Undermining of Democracy: Are Trade Agreements Flawed?

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Abstract

This article critically examines the role of modern trade agreements—specifically CETA, TPP, and TTIP—and their impact on the democratic sovereignty of member states through the controversial Investor-State Dispute Settlement (ISDS) mechanism. While ISDS was originally designed to protect foreign investors from unfair treatment, evidence suggests it increasingly empowers multinational corporations to challenge public-interest regulations and national policies outside domestic legal systems. Through a review of key cases such as Lone Pine vs. Canada and Vattenfall vs. Germany, the paper highlights how ISDS mechanisms have led to a phenomenon known as "regulatory chill," where governments refrain from enacting policies benefiting the public for fear of litigation. It also contrasts the critiques from civil societies with the defences offered by proponents of ISDS, such as the European Federation for Investment Law and Arbitration (EFILA). Ultimately, the article argues that unless trade agreements are reformed to safeguard democratic governance, multinational corporations will continue to erode the policy autonomy of sovereign states under the guise of investment protection.

Keywords: *Investor-state dispute settlement, Trade agreements, democracy, regulatory chill, Multinational corporations*

1. Introduction

As the member states have already signed trade agreements like CETA and TPP, and TTIP is in negotiation to be signed, these agreements have garnered a lot of attention for the sheer reason of providing multinational firms with the power to undermine the state's authority over its own jurisdiction. Quoting Stiglitz:

"Those supporting the investment agreements are not really concerned about protecting property rights. The real goal is to restrict governments' ability to regulate and tax corporations – that is, to restrict their ability to impose responsibilities, not just uphold rights. Corporations are attempting to achieve by stealth – through secretly negotiated trade agreements – what they could not attain in an open political process" (Stiglitz, 2013).

The multinationals, with the help of government officials, are advocating for policies and regulations that conform to their business strategies and future investment plans without much

regard to public interest (Ranald 2015). Apart from this, the fact that the negotiations of these agreements have conducted secretly by an elite panel of government officials and corporate lobbyers behind the back of the public, even the negotiation documents have been kept as a secret to repel any possible debates from civil societies. But the most controversial element of these trade agreements is the inclusion of the Investor to State Dispute Settlement (ISDS)mechanism, which has allowed multinational corporations to file suits against governments if any policy decision hampers the corporations' profits, current or future, undermining the principles of the participating democratic states. The proponents of the trade agreements back them up claiming the trade agreements bear the flag of liberalization and provides safety to foreign investors from expropriation and losses in profits but the opponents of the trade agreements do not want the governments to be dictated by the multinational corporations to such an extent that it hampers the government's decision making regarding policy or reform matters (Crouch 2014).

This essay will look into the reasons that the opponents of the trade agreements, like CETA, TPP, and TTIP, feel these agreements will undermine democracy and the authority of the government, the Investor-State Dispute Settlement (ISDS) mechanism. ISDS allows multinationals to sue governments in international tribunals if any harm is caused to the former's profits due to any decisions made by the latter. Examples of cases under NAFTA and various bilateral agreements between governments and multinationals in the recent years will be provided to substantiate the claims of civil societies that the trade agreements are undermining democracy of member states in return for higher profits for corporations and to show the loop holes exploited by corporations which have led to corporations either receiving or claiming huge amount of financial compensation through ISDS mechanism. As these cases have led to a phenomenon called "regulatory chill", which is a situation where the government limits itself from making decisions related to public interest in a bid to lower the chances of being sued by multinationals, we will look at what the literature has to say about this phenomenon. Further, we will look into counter arguments made by the supporters of trade agreements on how it will only liberalize trade and benefit the participating member states and that ISDS is only a measure to protect foreign investor and is not affecting or going to undermine the democracy of the member states and then present the concluding remarks.

