Multilateral Agreements on Investment: Lessons from the Past and the Road Ahead

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ABSTRACT

A multilateral agreement on investment (MAI) is an agreement between sovereign states which is meant to safeguard the investments that companies undertake in foreign countries. Given the importance of foreign direct investment, one would expect to find such an agreement on the top of every international organization’s agenda. The OECD started negotiations for such agreement in 1995 and the newly established WTO set up a working group in 1996 regarding the same. At that time, however, those attempts failed. The negotiations at the OECD were suspended in 1998 and the WTO did not move beyond TRIMS, the Agreement on Trade-Related Investment Measures that is limited, to the subset of trade-related investments. The study traces the history of International Investment Agreements, along with their features, advantages and disadvantages. The paper takes at the chronology of the events which led to the failure of MAI. The analysis concludes with the road ahead for multilateral agreements on investment.

Keywords: Multilateral Agreement on Investment, WTO, Foreign direct investment, Capital Flows, Development.

1.0 Introduction

International collective action on investment has a long and troubled history. The history of multilateral investment rules is a tale of successive disappointments. The history begins with the proposal for an International Trade Organization (ITO) in the 1940s, and its rejection by the United States Congress. FDI-related topics were among the most important and controversial. In the end, they were a crucial factor in the rejection by the United States of the Havana Charter that would have created the ITO. As a result of these developments, FDI-related aspects were largely ignored in the context of the General Agreement on Tariffs and Trade (GATT) until the Uruguay Round negotiations.

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In between times, however, a range of initiatives were promoted in different forums, key among these being:

- The binding codes of the Organisation for Economic Cooperation and Development (OECD) on *Liberalisation of Capital Movements and Current Invisible Operations* (1963), requiring the liberalisation of inward and outward capital movements over the long-term.


- The voluntary OECD *Guidelines for Multinational Enterprises*, published in 1976 and regularly updated (with little evidence of implementation by transnational corporations (TNCs)).

- Investment came back on the GATT agenda with the Uruguay Round Agreements (1995). As part of a package that led to the establishment of the WTO, a number of agreements with explicit investment content were approved, namely, the Agreement on Trade-Related Investment Measures (TRIMs), which limits FDI performance requirements to some extent; and the General Agreement on Trade in Services (GATS), which includes FDI in services.

- In addition, agreements with continuous and direct relevance to investment include the Agreement on Trade-Related Intellectual Property Rights (TRIPS), which establishes standards and enforcement procedures for intellectual property; the Agreement on Subsidies and Countervailing Measures restricting some subsidies and retaliatory actions; and the Agreement on Dispute Settlement Understanding where government-to-government disputes on investment issues are included.

However, most of the above agreements do not appear to have been designed specifically with investment in mind, are limited in scope and lack integration. Despite the advances, attempts at crafting multilateral disciplines on investment have tended to encounter recurring difficulties. While the need for foreign direct investment (FDI) is generally recognised, even among the skeptics, the push for an international agreement has been rather lukewarm in some countries. This lack of enthusiasm or sometimes even an outright hostility could be a serious problem for the international trading system and for capital markets.

### 2.0 Review of Literature

There have been a number of studies which trace the implications of Multilateral Agreements on Investments. Khor (1996) investigates the grave implications of such
Multilateral Investment treaty for developing countries, and suggests alternatives that are available to them. The proposed treaty would deprive developing countries of a large part of their economic sovereignty. This goes against various UN charters and declarations. It removes the right of states and the powers of governments to regulate foreign investments and investments in general, as well as other key elements of macro-economic policy, financial management, and development planning. The rich countries are pushing for this treaty to strengthen their own companies' access to Southern countries' markets and resources. If there is a need to discuss the inter-related issues of investment needs, and the rights and obligations of investors, the forum should not be a negotiating venue like the WTO, but a more open and neutral body such as UNCTAD, which has the mandate to discuss policies within the context of development.

