EU have also increased. The stock of FDI into the EU by non-EU investors reached USD 8.6 trillion in 2013, and, as a consequence, the EU has become a net capital exporter in relation to the other nations worldwide.

Table 1. FDI flows and stocks for EU, in 2013

Indicators	Millions USD	Percent of world
FDI Inward (into the EU)	246,207	17
FDI Outward (EU to the rest of the world)	250,460	18
FDI Inward stock	8,582,673	34
FDI Outward stock	10,616,765	40

Source: *UNCTAD (2014), World Investment Report, Investing in the SDGs: An Action Plan, available on http://unctad.org/*

Even though there has been an increase of the number of investments coming from non-EU countries, however, more *than 60 percent of total inward FDI flows into European countries are intra-EU investments.*

Intra-EU investments have recorded a faster evolution in comparison with outward FDI. *Investments within the EU* have increased much more rapidly than investments performed by EU firms outside the EU, and *cross-border investments within the EU* have recorded a much higher level than outward FDI. EU outward FDI comes largely from developed countries such as the United Kingdom, France, Germany or the Netherlands.

Thanks to their economic dimension, the large countries are *large investors*. The investments corresponding to domestic GDP (stock of outward FDI relative to GDP) could thus be a more suitable indicator of which EU countries perform the most investments. If the economic size of a country is considered, the *United Kingdom* still proves to be one of the *most important outward investors*. As well as that, smaller countries, such as the *Netherlands, Luxemburg, Cyprus, Ireland, Sweden and Denmark* have outward investments which go beyond 20 percent of their GDP.

Both high and low-wage countries are aimed by EU outward FDI. EU outward FDI is mostly sent towards *North America* and *other European countries* not in the EU such as Switzerland or Norway. In comparison with *Africa*, the stock of EU outward FDI to *India and China* is much reduced. This was unexpected as there were concerns that EU jobs are moving to Asia as a result of their low wages. The low level of *European FDI in Asia* may have at least two possible reasons.

On the one hand, EU countries have been investing in *more advanced countries* such as North America for a longer time whereas EU outward FDI to Asia is in its early stages. Therefore, in order to make an impression over the situation, it takes some time. It is worth mentioning the fact that EU represents the main foreign investor in most of the Asian countries.

On the other hand, the *EU outward FDI stock measures the result of accumulated net capital flows and not job relocations.* Starting to import labour-intensive intermediate goods produced in China might be expensive in terms of jobs lost but might not be very capital demanding. In this case, a small raise in the outward FDI stock will thus lead to large labour market impacts. Nevertheless, establishing a foreign affiliate in the United States might be very expensive in terms of capital whereas the relocation of jobs might be insignificant. This will be the case if the investment is motivated by a desire to access the American markets in which case the foreign establishment might be a sales office rather than a production site.

The available information with respect to what *EU companies actually invest* in when they carry out outward FDI is very little. More data is provided with respect to the sectors in which EU companies invest in. Financial intermediation represents one of the preferences. In that case, *financial holding companies, insurance companies and pension funding firms* purchase shares in foreign companies just for investment purposes.

This type of outward FDI has a different impact on the home economy than the outward FDI by EU companies which *transfer or copy part of their production overseas*. This latter type is expected to lead to a greater *EU competitiveness and productivity*. There is not a clear picture of the various types of investments performed by EU companies due to the lack of available outward FDI information.

The Eurostat study gives an account of international sourcing activities of EU companies and covers the relocation abroad of functions that used to be served at home. *EU companies source internationally in two ways*:

- EU companies source activities to foreign associates *set up or acquired abroad*. This is known as international *insourcing* and is no different from outward FDI.

- EU companies source activities to external providers. This is known as international *outsourcing*.

The Eurostat information refers to all international sourcing activities of the responding EU Company. Nevertheless, international sourcing mostly exists within the company. 70 percent of the responding companies claim that they have performed *international insourcing,* at the same time as just 37 percent of the companies has performed *international outsourcing*. The Eurostat information referring to international sourcing can provide up-to-date details on the features of outward FDI which should be of interest to the policy makers.[1]

2. EU investment policy

Due to the fact that EU's common commercial policy includes investment, the European Commission may create laws with respect to investment. The European Commission described its approach for the EU's future investment policy in its document "*Towards a comprehensive European international investment policy*" in 2010. This policy brings a great contribution to the objectives of smart, sustainable and comprehensive increase, set out in the Europe 2020 Strategy.

