

US FDI in the Baltic Sea region: The state of American investment and selected challenges

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Summary

This report reviews the patterns of United States foreign direct investment (FDI) in the Baltic Sea region and selected related key policy issues. American investment in the region has not lived up its potential, and has been on a downward trend, in contrast to a good potential for its expansion found in some studies. Moreover, US FDI is unevenly distributed, with Germany attracting the bulk of it, related to its large market and technology assets. The report indicates the adverse effects of the current protectionist trends in the world economy on American investment in the region, especially in relatively smaller and more open economies. It also show that the abandoning of negotiations on the Transatlantic Trade and Investment Partnership can have long-term negative repercussions for bilateral investment flows, and the sanctions wars between the United States and the Russian Federation has created further obstacles to US investment to the region. While focus has been mostly on medium- to long-term issues, the report also analyses the one-off shock of the US tax reform in 2018, predicting a recovery of flows in 2019 and beyond.

Keywords

Foreign direct investment, United States, Baltic Sea region, Transatlantic Trade and Investment Partnership, investor-State dispute settlement, US tax reform, sanctions

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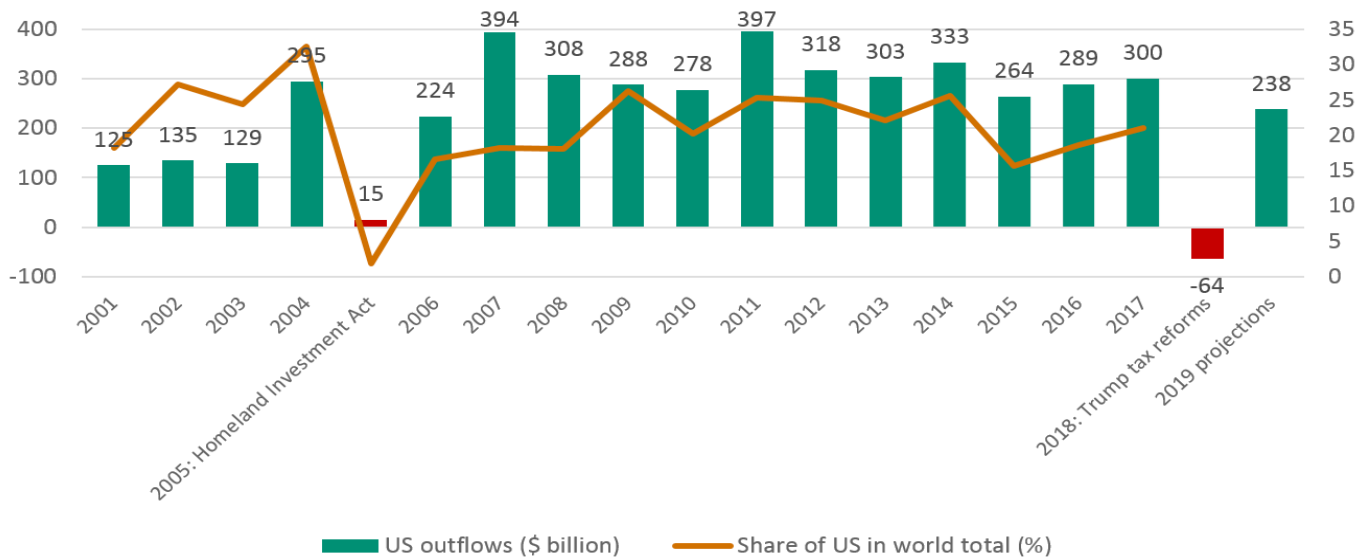
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1. The almost unlimited potential for American investment in the Baltic Sea region

In principle, the potential of the Baltic Sea region to attract foreign direct investment (FDI) from the United States is unlimited. On the supply side, the United States has been the largest source of outward FDI in the world since 1991, with the exception of 2005 (the year of the entry into force of the Homeland Investment Act) and 2018 (the year of the entry into force of the Tax Cuts and Jobs Act). On average, the United States accounted for 21 per cent of global outflows in 1991–2017 (see Figure 1). In 2018, the Tax Cuts and Jobs Act made the US outflows drop to an unprecedented negative -\$64 billion, making the country exceptionally the last (181th) of the home countries of the world monitored in the FDI/MNE database of the United Nations Conference on Trade and Development (UNCTAD) (for more details, see section 5). However, a projection for 2019 based on first-quarter real data suggests that the outflows of the country would swing back to a positive value of over \$200 billion, making the United States in all probability the largest source country of the world again (see Figure 1).

For American multinational enterprises (MNEs) seeking for investment opportunities, the Baltic Sea region is particularly attractive. As pointed out by Kalotay and Sulstarova (2013) the advantages of the region are structural and are to stay in the long term, including stability, openness and resources. Indeed, the region provides opportunities for all types of investors. Those motivated by natural resources will find abundant resources not just in the Russian Federation, but also Norway, Poland and Sweden, to mention a few others. Market seeking investors would find two large economies in the region (Germany and the Russian Federation), but also the opportunity to access the 500+ million consumers of the European Union (EU) should they decide to establish themselves in smaller Baltic Sea region countries. For efficiency seeking investors, Estonia, Latvia Lithuania and Poland are still very attractive options, combined with the advantage of EU membership (which is essential for the first three due to the very small size of the national economy). Finally, for strategic asset seeking investors, the region is host to five of the top 20 countries of the 2019 *Global Innovation Index*: Sweden is 2nd, Finland 6th, Denmark 7th, Germany 9th and Norway 19th (Dutta, Lanvin and Wunsch-Vincent, 2019). To be considered with these rankings that are kept or improved over time is the observation of Liuhto (2018) that production processes between the United States and the Baltic Sea region are very closely integrated as evidenced by trade statistics.

Figure 1. The United States in global FDI outflows, 2001–2019 (Billions of US dollars and per cent)



Source: Author’s calculations, based on data from UNCTAD, FDI/MNE database, and from United States, Bureau of Economic Analysis.

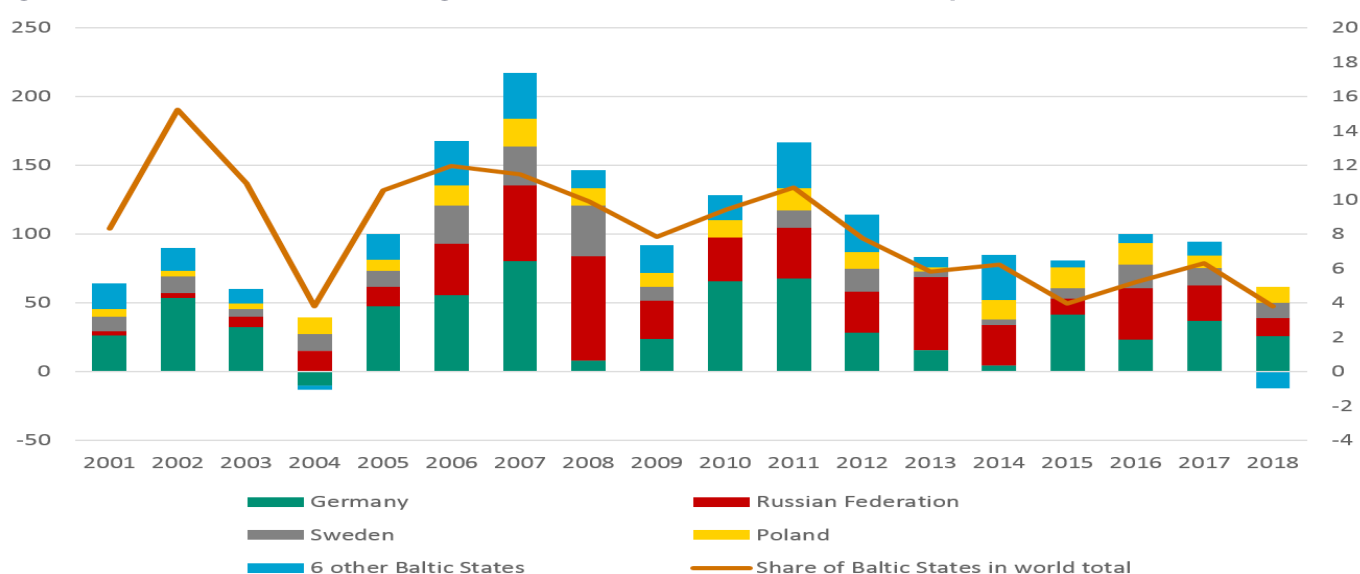
Despite these positive fundamentals, the importance of the United States for the region is on the decline. Therefore, there is a need to understand if this relative decline is due to changes in the policy environment (some of its elements will be discussed below) or to new technological developments such as the patterns of the 4th industrial revolution, not necessarily fully captured by the *Global Innovation Index*. The *Industry 4.0 Readiness Index*¹