Mukherjee (1996) suggests that based on current trends in global demand for labour and professional services, gains to poor countries from accessing foreign labour markets through WTO can be considerable both at micro and macro level. A treaty such as the MAI would help in liberalisation of labour services as a part of the multilateral trading system where dispute settlement machinery of WTO can be accessed for settling disputes. It would help the poor countries to reduce present arbitrariness and uncertainties regarding export of labour services. It would also provide them with opportunities to increase their gains by participating in the multilateral trading system and augment their export earnings, income, employment and reduce poverty.

Dhar and Chaturvedi (1998) analyse the implications of lifting of controls over the movement of all forms of capital. The proposed multilateral agreement on investment could bring about significant changes in the foreign investment regime. Foreign investors would not only enjoy the advantages of national treatment and most favoured nation treatment, they would also have unrestricted rights to transfer, particularly from their host countries, any payments that would be due to them from their investments. Furthermore, the rights they enjoy would not be tempered by any obligations to their home or the host states.

Kumar (2001) discusses, from a developing country perspective, issues concerning the ongoing review of the Agreement on Trade Related Investment Measures and the move of the industrialised countries to bring the investment issue on the WTO agenda. The paper concludes that bringing an agreement on investment, beyond TRIMs, on the WTO agenda will not be in the interests of the developing countries. Nanda (2003) argues that the case for further trade facilitation in developing countries is not well established, given the remarkable differences in their levels of development.

Kumar (2003) examines the relevance of a multilateral framework on investment from a developing country perspective in the light of available evidence on the role of
FDI in development. It also suggests the policy options that developing countries may consider at the Cancun Ministerial Conference on the issue of Trade and Investment.

Sauvé (2006) explores the forces that have to date impeded the development of a multilateral set of rules on investment. The fact that investment is off the Doha Round’s negotiating agenda means that bilateral and regional initiatives are currently the only feasible avenues for countries to pursue and deepen investment ties with their key trading partners. Brunner and Folly (2007) put forward the fact that despite the large and growing importance of foreign direct investment (FDI), the international legal investment framework is highly fragmented. The paper analyses the ill-effects of such a situation. The current fragmentation of the legal framework creates transaction costs for multinational enterprises (MNEs) which range from the cost of legal advice to the cost of the uncertainty about rights and obligations. Willmann (2009) suggests that multilateral agreement, expropriation leads to a joint reaction by all MNEs. Switching to such a regime increases worldwide FDI and raises the world interest rate.

3.0 Multilateral Agreement on Investment: Developments

The European Commission (EC) has lobbied for a foreign-investment treaty (or 'multilateral investment agreement') within the World Trade Organisation (WTO), with the support of the USA, Japan, and other Northern countries. Negotiations on a proposed multilateral agreement on investment (MAI) were launched by governments at the Annual Meeting of the OECD Council at Ministerial level in May 1995. The objective was to provide a broad multilateral framework for international investment with high standards for the liberalisation of investment regimes and investment protection and with effective dispute settlement procedures, open to non-OECD countries.

The European Commission (EC) version of the MIA would give rights to foreign companies to establish themselves with 100% equity in all sectors (except security) in any WTO country, without restrictions, and to be given "national treatment" (or be treated equal to or better than local firms). National policies/laws that favour local enterprises or facilities would be deemed discriminatory, and thus against WTO norms and have to be cancelled. A Negotiating Group held its first meeting on 27 September 1995 with the participation of representatives of the OECD’s then 25 member countries and the European Commission. In a statement, they said the MAI would be a free-standing international treaty open to both OECD countries and non-OECD countries, which were to be consulted as negotiations progressed. Negotiations were discontinued in April 1998, however, and they will not be resumed.
4.0 Principal Elements of the MAI

The EC plan has been outlined by Commissioner Sir Leon Brittan in an EC paper, 'A Level Playing Field for Direct Investment Worldwide', which was informally circulated to WTO diplomats in Geneva. The draft paper proposed that multilateral rules on foreign direct investment (FDI) would be set up containing three principal elements:

- Generally free access for investors and investments;
- National treatment for investors and their investments;
- Accompanying measures to uphold and enforce commitments made to foreign investors.

4.1 Free access to foreigners

Under the issue "free access", the EC paper explained that worldwide there remains a "host of barriers that prevent foreign investors to enter the host countries freely."