The main purpose of the EU's investment policy is to provide EU investors with market access, a legal stability *and a steady, unsurprising, reasonable and suitably regulated environment* in which they could perform their business.

The two elements: increasing market access and supporting legal certainty and transparency will be discussed in detail as follows:

1. Increasing market access. There are negotiations with respect to investment rules in the context of free trade agreements with third countries and, besides, in stand-alone investment agreements. While the EU is at present negotiating stand-alone agreements with China and Myanmar, There are negotiations with respect to investment in the context of free trade agreements (FTAs) with India, Singapore, Japan, the United States, Egypt, Tunisia, Morocco, Jordan, Malaysia, Vietnam and Thailand. Negotiations with Canada were concluded in 2014.

The EU has an active involvement in work on international investment conducted in international conferences, meetings and debates (OECD, UNCTAD, WTO, G8, and IMF).

The business environment is positively influenced by the international rules on investment. The investors have more legal stability and the risks are greatly diminished. The EU is subscribed to a range of international rules on investment: the WTO General Agreement on Trade in Services (GATS); the WTO agreement on Trade Related Investment Measures (TRIMS); the Energy Charter Treaty which covers investments in the energy sector; the investment instruments of the OECD.

In addition to that, EU is consistent with the principles and standards related to responsible business conduct such as the *OECD Guidelines for Multinational Enterprises*. The document regarding the corporate social responsibility aims to balance the rights and obligations between investors and host countries.

2. Supporting legal stability and transparency. There will be a gradual introduction of the European complete investment policy. This suggests that nearly 1200 *Bilateral Investment Agreements* (BIA) of member states that at present provide investment protection to a lot of European investors will be kept until they are substituted by EU agreements. Regulation No 1219/2012 provides legal security to the existing BIAs between our member states and third countries until they are substituted by EU-wide investment agreements. Furthermore, the Commission has the right to authorise member states to open formal negotiations with a third country to modify or conclude a BIA under certain circumstances.

The purpose of the EU's investment policy is as follows:

- concentrate on long-term investment – more precisely establishment that leads to steady employment and development;
- develop market access and make sure that foreign investments has the same treatment as the domestic ones;
- promote transparency by simplifying the regulatory framework;
- make sure that host and home countries fully hold on to their right to adjust domestic sectors;
- free the flow of payments and investment-related capital movements, while preserving the option to take safeguard measures in special conditions; and
- make possible the movement of investment-related persons (key personnel).

[1] Sunesen, Eva; Jespersen, Svend; Thelle, Martin (2010), *Impacts of EU outward FDI*, Copenhagen Economics, available on http://trade.ec.europa.eu/doclib/docs/2010/june/tradoc_146270.pdf

3. Investor – to – state dispute settlement within international trade agreements

FDI was included in the *EU common commercial policy* by the Treaty of Lisbon. Therefore, the European Commission negotiates in the name of the EU with respect to the *liberalisation as well as the security of investment.* The EU is progressively negotiating *investment provisions in certain free trade agreements* (FTAs) or in *self-standing investment agreements*.

With the help of these new provisions on investment, a *legally binding level of protection for investment* will be established. They will be accompanied by investor-to-state dispute settlement mechanisms, which allow investors to bring claims alleging that one of the investment protection obligations has been breached. If necessary, due to these provisions, *an investor* could bring a case before an *international tribunal*.

At present, the EU is working on a legislation referring to the likely financial consequences which stem from investor-to-state dispute settlement.

The European Parliament and the European Council ratified a directive with the aim of establishing a legal and financial framework for investor to state dispute settlement in July 2014. This regulation deals with any likely financial responsibility which stems from investor-to-state dispute settlement as well as with who would defend a certain case.

Starting with July 2014, there are new internal rules given by the international trade rules enforcement regulation by means of which international trade agreements could be enforced more effectively. In case in which a third country does not observe its international obligations, the Commission has the power to adopt *commercial policy measures* which limits *access to the EU market of goods or services* provided by that third country until it observes the relevant international trade rules.

According to information provided by UNCTAD, *investors from the EU member countries are the largest users of ISDS*. In 2014, cases brought by investors from the European Union rise to 327, therefore accounting for *more than 50 percent of ISDS cases initiated.* Investors from almost all EU member states have brought ISDS cases, except for Estonia, Slovakia, Romania, Bulgaria, Malta and Ireland.