¹ It is composed of various indicators that are also applicable to pre-Industry 4.0 innovation such as Total intramural R&D expenditure (GERD), Gross domestic expenditure on R&D (GERD), Community trade mark (CTM) applications, Community design (CD) applications, Total R&D personnel and researchers and Tertiary educational attainment, as well as two indicators of the digital economy: ICT specialists and “Digital single market – promoting e-commerce for businesses, enterprises selling online”, the last one measured as a percentage (number) of enterprises.

(Kuruczleki et al., 2016) confers a relatively high score to some of the Baltic Sea region economies. Sweden is the leader of the European Union 28, Denmark is 3rd, Finland is 4th and Germany is 8th, and in the indicator of ICT specialists gives a 100 per cent score to Finland. The group of these front-runners is similar to that of the *Global Innovation Index*. In contrast to this group, Poland, occupying the 21st position, and Latvia, 25th, are seemingly laggards of the EU in “Industry 4.0 Readiness”.² All this gives us the feeling that the 4th industrial revolution and its separate indicators are to be better defined before drawing far-reaching policy conclusions. This report also will focus on selected FDI policy issues instead.

As a last element of general evidence, it is to be highlighted, too, that the FDI inflows of the Baltic Sea region have been on a relative decline compared with the rest of the world since 2011, belying the optimism expressed in Kalotay and Sulstarova, 2013. It is true that the cited article took a benign view on potential future policy uncertainty and could not factor in major changes such as the rise of global protectionism or sanctions and countersanctions between the Russian Federation and its Western partners. As a result, the share of the Baltic Sea region in global inflows reached an all-time low of 3.8 per cent in 2018, down from 10.7 per cent in 2011, and from the 10 per cent average of the previous decade (see Figure 2). In absolute value, the decline was even sharper, from \$167 billion in 2011 to \$50 billion in 2018.

Figure 2. FDI flows to the Baltic Sea region, 2001–2018 (Billions of US dollars and per cent)



Source: Author’s calculations, based on data from UNCTAD, FDI/MNE database.

2. Bilateral flows in a mirror: the US in the inflows of the Baltic Sea region, the Baltic Sea region in the outflows of the United States

The degree the potential of FDI flows from the United States to the Baltic Sea region has been fulfilled or missed can be tested only for the period 2001–2017 only due to the limitations and delays of data collection. To be noted also that bilateral data series are not complete as some data points are suppressed for reasons of confidentiality, especially for transactions with small economies, such as Estonia, Latvia and Lithuania. There are also methodological issues. Some countries, for instance Norway, collect more complete data on stocks than flows, therefore we could not consider their inflow statistics.

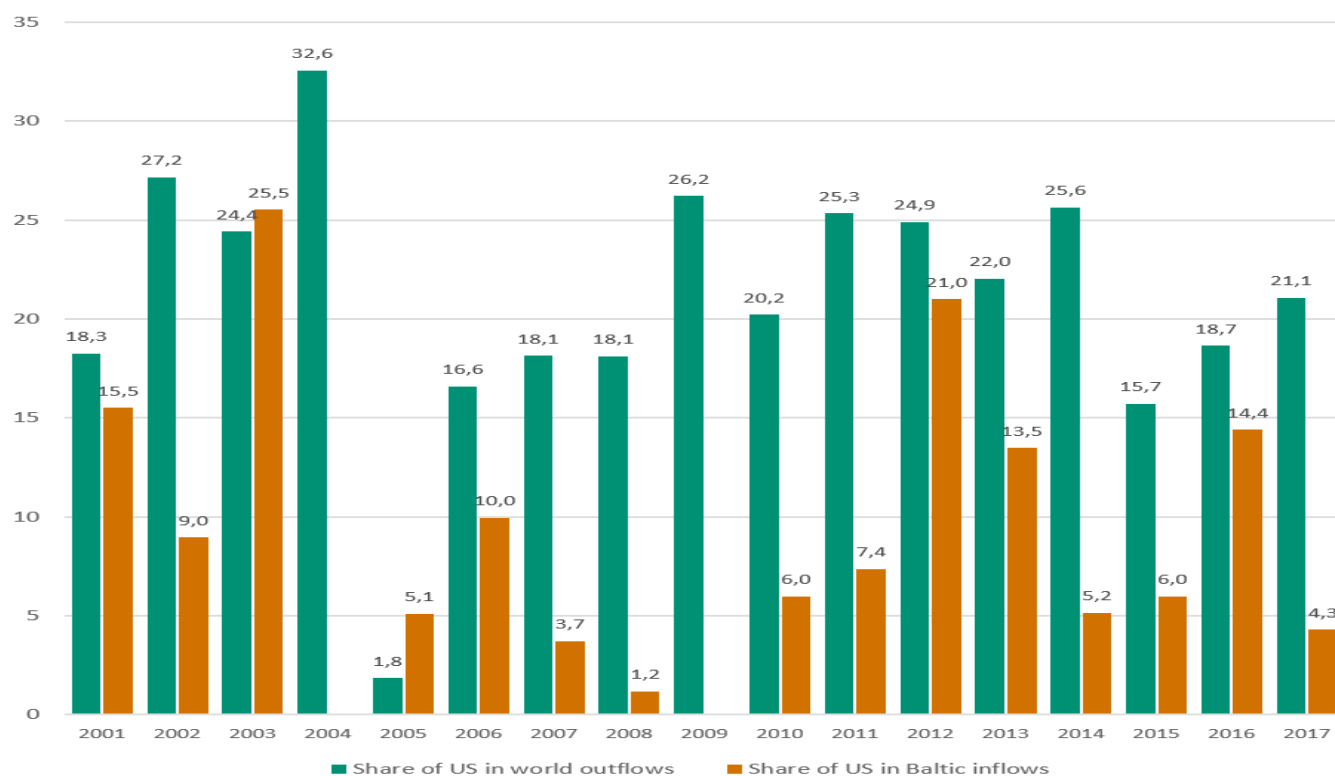
Most importantly, most of the data collection is done on the basis of the nationality of the immediate investor, not of the ultimate beneficial owner (Kalotay, 2015). That may result in an underestimation of American investment in the Baltic Sea region, especially in cases when US firms have vested interest in not revealing their exposure to certain countries such as the Russian Federation. Based on a probabilistic approach, Casella (2019) has estimated that the real size of US investment in the Russian Federation *could* be many times higher than the reported level. This was then picked up in Russian press reports, giving a political twist to the question of how much American investment in reality is in the country (RBC, 2019).

With all those reservations in mind, we can present a picture in which the potential for US FDI in the Baltic Sea region is underused. Even if we exclude from counting the years in which flows from the United States were reported to

²The status of frontrunner in the EU in terms of readiness for the digital economy in itself is not a guarantee of success on the international scene. UNCTAD 2017a has found that most of the innovation of the sector takes place in the United States and practically all leading MNEs are headquartered there. Therefore, a country missing to attract American investment may risk falling behind.

be negative, the share of the country in the inflows of the Baltic Sea region was less than 10 per cent on average, only half of the share of the United States among sources of FDI in the world (Figure 3). Moreover, looking beyond some sharp fluctuations, the trend is clearly downward.