It gives some examples:

a) Governments may only allow a foreign investor to set up a subsidiary or take over a local enterprise after a specific authorisation is given. Foreign investors may only be allowed to start operations in the form of joint ventures with local companies. Joint ventures sometimes cannot be majority-owned or controlled by foreigners.

b) Foreigners can be excluded from participation in privatisations or barred access to government concessions.

c) Performance requirements, such as export or local purchase requirements, can be made a condition for establishment.

d) Complete sectors like transport, energy or financial services can be closed for foreign investors.

The above rules quoted do exist in many developing countries, and have been set up by governments with the aim of increasing the benefits to the host countries from having foreign investments, or of enabling local companies to strengthen themselves by shielding them from the full force of competition from foreign firms. These barriers "clearly are costly", not only to the investor but also to the host economy, and its obvious implication is that such rules should be scrapped. However, there are a few areas where restrictions on foreign control are reasonable, for instance, in the case of a strategically vital defence industry.

The draft stated that the following "essential principles" should apply worldwide:

- A general commitment to grant the legal right for foreigners to invest and operate competitively in all sectors of economy.
Only transparent, narrowly defined and well justified exceptions from the general right of entry for FDI are permissible. National security restrictions or public order considerations might not develop into a pretext for protectionism.

Most favoured nation treatment (non-discrimination). Host governments should not be in a position to accord preferential treatment for investors from certain countries and thus discriminate against others.

A "standstill" commitment not to introduce new restrictions.

A "roll-back" commitment to gradually eliminate measures that run counter to liberalisation and to open up closed sectors.

It was clear from the above principles that the EC was trying to get developing countries to accept that foreign companies should have the "right of entry and establishment" in their countries. In other words, should a foreign company want to enter and set up operations in a country, the government should not have the power to stop it from doing so, unless there are exceptional reasons (which are multilaterally agreed on).

4.2 National treatment for foreign firms

The draft paper proposed that once they have been given entry and have been established in a country, foreign companies should then be given "national treatment". This is a term used in the General Agreement on Tariffs and Trade (GATT) and the WTO to imply that a foreign product imported into a country should be treated the same way as a local product. The EC paper makes clear what it means by "national treatment" in the context of investments. It says: "In general, the host country should treat the foreign investor and his investment operating in its territory in the same way as a domestic investor or firm." The paper adds that the national treatment principle should be complemented with the "most favoured nation standard" where host countries grant to foreign investors specific favourable conditions not available to national investors. In other words, there should not be discrimination between investors from different foreign countries.

The EC's rationale for national treatment is that in the absence of this principle, the foreign investor "might find the operation of his firm hampered by discriminating measures." The paper mentions the following "typical restrictions": a prohibition to own real estate, limited or no access to government aids and subsidies (example: participation in R&D programmes), discriminatory tax provisions or an exclusion from bidding for government contracts. The paper says that most of these restrictions discriminate against foreign investors and "should be outlawed." It concedes that there can be exceptions, such as access to R&D subsidies, public order and national security. But in general, national treatment must apply.
4.3 Accompanying measures

The EC paper goes further in saying the right of entry and national treatment alone are "not enough" to create favourable conditions for FDI. Multilateral rules should also cover "accompanying measures"; for instance, an effective mechanism to settle disputes between the source and the host country, the freedom to make financial transfers etc. Expropriation of a foreign investment is only possible in exceptional and internationally recognised cases and must be accompanied by adequate, effective and prompt compensation. Host countries must also have transparent domestic regulations, and assure that international obligations are honoured by sub- federal and local authorities.

Further, the EC proposes that rules on investment should also consider informal and structural barriers not directly linked to FDI but have consequences for investment flows. Examples include: merger control and anti-trust laws that prevent the making of an investment; private practices such as ownership restrictions in company by-laws that could discriminate against foreigners; exaggerated investment incentives that distort investment flows or lead to a "race to the bottom" between countries and regions. The paper adds that a multilateral investment instrument could also address "taxation, labour or environment policies" as these can influence the climate and conditions for FDI.