There are not many situations in which investors from *outside the EU* challenged EU member states. In total there have been 29 cases. This is the case of the investors from Russia, Norway, Switzerland, India, Israel, Turkey, Lebanon, US and Canada. However, these represent less than *5 percent of all ISDS cases worldwide.*

According to ICSID with respect to the EU, there are the following figures for disputes against EU Member States: in 44 percent of the cases, all claims were dismissed or jurisdiction was declined; in 36 percent of the cases, the dispute was settled or otherwise discontinued; in 20 percent of the cases, the dispute led to an award upholding claims in part of in full.

4. Transatlantic Trade and Investment Partnership (TTIP)

Transatlantic Trade and Investment Partnership (TTIP) is a proposed free trade agreement (FTA) between the EU and the United States. Discussions on this matter started in July 2013 and are likely to finish in 2015 or early 2016. If these conclude in an effective manner, TTIP would create the *world's largest free trade area.* Its most important purpose is to *harmonize regulatory regimes and decrease non-tariff "behind the border" barriers* to trade and investment. Aspects of TTIP could have *implications for FDI.*

The EU and the United States collectively account for more than *45 per cent of global GDP*. FDI flows within the TTIP bloc represented approximately *half of global FDI flows* over the period 2004–2012. Intra-EU FDI proves to be rather unstable, but *FDI flows between the EU and the United States have remained relatively constant* in latest years.

With respect to GDP, the EU economies account for almost 30 per cent of the world. United States perceived EU as a very important destination for FDI, with its share in flows ranging from 41 to 59 per cent over 2004–2012, and its share in outward stocks at over 50 per cent by the end of that period. On the contrary, the EU's share in United States exports averaged only 25 per cent over the same period.

It is clear evidence that almost four fifths of United States FDI stock in the EU is in services, in which holding companies (nonbank) represent 60 per cent and finance (except depository institutions) and insurance another 20 per cent. Manufacturing is responsible for 12 per cent.

As far as EU is concerned, a great deal of the inflows to EU countries comes from other EU states. Generally, between 2004 and 2012 63 per cent of FDI flows to the region came from other EU countries and 15 per cent from the United States.

The joint share of the EU and the United States in FDI stock in the EU at the end of 2012 represented 76 per cent. If we consider the EU as a single block, the United States was the largest investment partner, being responsible for one third of all investment flows from outside the EU.

As far as United States are concerned, the share of the EU in its inflows ranged from 45 per cent to 75 per cent between 2004 and 2012. In terms of FDI stock, the EU's share was 62 per cent at the end of 2012. The top investors include the larger economies in the EU, such as France and Germany, together with the United Kingdom. Luxembourg and the Netherlands rank high as source countries of FDI in the United States, as well. The high share of these economies can be explained by the fact that they have turned into favourite locations for incorporating global companies.

5. EU-Canada Trade Agreement (CETA)

The end of the negotiations of the EU-Canada trade agreement (CETA) took place on the occasion of the Canada-EU summit in September 2014 in Ottawa. This agreement will be subject to the approval of the Council and the European Parliament.

CETA will deal with various issues in order to make business with Canada without any difficulty. Its aim is to eliminate customs duties, end limitations in access to public contracts, open-up services' market, provide unsurprising environment for investors and, finally, help avoid illegal copying of EU innovations and traditional products.

In addition to that, this agreement aims to eliminate more than 99 percent of costs between the two economies and generate substantial new market access opportunities in services and investment.

It is common knowledge that the investment relationship is of great importance. In 2012, European investors held investments worth EUR 258 billion in Canada while Canadian direct investment stocks in the EU reached nearly EUR 142.6 billion.

It is worth mentioning that for both EU and Canada, a closer bilateral trade and investment relationship can turn out into a lucrative experience. The economic growth and the creation of jobs are among the most desired purposes.

At present, there are negotiations regarding the *investment protection which could result in an even safer investment*, which could generate benefits for companies on both sides. Both countries will gain from increased access to the public procurement markets. All sub-federal levels of government in Canada will be open to European companies to engage in tenders. Both transparency and legal stability for operators will be improved.

6. Conclusions

In EU states, the greatest attention and concern have been manifested towards FDI, ISDS, TTIP, and CETA.

A number of *1400 bilateral investment treaties* have been negotiated by EU governments for the last 60 years. This is what made European firms to grow into the largest foreign investors in the world opening the door to prosperity. As for the countries, they got the necessary capital inflows and reduced the unemployment.

All these agreements tend to be rather unsuitable nowadays as both the CETA with Canada and the TTIP with the U.S. are already *causing controversy* beyond the limits of the negotiating table.

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