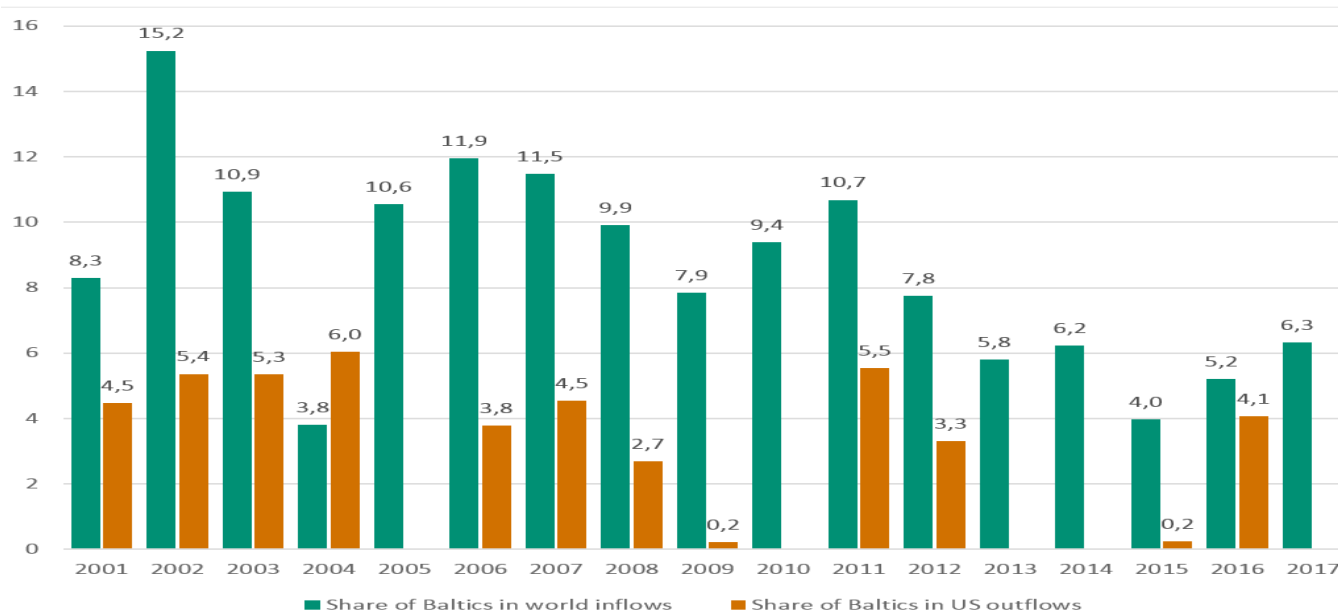
Figure 3. Share of US in world outflows versus share of US in inflows of the Baltic Sea region, 2001–2017 (Per cent)



Source: Author's calculations, based on data from UNCTAD, FDI/MNE database.

We have also checked if the mirror data of the United States (outflows towards the Baltic Sea region) provide a different picture. The answer is clearly negative. In 2001–2017, the Baltic Sea region accounted for 8.6 per cent of world inflows on average, while the share of the region in the US outflows amounted to 3.8 per cent, even if we do not calculate the years of negative outflows and again shares at the beginning of the period are higher than at the end (see Figure 4).

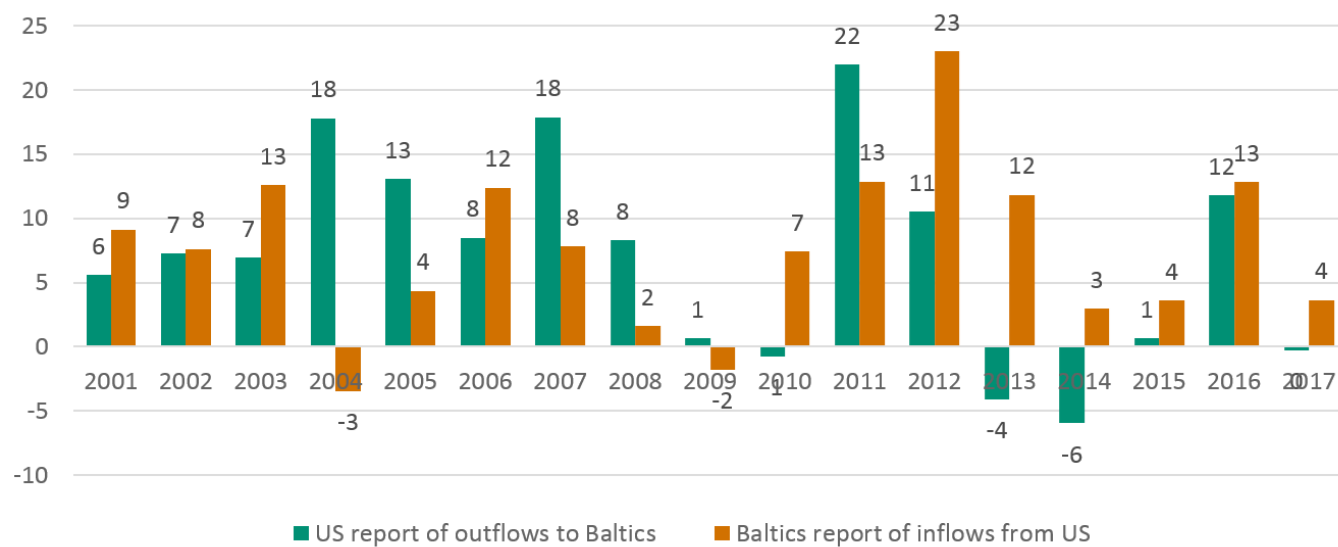
Figure 4. Share of Baltic Sea Region in world inflows vs. share of the Baltic Sea region in US outflows, 2001–2017 (Per cent)



Source: Author's calculations, based on data from UNCTAD, FDI/MNE database.

The incompleteness of collection of bilateral flow data has already been mentioned. It may be one of the reasons why mirror data between the United States and the Baltic Sea region countries are so different. Nevertheless, difference in the totals is only 7 per cent different. The United States reports a total of \$120 billion invested in the Baltic Sea region in 2001–2017, while the Baltic Sea region countries (in fact the nine of them with the exception of Norway) reported cumulative inflows of \$128 billion at the same period. The paradox that data for nine countries are slightly higher than for ten countries on the US side may be explained by the fact that usually inflow data are larger and more complete than outflow data. If you pick up the global series between 1990 and 2018, you will find that in 18 years, inflows were reported to be bigger than outflows, and the reverse was true only in 11 years. Moreover, the cumulative value of world inflows in that period was \$1.1 trillion higher than the cumulative value of world outflows.

Figure 5. Outflows to the Baltic Sea region as reported by the US vs. inflows from the US as reported by the Baltic Sea region countries, 2001–2017 (Billions of US dollars)



Source: Author’s calculations, based on data from UNCTAD, FDI/MNE database.

In sum, despite important discrepancies of mirror statistics in individual years, both US and Baltic Sea region data series indicate a below-potential performance and an overall downward trend in US investment in the latter.