5.0 Promoting Investment in the South: The Illusionary Motive behind the MAI?

In promoting its proposal to developing countries, the EC says the foreign investment treaty would lead to greater foreign investment in the South. However, concern for the interests of the South is only a pretext. The real motives of the proponents were to increase the access of their companies to resources and markets of the developing countries, and to have another powerful instrument that prevents the emergence of strong domestic enterprises in the South and thus block the development of potential rivals.

They have already introduced other instruments or concepts for controlling rivals and decreasing their competitiveness, such as the TRIPs (trade-related intellectual property rights) agreement, TRIMs (trade-related investment measures), social clauses (trade measures linked to labour standards and human rights), and environment standards (such as in PPMs or process and production methods). But the investment treaty would be the most serious. It would be a return to a colonial era situation, where the master country governments through force enabled their companies to enter and take over the land, minerals and other resources of colonies, and took over the colonies' markets as well.
The investment treaty is designed to erode or significantly remove the rights of Southern governments to regulate foreign investors and reduce their ability to build up local enterprises, which will not be able to compete with the bigger foreign firms. It would also prevent local firms from developing the capacity for manufacturing exports.

5.1 Implications for developing countries

The implications of these proposals for each developing country can be stated as follows:

a) The strategy of reducing foreign share and increasing local share of equity would be threatened. Social engineering through equity requirements would be impossible, thus denying countries with serious ethnic or other inequities a key instrument for structural reform.

b) Joint ventures would disappear; foreign firms would prefer to take the form of wholly-owned subsidiaries, without any equity restrictions. This affects the policy of encouraging or requiring joint ventures, to share the benefits of ownership and profit with locals, to facilitate technology transfer, and to limit foreign profit outflow. A worsening of the balance of payments (BOP) item 'investment income payments' can be expected.

c) The policy of requiring companies or financial institutions to incorporate themselves locally may become invalid. More seriously; the treaty will impose extreme financial liberalisation, with foreign banks and other financial institutions given the right to operate as nationals.

d) The EC proposal is that the treaty covers all sectors, except defence (even here, it warns that national security or preservation of public order should not shield protectionism). Foreign firms and foreign individuals must be allowed to enter all areas and be treated like locals, in sectors including land, real estate, services including health, law, travel and transport, media and communications, finance, agriculture, mining, construction, and manufacturing. Unrestrained foreign entry could overwhelm a national economy. Developing countries have to some extent tried to resist pressures for liberalization in services, especially in the financial sector. The investment treaty will be used as a new instrument to overcome what is seen as 'resistance'.

e) Policies favouring local businesses would have to be cancelled. Many local enterprises, their market-share cut, would be deprived of preferential management and development planning. Equity ownership, foreign-exchange inflows and remittances, and the direction of investment decisions, volume, and flows would increasingly lie outside the purview of government.
f) Government would be deprived of the right to regulate the terms of foreign ownership of houses, real estate, and land (urban and rural).

g) With government deprived of discretionary powers to set terms of entry and regulatory powers, the possibility of technology transfer (already at an unsatisfactory level) would be reduced further.

h) It would be much more difficult for government to reduce BOP problems, reduce imports, or strengthen export potential. Many developing countries could fall into BOP crisis, or be unable to escape from such a problem.

i) Other aspects of the economy (tax system; company laws; government contracts, awards and purchases; the industrial structure and local monopolies) would also come under scrutiny for signs of favouring locals against foreigners, and changes would be sought.

j) There would be major cultural implications, as the proposed treaty would not allow exclusion on cultural or moral grounds. Foreign companies in the sensitive areas of media, communications, and information would be allowed to enter and be treated on a par with local firms.

6.0 The Collapse of the Multilateral Agreement on Investment: The Timeline

The issue of investment rules at the WTO has its origins in the desire of capital-exporting countries and investors to secure market access and stronger protection for investors through agreements that would ensure national treatment of foreign investors, limit host state regulation of entry, and ensure adequate compensation for expropriation and effective dispute resolution measures. A multilateral agreement had the advantage of coverage of a broad range of countries and thus would ensure consistency.