2. Investor-to-State Dispute Settlement

European Commission (2015:3) defines Investor-State Dispute Settlement (ISDS) as *"a*

mechanism included in international investment agreements to ensure that commitments that countries have made to one another to protect mutual investments are respected." A set of rules and regulations is agreed upon for the protection of foreign investors from expropriation, unequal treatment, and sufficient compensation when profits have been hampered in an unjust manner due to government decision-making (European Commission 2015).

As the years have gone by, ISDS has garnered its share of proponents and opponents. As trade deals like TTIP and TISA are in the pipeline, while CETA and TPP are signed but terms are still being negotiated, the clause of ISDS has caused a lot of controversy. Opponents are asking the governments to back out of the agreements as they do not want the power to go into the hands of corporations. History shows that arbitration became the preferred mode of resolving matters between corporations and governments if no settlement was agreed. The International Court of Justice was appointed to settle any disputes arising between parties in the bilateral agreement between Germany and Pakistan in 1959 (Tiejte and Ecorys2014).

In bilateral agreements prior to this if the government violated any international law had a negative impact on the profits of the investors; the options of the investors were to either first "*negotiating directly with the host government*", second "*suing the host government in the sovereign's own courts*" third "*requesting the home government to negotiate diplomatically with the host government*" and fourth "*requesting the home government to espouse a claim on their behalf before the International Court of Justice, provided the ICJ had jurisdiction*" (Tiejte and Ecorys2014: 21). But the failure to address investor's claims and the uncertainty of whether or not they would receive compensation in case of damages led to opting of ISDS mechanism which aimed to solve the issues of investor protection, biased decision making, and unproductive solutions from host governments. But looking at the current context, it has been used by corporations to impose investor rights on the host governments and get their way under various bilateral and multilateral trade agreements (Tiejte and Ecorys 2014). As a result, it has become a controversial element in the current trade deals being negotiated.

3. ISDS – The Reason Civil Societies Feel Trade Agreements Will Undermine Democracy

ISDS was implemented with the basic idea of providing a safety net for foreign investors from decisions of the state that threaten their investments, especially in developing countries vulnerable to future turmoil. It was used as a mechanism to attract foreign corporations to invest in the domestic market by reassuring them of a long-term future by willing to go to international courts in case of any losses to investors due to state decision-making. But ISDS is being used to transform

democratic societies into Post-democratic societies where the institutions pretend to exist and the power is in the hands of political aristocrats and multinational corporations who look to undermine democracy as they aim to bypass the domestic legal system and sue the state and take them to international tribunals, where private corporate lawyers with no public interest make judgements, in case of any loss of profits due to the state policies (Crouch 2014).

Maier (2013) states that the ISDS mechanism was included in trade agreements to prevent any losses to investors in countries with „unstable jurisdictions, "but instead it has been used as a means to bypass the legal system of full-fledged democracies" like the member states of the European Union and the USA. Warren (2015), who is a senator in the USA, also argues against ISDS and says that ISDS would allow multinational corporations to challenge the American legal system in international tribunals and undermine the democratic foundations of America without entering into courts in America.

Maier (2013) adds that any policy decision that hampers current or future profits of the corporations can be challenged behind closed doors in an international tribunal, neglecting the legal institutions established on the foundations of democracy. The civil societies and the general public have no right to access to any information regarding cases and are not allowed to participate in any debate, which makes it impossible to appeal the judgment if it is against public interest or if the judgment undermines the decisions made by the democratic decision-making process.

The ISDS mechanism in CETA allows multinationals to sue governments in offshore courts for financial compensation on losses of revenues due to policy decisions on public interest areas like public health safeguards, environmental protection, public services, and domestic protection to local firms and industries. And the fact that these private international courts are available only to foreign multinationals and the judgements are made by „for-profit" corporate lawyers, instead of lawyers who act in favour of public interest and have no financial interest in the cases, who make favourable judgements for investors by clever interpretation of clauses in the trade agreements (Eberhardt et al. 2014).