3. Germany, the dominant host country

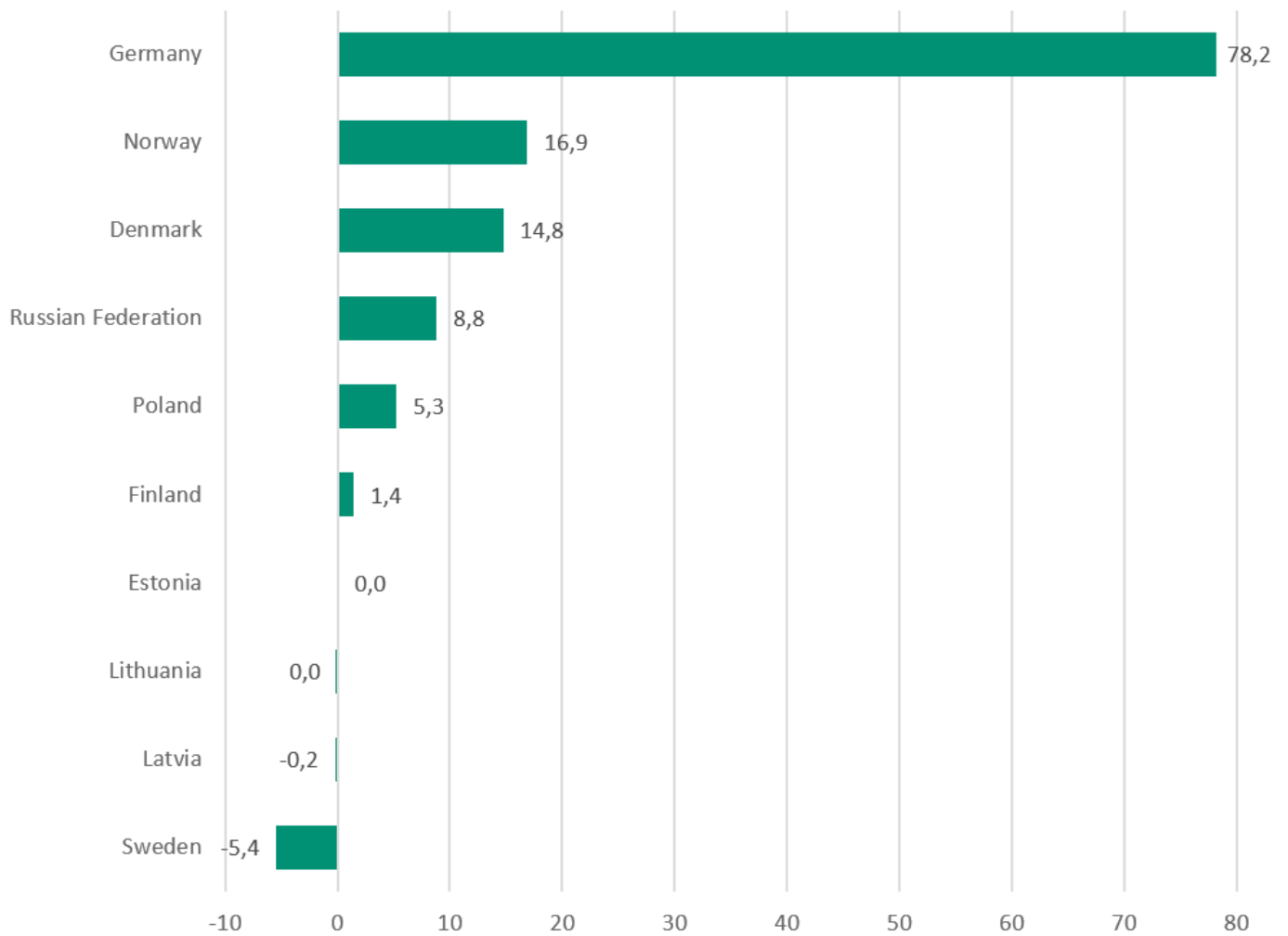
Not all Baltic Sea region countries seem to have been equally attractive for American investors. According to Bureau of Economic Analysis data for FDI outflows in 2001–2017, almost two-thirds of the US flows to the region targeted Germany (see Figure 6), which is also the largest economy in the subgroup in terms of GDP (accounting for roughly half of the region’s GDP in 2017).³ It is followed by Norway and Denmark. The Russian Federation is only fourth, accounting for less than 8 per cent. It is also striking the flows towards Sweden were negative during the period in question. These findings are at least counter-intuitive because Germany is not a low-cost nor a low-tax environment, and if we take into consideration that a counting of final beneficial owners could provide a slightly different picture.

³ Footnote table: Total gross domestic product, 2017 (in millions of current dollars)

Country	GDP	As a share of the Baltic Sea region total
Denmark	329'866	4.45%
Estonia	25'921	0.35%
Finland	252'247	3.40%
Germany	3'693'204	49.79%
Latvia	30'463	0.41%
Lithuania	47'544	0.64%
Norway	399'470	5.39%
Poland	526'212	7.09%
Russian Federation	1'577'524	21.27%
Sweden	535'607	7.22%

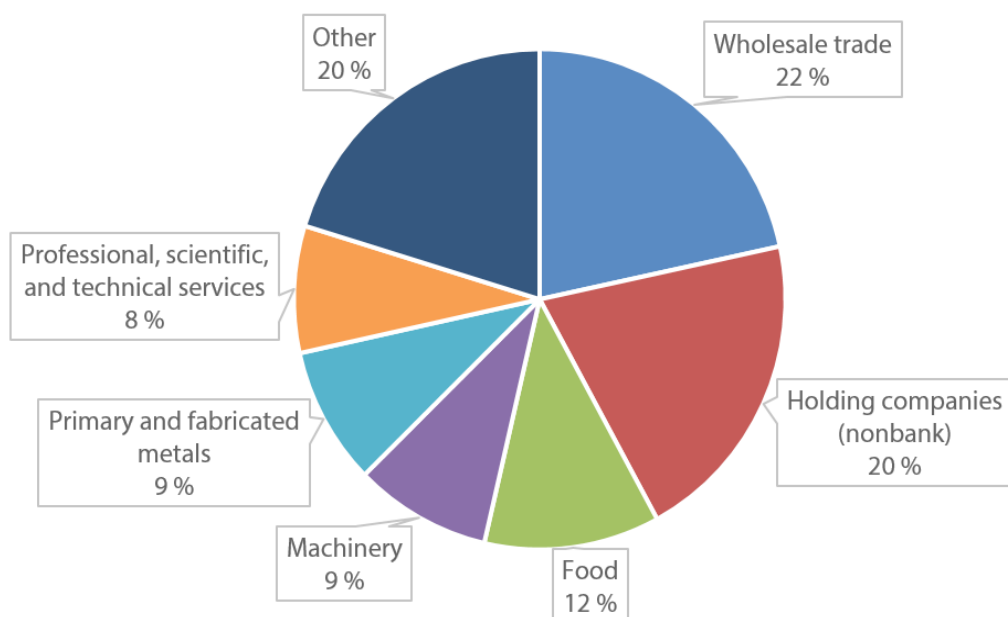
Source: Based on UNCTADStat data, retrieved on 23 June 2019.

Figure 6. American investment flows to the Baltic Sea region by host country, 2001–2017 (Cumulative values in billions of US dollars)



Source: Author's calculations, based on data from United States, Bureau of Economic Analysis.

Figure 7. Sectoral composition of American investment in Germany, 2001–2017 (Cumulative values in per cent)



Source: Author's calculations, based on data from United States, Bureau of Economic Analysis.

A closer look at the industry composition of US FDI flows to Germany in 2001–2017 reveals the presence of what could be called “corporate engineering” (creation of an affiliation structure) reflected in the high share of holding companies, the importance of market seeking FDI (especially in the area of wholesale trade), but also the impact of German engineering traditions (in machinery and in professional, scientific and technical services; see Figure 7). In other words, the German economy is attractive because it offers a broad variety of possibilities for economic activities. It also belies that view that only low-cost locations would be attractive to investors.

4. Protection of US corporate interests in the Baltic Sea region

In the majority of the Baltic Sea region economies, the business environment is fairly easy. As an imperfect proxy, let us refer to the 2019 Doing Business Ranking of the World Bank, although this is more amenable to measure the conditions for local firms. Foreign MNEs usually can negotiate a treatment better than what the average ranking would indicate. In any case, seven of the Baltic Sea region countries figure among the top 20 of the 2019 list. Even the region’s so-called laggards are among the top 20 per cent of the 190 economies of the world monitored: Germany is 24th, the Russian Federation 31st and Poland 33rd.

In addition, US business is active in local lobbying for better conditions in the Baltic Sea region. An overall umbrella including the eight Baltic Sea region countries that are full EU members is the Transatlantic Business Council (TABC), an advocacy group of over 70 European and American MNEs, offering an umbrella for the Transatlantic Business Dialogue, which dates back in 1995, and focuses on both trade and investment issues. TABC as a cover organization came into existence in 2013.