- The United States led efforts to launch negotiations at the OECD in the early 1990s because it was pessimistic about the prospects at the WTO.

- In 1995 the club of the world’s richest countries – the Organisation for Economic Cooperation and Development (OECD) – began negotiations on a Multilateral Agreement on Investment (MAI). This proposed agreement was hailed by critics as a ‘corporate bill of rights’ giving multinational companies sweeping rights to invest in countries and challenge government regulations. As a result of public pressure and disagreements between OECD members, the MAI collapsed in late 1998.

- At the WTO’s Singapore Ministerial Conference in 1996, the EU got an agreement from other WTO members to establish ‘working groups’ to study the feasibility and desirability of WTO rules on a range of issues, including investment. These issues became known as the ‘Singapore issues’ or the ‘new issues’. 
• At the 1999 WTO Ministerial in Seattle, the EU supported by a small number of countries such as Japan, attempted to push for an end to the ‘working group’ stage and the beginning of negotiations on new rules on investment. The total collapse of the Seattle meeting meant no deal was struck to start any talks let alone on investment.
• After the failure to initiate a millennium round of negotiations at the 3rd Ministerial Conference in Seattle in late 1999, eventually in November 2001 the Doha Round was launched.
• Heralded as a “development round” 21 subjects are listed in the Doha Declaration, including a number of investment-related items, namely: negotiations on specific issues in the GATS, in the TRIPS Agreement, and in the Anti-Dumping and Subsidies Agreements; while working groups study the topics of the relationship between trade and investment, the interaction between trade and competition policy, and trade and technology transfer.
• The 5th Ministerial Conference (2003) in Cancún, Mexico, proved a setback to the Doha Round, and to its claims to be a development round. At the WTO Ministerial in Cancún in September, 2003, a group of more than twenty developing countries united to block the inclusion of the Singapore issues, including investments, in the Doha Round of trade talks.
• The impasse surrounding investment and its treatment in the WTO system was ultimately resolved in the WTO General Council’s July 2004 decision to confine Singapore Issue discussions under the Doha Development Agenda (DDA) solely to the subject of trade facilitation.
• WTO members agreed in the July 2004 framework that the three other Singapore issues (including investment) ‘will not form part of the Work Program set out in that (Doha) Declaration and therefore work towards negotiations on any of these issues will take place within the WTO during the Doha Round’. Thus, any further discussions on investment at the WTO for the time being would be limited to work that does not relate to negotiations.
• The most immediate fallout from the failed WTO initiative will be to shift the focus of key rule-making initiatives on investment at the bilateral and regional levels. These will take the form either of BITs or of preferential trade and investment agreements (PTIAs).
• The OECD promotes the Declaration on International Investment and Multinational Enterprises and the OECD Guidelines for Multinational Enterprises, last revised in 2000. In addition, from May 2006, the OECD has promoted a non-binding set of
7.0 Arguments in Favour of MAI

Some of the powerful arguments laid out in favour of MAI have been listed below.

a) **Growing importance of FDI**: The reality of the post-war economic developments has been the growing importance of FDI in many countries of the world and in international economic relations. This trend has accelerated in the last decade. The growth of FDI has its origin in powerful forces of capital movements which go hand in hand or may even replace trade flows. It is generally thought that these forces work very strongly both on the supply side (home country) and demand-side (host country). In home countries, these forces include the benefits from increased market access and improved competitiveness due to a better access to cheaper inputs or to strengthening of the company's capital base as result of strategic alliances with foreign partners. For the host countries, the benefits of FDI include an improved access to technology, marketing channels, organisational and managerial skills, and the contribution to domestic savings and investment. A number of studies such as WTO (1996) and the research carried out by the Centre d'Etudes Prospectives et d'Informations Internationales in Paris clearly show that there is a strong element of complementarity between trade and FDI, both in the home and host countries. In other words, trade tends to encourage FDI, and FDI tends to encourage trade. The contribution to domestic resource allocation and investment can also be very positive. Hence, an investment agreement will turn out to be beneficial for both the host country and the home country.