Maier (2013) suggests that in the TTIP negotiations, „the struggle between corporate power and democratic decision making". The reason civil societies are protesting is that in the trade negotiations there is an attempt to limit democratic decision making on regulations, reforms and policies and provide the power the multinationals which can be a serious threat to public health, environment and public service sector as well as limits participation of the public in these important issues undermining the democratic principles of the states. From being used as a mechanism to protect multinationals and their investments from frivolous decisions of host

governments, ISDS is now being used by multinationals to restrict the decision-making process of democratically elected governments, current or future (Ranald, 2015).

The civil societies oppose the ISDS mechanism as it contradicts and undermines the democratic legal system present in the majority of the so-called big democracy countries. The ISDS mechanism is based on principles that have no existence in democratic legal systems (Ranald 2015) and also discriminates the domestic investors, and the jury selected is not independent and is selected from a group of corporate lawyers with financial interests rather than public interests (Eberhardt and Olivet 2012). Also the judgements made in one case is binding only to the concerned case so lacks consistency in decision making as the jury changes and that the cases take place in secret international courts away from the eyes of the public and civil societies to minimize potential debates and even the result from the cases may not be published until both parties decide (Ranald 2015).

Table 1 presents a list of cases filed by multinational companies against governments regarding decisions related to various public interest matters.

Table 1: Cases against National governments

Case	Policy / Public interest Area	Financial Compensation (Claimed or Awarded)
Lone Pine vs. Canada (2011)	Democracy and the environment	Seeking C$250 million (€175.7 million) plus interest in damages.
Investors vs. South Africa (2007)	Anti-discrimination policy	Italian and Luxembourg investors sued South Africa for US$350 million (€276.5 million)
Investors vs. Argentina	Policies to combat economic crises	By January 2014, Argentina had been ordered to pay a total of US$980 million (€774.4 million) in compensation.
Veolia vs. Egypt (2012)	Minimum wage policy	Seeking €82 million (C$116.6 million) in compensation.
Vattenfall vs. Germany I & II	Environmental protection	2009 - Seeking €1.4 billion plus interest in compensation.2012 - Seeking €4.7 billion.
Ethyl vs. Canada (1997)	Environmental and health protection	Sued under NAFTA agreement for US$201 million (€158.7 million) in compensation.

(Source: Eberhardt et al. 2014)

Lone Pine vs. Canada: The Canadian government was sued by Lone Pine Resources Inc. under the NAFTA for banning drilling activities as its public raised their concerns on pollution of water sources, and the government had to revoke the ban and permit drilling activities (Eberhardt et al. 2014, Global Affairs Canada 2017).Piero Foresti and others vs. South Africa: The Government of South Africa required mining companies to transfer a certain percentage of shares under the Black Economic Empowerment Act to address inequality and injustice of the apartheid. But the

government was sued under bilateral agreements, and the government settled the dispute by providing investors with new licenses and requiring them to transfer a lower portion of shares than before (Eberhardt et al. 2014). Investors vs. Argentina: The Argentinian Government was subject to lawsuits from European investors when it decided to put a hold on prices of basic amenities, and also because it devalued its currency (Eberhardt et al. 2014). Veolia vs. Egypt: The government was sued under the bilateral agreement because the city of Alexandria had introduced a minimum wage rule, leading to a breach of contract and also increased costs for Veolia (Eberhardt et al. 2014).

Vattenfall vs. Germany I & II – Swedish Energy Company Vattenfall in 2009 took the German government to court for imposing restrictions on the coal-fired power plants to protect the environment under the Energy Charter Treaty. The government agreed to settle the matters outside the court and lowered the restrictions imposed on the power plants. In 2012, the German government was taken to court again by Vattenfall when the government decided to phase out nuclear energy by 2022 after the nuclear mishap in Fukushima, Japan. Vatenfall sued Germany for lost profits under the Energy Charter Treaty (Eberhardt et al. 2014, Vattenfall 2014).Ethyl vs. Canada: Ethyl Corporation, U.S. U.S.-based company, sued the Canadian government under Chapter 11 of the NAFTA agreement when the Canadian Parliament passed a bill, in a bid to protect public health and the environment, to prohibit the transportation and importing of toxic substances. The case was settled outside the court with the Canadian government withdrawing the ban and agreeing on a US$13 million settlement (Eberhardt et al. 2014, Swan 2000).