At the level of individual Baltic Sea region economies, each country has a local American Chamber of Commerce, with a long list of advocacy with the host Government (most sites mention advocacy events on the front page). Naturally, membership of American Chambers of Commerce is open not only to affiliates of US MNEs established in the host country, but also other MNEs with major business links with the United States and local firms exporting to the US. In the majority of countries, large and technologically advanced American MNEs have taken the Presidency of the Board (see Table 1). The most salient cases are IBM in Finland, Northrop Grumman (aerospace) in Poland, Citi in Norway and Pfizer in Sweden. However, in Estonia, a local firm exporting to the United States has been chosen for the Board Presidency. From the point of view of the Baltic Seas region, it is to be stressed that in the Russian Federation, the subnational St. Petersburg Chapter of the American Chamber of Commerce in Russia is one of the oldest (established in 1997) and one of the most active.

Table 1. American business representatives in the Baltic Sea region, 2019

Baltic Sea region country	US business representative	Web page	Chair of Board of Directors
Denmark	American Chamber of Commerce in Denmark	http://www.amcham.dk	DuPont Nutrition & Biosciences
Estonia	American Chamber of Commerce in Estonia	http://www.amcham.ee/	Estonia Piano Factory (exporter)
Finland	American Chamber of Commerce in Finland	http://www.amcham.fi/	IBM Finland (IT)
Germany	American Chamber of Commerce in Germany	http://www.amcham.de	United Parcel Service (package delivery)
Latvia	American Chamber of Commerce in Latvia	http://www.amcham.lv/	COBALT (law office)
Lithuania	American Chamber of Commerce in Lithuania	http://www.acc.lt	Harbortouch Payments (POS provider)
Norway	American Chamber of Commerce in Norway	http://www.amcham.no	Citi Norway (bank)
Poland	American Chamber of Commerce in Poland	http://www.amcham.com.pl	Northrop Grumman (aerospace)
Russian Federation	American Chamber of Commerce in Russia	http://www.amcham.ru	GE (conglomerate)
Sweden	American Chamber of Commerce in Sweden	http://www.amchamswe.se	Pfizer (pharmaceuticals)

Source: Author’s collection, based on U.S. Chamber of Commerce, ‘American Chamber of Commerce Directory’, <https://www.uschamber.com/amcham-directory>.

The American Chambers of Commerce of the Baltic Sea region countries work closely with their sister organizations in the United States, Business Councils (American-Danish, German American, American-Lithuanian, US Poland and U.S.-Russia) or Chambers of Commerce (Estonian American, Finnish American, Latvian American, Norwegian-American and Swedish-American). These business associations on both sides of the Atlantic work closely with Embassies and with local lawmakers and policy makers.

With Estonia, Latvia, Lithuania and Poland, the United States also has a bilateral investment treaty (BIT) in force protecting American business interests via various means, including access to investor-State dispute settlement (ISDS) mechanisms. This is a quite salient concentration of protection, as the United States has only 39 BITs in force in 2019. The BIT with the Russian Federation was signed in 1992 but has never been ratified by the Russian Duma and thus has never entered into force, and under current political tensions stands no chances to be ratified. We have to assume that BITs in force have a major incidence on initiating ISDS cases. Since 1987, US companies have started eight cases in the Baltic Sea region (see Table 2), all of which under the BITs with Estonia and Poland, respectively. It is notable that they represent less than 0.1 per cent of the 942 cases known till the end of 2018 and less than 5 per cent of the 174 cases submitted by US investors. Moreover, as an indicator of relatively limited gravity of cases in these two Baltic Sea region countries, none has been decided in favour of the investor. Two were settled between the parties, three were decided in favour of the respondent State, and three are still pending. For comparison, globally, 29 per cent of the cases are won by plaintiffs (UNCTAD, 2019, p. 104). It is also to be added that Baltic Sea region companies have not yet initiated any ISDS case against the United States Administration.

Table 2. Known ISDS cases initiated between the United States and the Baltic Sea region, 1987–2018

Year of initiation	Case name	Outcome of original proceedings	Respondent	Home State	Subject	Claims arising from
1996	Ameritech v. Poland	Settled	Poland	US	Shareholding in local cellular phone company	Certain telecommunications statutory enactment overturning a Government's letter of intent which contained Poland's commitment to award the claimant digital cellular licenses
1999	Genin v. Estonia	Decided in favour of State	Estonia	US	Shareholding in local financial institution	Cancellation by the Central Bank of Estonia of an operating license held by a financial institution incorporated in Estonia in which the claimants were shareholders
2006	Rail World v. Estonia	Settled	Estonia	Netherlands / US	Rights under an operations contract concluded with the State concerning railway related services	Estonia's renationalization of its national railway, which allegedly reversed a planned privatisation and modified claimants' rail operations contract
2010	Minnotte and Lewis v. Poland	Decided in favour of State	Poland	US	Shareholding in company set up to construct and operate a plasma protein fractionation plant in southern Poland	A series of alleged actions by the Polish ministry of finance aimed at ensuring that certain banks discontinued their financing of a construction project for the development of a plasma processing plant in which the claimant had invested
2011	Ryan and others v. Poland	Decided in favour of State	Poland	US	Interests in a vegetable oil production and processing enterprise	A series of Governmental actions that allegedly caused the bankruptcy of a margarine production company in which the claimant had invested

2015	Manchester Securities v. Poland	Pending	Poland	US	Loan to a Polish real estate developer for the construction of an apartment complex in Kraków, Poland	Polish courts' decision concerning an unfinished apartment complex in Kraków, allegedly resulting in the claimant's inability to collect its debt from the developer of that complex
2018	ELA v. Estonia	Pending	Estonia	US	Ownership of Estonian companies that owned and operated the port of Lennusadam in Tallinn	The Government's alleged interference with the claimant's investment in the port of Lennusadam, including the invalidation by Estonian courts of the property title to the port, seizure of the claimant's assets and criminal prosecution of the claimant's officers
2018	Invenergy v. Poland	Pending	Poland	US	Investments in wind energy projects in Poland	The Government's conduct adversely affecting the claimant's wind energy projects, including termination by Polish State-owned companies of long-term energy contracts concluded with the claimant

Source: Author's collection, based on information from UNCTAD, ISDS Navigator.

5. The impact of the US tax reform

Donald J. Trump was sworn in as the 45th President of the United States in January 2017. His Administration has been characterized by a sharp U-turn in international economic policies, breaking with the tradition of United States as a champion of opening up, liberalization and multilateralism. Limelight has been focused mostly on his protectionist trade policies and trade wars with China and the European Union.

The rising protectionism of the United States has also spread to the field of FDI. It is to be noted that once the US adopts protectionist measures in this domain, as it already happened in 1995 with the entry into force of the Homeland Investment Act under President George W. Bush Jr., the effects are felt all host countries of American outward investment. Moreover, the scope for effective countermeasures is limited. The only consolation for host countries is that usually the impact of such measures changing the taxation of American MNEs is usually short-lived, and within two years, US outward FDI recovers (Figure 1).

The main difference between the Homeland Investment Act and the U.S. Tax Cuts and Jobs Act signed by President Trump on 22 December 2017 is the latter is deeper and more far reaching. Paradoxically, Tax Cuts and Jobs Act is classified in the UNCTAD Investment Policy Monitor as an inward FDI promotion measure and not as outward FDI protectionism, although the contents clearly indicate the latter. Moreover, if the aim was to promote inward FDI, the goal was not met because in 2018 the inflows of the United States declined by 9 per cent, close to the global average of 13 per cent. The Tax Cuts and Jobs Act is described as follows in the UNCTAD Investment Policy Monitor:

"The President signed the 'Tax Cuts and Jobs Act' into law, aiming to boost investment in the United States and to create jobs. To that end, the bill contains measures that directly affect the investment climate in the United States, and measures aimed at Multinational enterprises (MNEs) to encourage them to bring overseas funds back home and to reduce the incentive for them to locate certain assets and activities abroad.

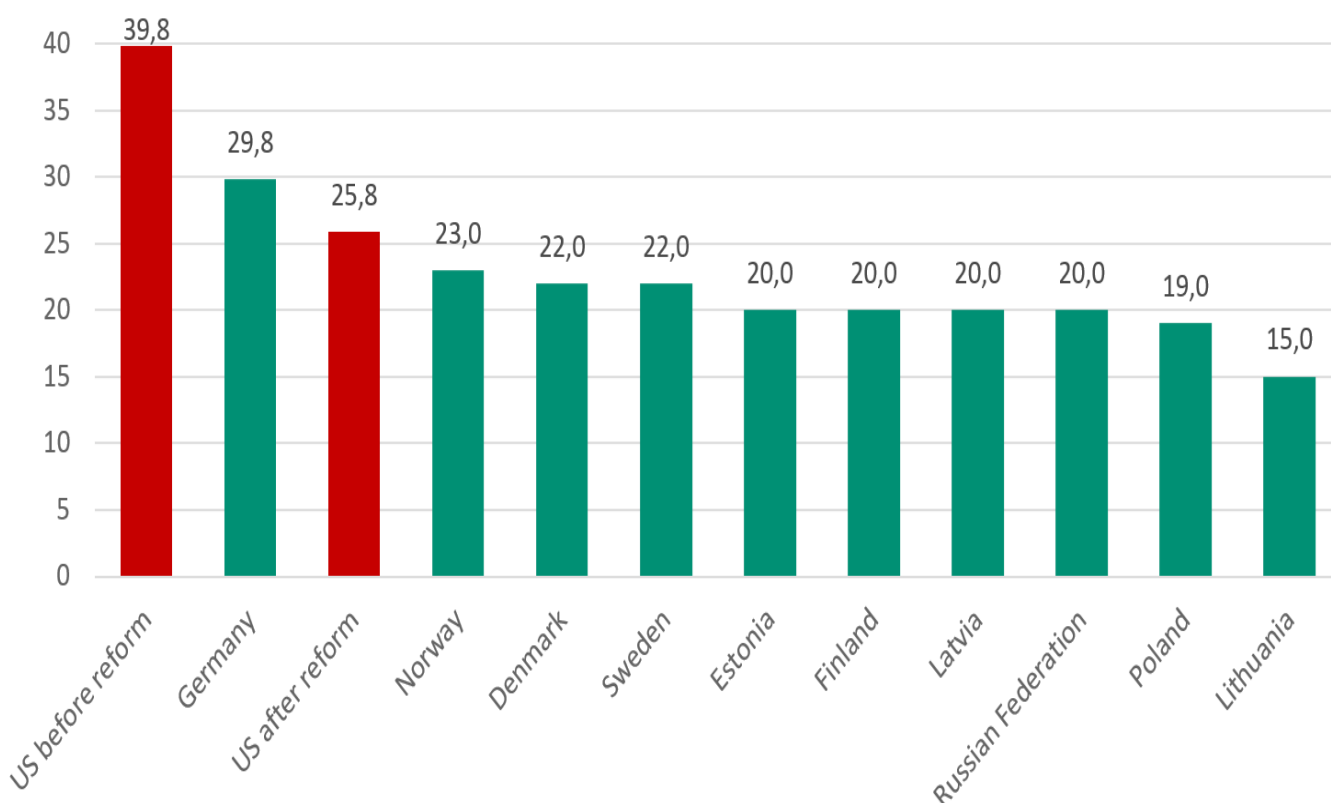
Measures that will directly affect the investment climate in the United States include; (1) A reduction of the statutory corporate income tax rate from 35 per cent to 21 per cent effective from 2018, (2) Immediate full expensing of investment cost, (3) The capping of deductible interest to 30 per cent of taxable income. Measures directed at the international tax regime for MNEs include; (1) A switch to a territorial tax system through a 100 per cent deductibility of dividends of foreign affiliates, (2) A transitional measure for existing overseas retained earnings in the form of a mandatory deemed repatriation subject to a one-off tax payment, (3) A set of anti-tax avoidance measures" (UNCTAD 2017b).

This tax reform affected to almost half of the FDI stock of the world, as 24 per cent of that stock in 2017 was located in the United States and 24 per cent was owned by American MNEs (UNCTAD 2018). The assets of US multinationals potentially subject to repatriation were estimated at \$2 trillion. Although it was not clear how much this potential

would be actually used and how long the effects of the reform would last. In the longer term, US MNEs would reinvest less earnings in those Baltic Sea region countries that apply higher corporate income tax rates than the 21 per cent established by the United States. To compare like with like, the net effect of the sub-central government corporate income tax has to be added to that rate, putting the gross tax level in the US at 25.8 per cent (Figure 8). The same procedure has been applied to Germany where Länder are levying 14 per cent of regional taxes. In the rest of the Baltic Sea region, the central government tax rates were taken into consideration. Figure 8 suggests that after the tax reform, the US statutory rate fell below that of Germany and came close to the rate of some other Baltic Sea region economies (especially Norway, Denmark and Sweden). However, this raw comparison does not tell the full picture because the US system allows for a broader range of tax deductions than that of the Baltic Sea region economies, making its more competitive than the chart shows. Therefore, we have to assume that the US reform has reopened the question of international tax competition on the two sides of the Atlantic, with reactions to be expected from the Baltic Sea region partners once the full effects of change are felt.

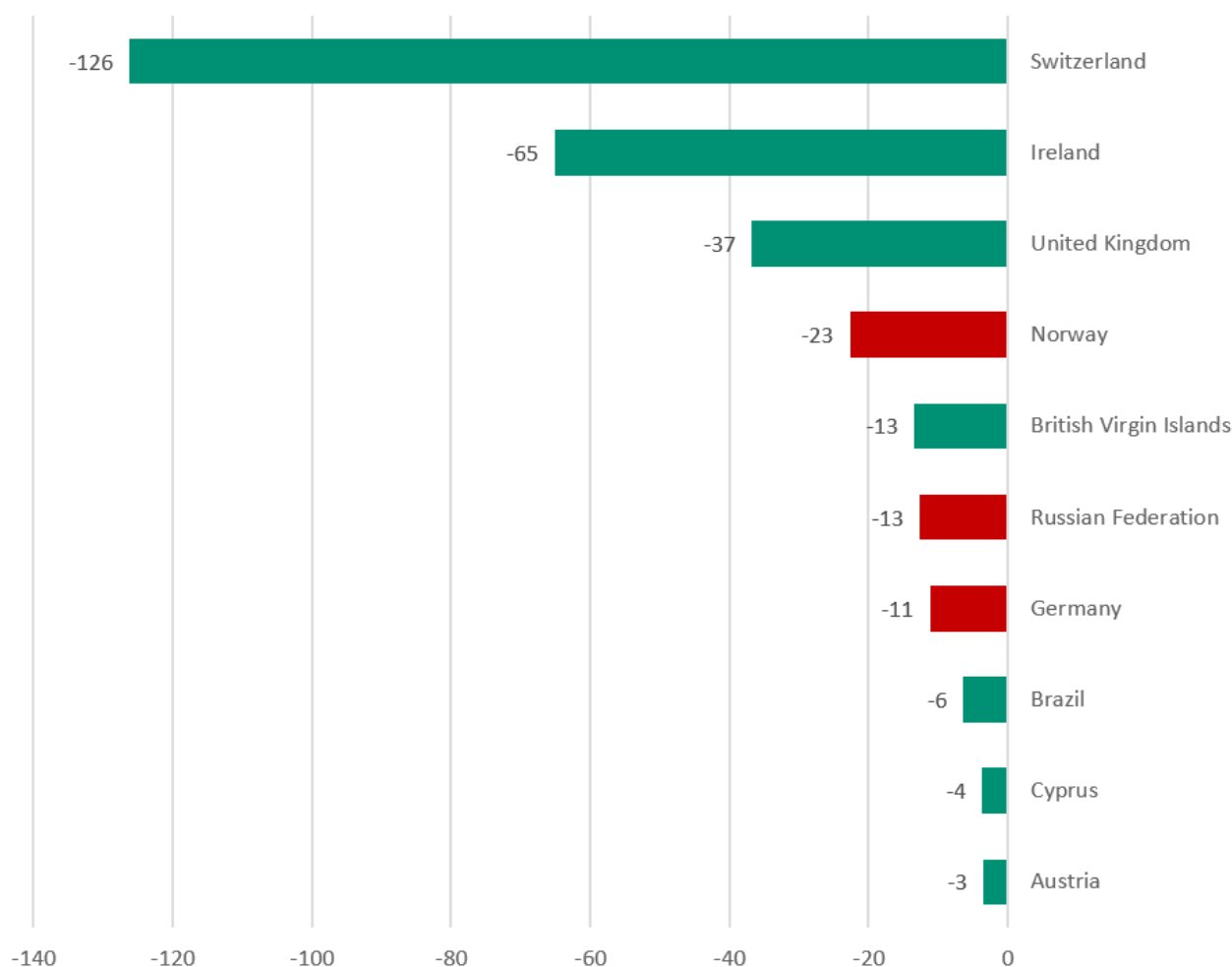
US Investment to the Baltic Sea region countries was immediately hit by the US tax reform, although it has not been possible to come up with an exact number due to a lack of comprehensive bilateral FDI data for 2018 and problems of attribution (if bilateral FDI declined, how much of this could be attributed to the US tax reform). With those reservations in mind, we can use the overall performance of inward FDI in the region as a proxy. It declined by 48 per cent in the Baltic Sea region, much sharper than the 13 per cent world average. Of the ten economies with the sharpest decline in 2018, three (Norway, the Russian Federation and Germany) were from the Baltic Sea region (Figure 9), in addition to economies which have been traditionally conduits for indirect FDI, such as Switzerland, Ireland, the British Virgin Islands, Cyprus and Austria, in that order (cf. Kalotay, 2015; Casella, 2019). It remains to be seen if the impact of the tax reform fades away quickly or stays with us for the longer term.