One of the major concerns of civil societies is that cases against state governments, requiring them to pay massive financial compensation, settlement fees, and costly lawyers' fees, all from taxpayers' contributions, are limiting the government from making policy decisions on behalf of the public interest, fearing being sued by multinational corporations. This phenomenon is called "Regulatory Chill", the negative impact of the cases under ISDS mechanism is that governments elected through democratic election process fail to act in the interest of public and to limit themselves from making regulatory decisions and policy reforms fearing backlash from the multinational corporations (Barlow 2015, Benvenisti 2015, Ranald 2015). Civil societies warn that "regulatory chill" would significantly reduce the role of democratic elements of the state, like elections, parliaments, and the legal system, by providing the power to corporations to regulate and influence policies and reforms (Basedow 2015). The regulatory chill effects can be seen in most of the cases mentioned above, where governments have had to settle the cases out of court, take back their regulatory decisions in a manner that benefits the corporations to avoid paying huge

amounts of financial compensation. The governments have been restricted from acting in favor of public interest and rather stick to decisions that do not hamper the profits of the corporations.

Counter Arguments

The trade agreements in negotiations have strong opponents in the civil societies and ever ever-growing public opinion against it. But it has its fair share of supporters who are the elitist groups of multinationals, government officials, and international tribunals, and their proponents, a portion of international lawyers. Proponents claim that the international tribunals and the selected panel of arbitrators can only be involved in cases if there was discrimination or other breaches in agreement with a foreign investor, which was "arbitrary". They also claim that ISDS fair and just system and the judgements made require the states, if guilty of making faulty decisions, to pay damages and do not compel any state to rescind the policies made by the state (Barlow 2015, Benvenisti 2015). The European Federation for Investment Law and Arbitration(EFILA) has presented a comprehensive argument in favor of ISDS. EFILA claims that the states have won more cases than corporations claimed otherwise, and the inconsistency in judgments is due to the nature of cases and the fact that each case may be based on different bilateral or multilateral agreements. Further, they claim that the ICSID rules are followed in court proceedings and the judgments are published on the website, so there should be no issue of lack of transparency as claimed by civil societies, and that there are control mechanisms to provide an impartial and independent jury and arbitrators. Finally, they claim that ISDS is the best way to cater to investment disputes, and it is not a mechanism to bypass judicial systems and undermine democracy and sovereignty of the host nation, and that there is no evidence on the "regulatory chill" phenomenon (Alvarez et al. 2000).

4. Conclusion

The opponents of the new trade agreements present a contrasting picture of the ISDS mechanism. Contradicting the claims of ISDS being the best and fair way to settle investment disputes, critics of ISDS claim that elitist groups of corporate lawyers, arbitrators, and multinational corporations are using this mechanism to sue governments all over the globe by challenging policy decisions in public interest areas (Barlow 2015). Not only is ISDS restricting governments from acting in behalf of public interest and taking necessary steps to protect health and, environment, but it also allows the multinationals to play around the domestic legal system and undermine the democratically elected government by threatening to claim damages in case of loss of profits. Especially in smaller economies, the financial compensation may have to be paid from the taxpayer's money, which is why governments "s fear taking policy decisions that might lead to challenges by multinationals.

The conclusion, therefore, is that governments need to re-examine the terms of ISDS in the new trade agreement negotiations if they are to avoid public backlash and if they are not to be dictated by multinational corporations.

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