Figure 8. Combined statutory corporate income tax rates in selected economies, 2019 (Per cent)



Source: Author's calculations, based on data from OECDStat, Corporate Tax Statistics Database, Statutory Corporate Income Tax Rates.

Figure 9. Ten economies of the world with the biggest decline in FDI inflows, 2018 (Change over 2017 in US dollar billion)



Source: Author's calculations, based on data from UNCTAD, FDI/MNE database.

6. The spectre of ISDS and the failure of TTIP: a challenge for American investment in the EU member countries of the Baltic Sea region

As mentioned in section 4, of the ten Baltic Sea region countries, eight are full members of the EU. A tenth one, Norway, is intricately linked with the EU via the European Economic Area, which can be interpreted as a sort of deep and comprehensive free trade agreement, enabling the extension of the single market to third parties. As a consequence of this situation, the policy making efforts of the EU with the United States are of paramount importance for this group of eight plus one, although there is a debate about exactly what Norway is linked to the process (Melchior, 2016).

The most ambitious project of cooperation between the EU and the US has been the Transatlantic Trade and Investment Partnership (TTIP), launched in 2013. Its format is very similar to that of the EU accession, namely the creation of 24 joint EU–US working groups. Between 2013 and 2016, 15 negotiating rounds took place. Then in 2017, President Trump decided to halt the negotiations, although it was not clear if this meant a full end to TTIP or there was a way for resuming it in a different format as in the case of the NAFTA renegotiations.

TTIP has been under heavy criticism because of its alleged encroachment on the right to regulate of countries at least due to potential provisions on regulatory cooperation, treatment of geographical indications, facilitation of cross-border data flows, and especially the inclusion of ISDS (Akhtar, Jones and Johnson, 2015, p. 2). There have been also critical remarks about the potential impact of the TTIP, subject to negotiations, on liberalizing new sectors for mutual investment, some of which may be controversial.

By far the biggest debate surrounded the provision of ISDS in the TTIP, usually gaining high-level political attention and attracting activism from civil society opposing what they see as excessive rights of MNEs at the expense of development concerns (see Toivakka, 2014). The debate was heated in part due to limited public knowledge about the often highly technical and confidential nature of the ISDS processes. In the meantime, the limitations of ISDS were often overlooked. For example, the discussion missed the point that an ISDS judgment cannot force a

country change its regulations or decisions, only pay damages to investors in case that harm is proven. To illustrate this point with an example relevant for the Baltic Sea region, majority shareholders of the expropriated Russian oil company Yukos registered abroad have been fighting various cases before arbitration courts, based on the provisions of the Energy Charter Treaty.⁴ They have won interim awards to the tune of a record \$50 billion but are far from getting the award enforced. For that to happen, the award should be recognized as executable by regular courts with the power of enforcement, and the courts should order of the seizing of the assets of the non-paying party. These awards will not be paid in the short run.⁵

It was also overlooked by critics of ISDS that, as mentioned above, only 29 per cent of the cases were won between 1987 and 2018 by investors, indicating that ISDS is not a free lunch for corporations. Mistrust also arose from the lack of appeals mechanisms. This explains the EU proposal for a permanent court that would act as an appeals body and a forum of discipline over the interpretation of the principles of ISDS.

It is also necessary to evaluate the threat of countries being overwhelmed by excessive complaints by MNEs. In the case of the US, the country has been defendant in 16 cases between 1998 and 2018, all of which initiated by Canadian companies under NAFTA provisions. Of these, *Methanex v. USA*, initiated in 1999, and completed in 2005, became cause célèbre because it contained a complaint about environmental regulations. Finally, the case was decided against the MNE and in favour of the host State. It is also interesting to evaluate the fears of ISDS on the EU side as this group has been definitively more on the complaining side: 561 cases initiated, versus 234 cases as plaintiff (including the new member countries in which the balance is different: 28 cases initiated versus 157 cases as plaintiff).

As the TTIP has not been materialized and will probably never be materialized in its original form, it is not clear what Norway's policy choices would have been vis-à-vis this instrument. It has been assumed that, on average, joining TTIP would have been the most rational, with question marks about specific sectors, especially agriculture (Melchior, 2016). Technically that would have happened with in the form of a trade agreement in which Norway or its grouping the EFTA, would have been formally equal to EU and the United States. Alternatively, Norway or the EFTA could have initiated a trade agreement with similar contents with the US. Naturally, with all negotiations frozen and trade wars looming, these have remained hypothetical questions.

The consequences of the halt of TTIP on US FDI in the Baltic Sea region have not yet been analysed and measured. We have to accept the hypothesis that probably the impact is negative, especially coupled with tensions in the international trade agenda.

7. The policy challenge of US sanctions and Russian countersanctions for American investment in the Russian Federation

The Russian Federation is the only Baltic Sea region economy which has relatively loose relationship with the EU. A general framework called Partnership and Cooperation Agreement (PCA) has been in place since 1997. Negotiations on a deeper agreement started in 2008 but halted in 2010 due to lack of progress on both trade and investment issues and suspended in 2014 after the annexation of the Crimea by the Russian Federation. As a consequence, the Russian Federation is the only country in the Baltic Sea region not affected by a potential trade war between the US and the EU.

US investment in the Russian Federation is affected largely by the sanctions that the United States started administering after the Ukrainian and Crimean crisis in 2014. Already at that time, it was assumed that flows towards the Russian Federation would be more affected than the countries outflows due to the clout of the United States and EU to pressure firms with business transactions in the country (Kalotay, 2014). Then the Russian Federation applied its countersanctions, further limiting the margin of manoeuvre for MNEs established on its territory to

4 *Hulley Enterprises Limited (Cyprus) v. The Russian Federation* (PCA Case No. AA 226); *Yukos Universal Limited (Isle of Man) v. The Russian Federation* (PCA Case No. AA 227); *Veteran Petroleum Limited (Cyprus) v. The Russian Federation* (PCA Case No. AA 228).

5 Enforcement is a weak point of ordinary international judgments, too. In the Yukos case, in addition to ISDS, there took place also a "normal" proceeding before the European Court of Human Rights (ECtHR), with similar results and similar limits to the execution of the judgment. In 2012 ECtHR found that the expropriation of the Yukos company by the Russian authorities back in 2004 (eight years before) was illegal, and in 2014 ordered the Russian Government to pay about €1.9 billion to those who were registered shareholders of Yukos at the time of its liquidation, including the Russian ones who could not be party to ISDS (McCarthy, 2016). However, the judgment was never enforced, as in July 2015 the Russian Constitutional Court ruled that that the Government "can step back from its obligations" to safeguard the Russian Constitution as the judgments by the ECtHR did "not override the pre-eminence of the constitution in the Russian legal system" (BBC News, 2015). This declaration of the superiority of national law over international obligation constituted a major blow to efforts towards building trust among investors in the rule of law in the Russian Federation, contributing to the sluggishness of FDI (in addition to low GDP growth and sanctions; for the latter see section 7). Two years later the same Russian Constitutional Court rejected the request of the ECtHR to pay the awarded €1.9 billion to shareholders of Yukos. As a formal retaliation, the Council of Europe condemned the refusal of the Russian Federation to implement the judgment of the ECtHR, as it "bears far-reaching consequences for human rights protection in Russia and elsewhere in Europe" (BBC News, 2017).

“please” both the host and the home country at the same time (cf. McNamee, 2017). It is to be stressed here that all these sanctions and countersanctions are different from the ones officially adopted by the United Nations Security Council.⁶ These are measures by individual countries or country groupings, without a global obligation to apply them universally.⁷

In the majority of cases, including between the US and the Russian Federation, sanctions do not ban all transactions and consequently do not stop all business links between partners, rather make their dealings more complicated and, consequently, more costly. In the Forbes magazine, it has been noted about the sanctions imposed by the United States on business in the Russian Federation that *“The CAATSA [Countering America’s Adversaries Through Sanctions Act, 2017] offers a complex web of instructions and prohibitions, many of which are open to interpretation. Nevertheless, several key blacklisted areas are clear: the law bans companies from working with the Russian defense/intelligence sector, in ‘special oil’ projects – deepwater exploration, Arctic oil, shale oil, on Russian export oil pipelines, and from any business involvement in Crimea... As usual, the devil is in the details. The most glaring example is the defense/intelligence sector: CAATSA only bans ‘significant transactions’ with it, but neither the law nor OFAC [Office of Foreign Assets Control of the Treasury Department] have offered a clear explanation of what constitutes ‘significant’...”* (Eremenko, 2018).

When analysing the impact of sanctions on FDI flows, it has to be borne in mind that FDI is not the main target, in fact there is ambiguity if the economy is target at all. The usual interpretation is that only “bad” individuals and selected enterprises are targeted, and on the side, imports of certain goods and services. They are often applied in a mirror effect: sanctions against individuals trigger sanctions against individual from the other side, sanctions against firms trigger sanctions against firms and trade (import and export) bans trigger trade bans. These complexities make the study of the effect on a given set of FDI flows (e.g. from the US to the Russian Federation). To be noted equally that comprehensive studies to be relied on in the analysis of the impact of sanctions is more available on Russian outward FDI (see, for example, Liuhto, 2015; Kheyfets, 2018) than on Russian inward FDI.

As expected, one of the main areas where sanctions matter is the system of international payments (cf. Kalotay, 2014). By payment system we mean not only the channels which are the more visible (such as the credit card systems in which US restrictions on Visa and MasterCard have been countered by Russian attempts to switch third countries), but also access to international clearing systems. These are major obstacles to US firms operating in the Russian Federation. Trade sanctions also bite MNEs, especially those that specialized on goods (mostly food items) under import embargo from the Russian side (cf. Oja, 2015). In general, the fact that GDP growth is hindered or held back in the Russian Federation (see Kholodilin and Netsunajev, 2017; Oxenstierna, 2018)⁸ is a loss of business opportunities for US MNEs. Then the fact that their chances are limited by Russian restrictions in accessing import substituting programmes can further add to difficulties.

The fact that sanctions and countersanctions have increased the cost of doing business in the Russian Federation has been confirmed by the year 2018 survey of members of the American Chamber of Commerce in Russia. It was reported that *“One out of four American companies put new projects in Russia on hold while more than one-third said they face disadvantages because of U.S. sanctions... The sanctions negatively affected the plans of 84 percent of the surveyed companies...”* (Moscow Times, 2018). These results highlight one of the unintended adverse effects of sanctions, namely the creation of competitive disadvantages for American business in the Russian Federation compared with MNEs from countries not applying sanctions.

Despite all difficulties, including uncertainties about business prospects and the Russian currency, there are signs that most MNEs wish to stay in the Russian Federation. It has been pointed out in the Financial Times that *“The sanctions will deter investment for a while but new developments will soon begin and life will continue as before. Russia may not be loved but its resources are needed”* (Butler, 2018).⁹ In addition to natural resources, the technology capacities of the Russian Federation have remained very attractive, for example in aerospace (Ferris-Rotman, 2018) and in information technology (Russia Business Today, 2018).

6 “Since 1966, the Security Council has established 30 sanctions regimes, in Southern Rhodesia, South Africa, the former Yugoslavia (2), Haiti, Iraq (2), Angola, Rwanda, Sierra Leone, Somalia and Eritrea, Eritrea and Ethiopia, Liberia (3), DRC, Côte d’Ivoire, Sudan, Lebanon, DPRK, Iran, Libya (2), Guinea-Bissau, CAR, Yemen, South Sudan and Mali, as well as against ISIL (Da’esh) and Al-Qaida and the Taliban... Today, there are 14 ongoing sanctions regimes which focus on supporting political settlement of conflicts, nuclear non-proliferation, and counter-terrorism. Each regime is administered by a sanctions committee chaired by a non-permanent member of the Security Council. There are 10 monitoring groups, teams and panels that support the work of 11 of the 14 sanctions committees” (United Nations Security Council, no date).

7 It is also beyond the scope of this report to evaluate to what degree certain sanctions are legal or legitimate (ethical). It takes note of the impact without taking position in those delicate issues.

8 Oxenstierna (2018, p. 4) reviews various estimates about the loss of Russian GDP due to sanctions. They vary between 1 and 2 per cent of GDO, which may be lower than losses due to sluggish oil prices, estimated to contributing to a 4–5 per cent reduction of GDP.

9 To substantiate that point, it was further argued that *“The country’s remaining resource base is enormous, with proven reserves of 106bn barrels of oil and 3tn cubic meters of gas, according to the latest BP Statistical Review. And, for all the immediate political challenges, western companies are still able to work there and repatriate profits. Mr Putin understands the industry and knows international investment is key to the flow of revenue that sustains him in power”* (Butler, 2018).

8. Conclusions

In sum, it can be affirmed that US FDI in the Baltic Sea Region is well below its potential. It is also unevenly distributed among partner countries, with Germany benefitting from the blunt of the flows. Moreover, the trend is generally downward, belying the good potential for increase in the long term (Kalotay and Sulstarova, 2013). Reasons for this underperformance may be in the current protectionist international policy environment, discriminating against the small open economies of the Baltic Sea region, having vested interests in a well-functioning multilateral system. In the case of American investment in the Russian Federation, it is largely hindered by political tensions, including sanctions and countersanctions.

This report has touched upon only briefly the technological fundamentals of US FDI in the Baltic Sea region. In principle, the two partners should have mutual interest in intense cooperation except if policy obstacles completely prevent it. The United States continues to be the global leader in many new technologies, while the Baltic Sea region economies have expertise in selected areas. Future will show how the sluggishness of American investment in the Baltic Sea region would hurt development on the two sides of the Atlantic, and which of the two partners would lose more under these circumstances.

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