b) **Transparency, predictability and legal security**: Foreign investors need transparent and predictable rules on which they can operate, and these rules must include legal security. Otherwise, they would require a corresponding financial return as compensation for these additional risks. In many circumstances, such risk and the corresponding rewards would be prohibitive for the host countries. A powerful argument for an MAI is, therefore, that it will provide the needed transparency, predictability and legal security. Ambiguous, biased and controversial rules are the classical deterrent to foreign investors. Unwritten conventions or traditions do not have the same value as agreements signed by governments.

c) **National legislation is no alternative**: Many developed and developing countries have been undergoing a rapid and profound process of policy liberalisation. The process has affected fiscal, monetary, financial, infrastructural, trade and other
policies (Drábek and Laird, 1997). The process has made both outward and inward FDI more attractive but the legal provisions underlying this process are not sufficient. In fact, the absence of an international agreement can have serious consequences for FDI flows. First, foreign investors need a legal protection to do business. Without such a protection, the risk of doing business in a foreign country may be so excessive that they decide not to invest. Moreover, the cost of compliance may be too high, resulting in investment that would typically be highly speculative and short term. Second, national legislation is often not sufficient to provide adequate security to foreign investors. National laws and their enforcement may differ between the host and home country requiring, in the very least, an international mechanism for dispute settlement. Therefore, the Governments should adopt an international agreement like MAI.

d) Policy coherence: There has been a dramatic proliferation of various international agreements in the past. Many of these agreements have been signed bilaterally, others are regional (such as NAFTA and Mercosur) or plurilateral. By June 1996, the total number of bilateral investment treaties was nearly 1160, of which two thirds were signed during the 1990s (WTO, 1996 and UNCTAD, 1996). Different agreements often have different coverage of issues and may even apply different rules. Separate negotiating initiatives increase the risk of inconsistent rules established in different agreements. The presence of different agreements also increases the costs of doing business, something that is often overlooked by the proponents of bilateral and regional approaches. This too is an impediment to FDI. In sum, the need for rule and policy coherence rough the MAI is now well recognised.

e) Marginalisation of non-signatories: One serious problem of regional or bilateral agreements is the marginalisation of those countries that are not signatories of these agreements and remain outside them or the existing plurilateral or regional investment agreements. It is evident that foreign investors will always prefer to do business with those countries in which they have a legal protection through an international agreement. Thus, there are two main advantages of a truly multilateral MAI. First, it is a ‘complete’ instrument while regional, bilateral and plurilateral agreements are not. Second, a non-MAI would have to be a standalone agreement which would still have to be integrated into international law.

f) Competition for FDI: It is sometimes argued that governments should adopt policies of fiscal incentives to encourage FDI. In practice, the policies have indeed been adopted quite frequently. However, while there may be a theoretical argument in favour of such incentives under rather extreme conditions, the general position of
most economists is that incentive schemes are distortionary, inefficient and also costly. Moreover, a system of fiscal incentives may not even be effective to achieve the desired objective of attracting FDI because other countries that provide more generous fiscal incentives may divert FDI away from those countries that provide less generous incentives. Last but not least, competition for FDI is intense as more and more countries are hoping for a greater share of FDI inflows. Richer countries can provide more attractive incentives leading to further marginalisation of poorer countries. In order to reduce the likelihood of further marginalisation of poorer countries and the waste of resources needed to finance these incentives, the recourse to fiscal incentives as a stimulus to attract FDI must be eliminated. The problem is, however, how to convince countries to stop using incentives even if they know that these policies are wrong. In the presence of competition from other countries using fiscal incentives, it is very unlikely that any single country will be willing to abandon the practice of fiscal incentives unilaterally. The country will be prepared to do so only if other countries are prepared to give up their policies of fiscal incentives as well. Such a concerted action would clearly require an international agreement like MAI.

7.1 Arguments against an Investment Agreement at the WTO

The following arguments are generally levelled against an investment agreement at the WTO.

a) **An MIA would not increase FDI flows to the poorest countries:** A common claim made in favour of an MIA at the WTO is that the increased security and predictability this provides investors will translate into greater FDI flows to developing countries, and in particular those marginalised countries which currently receive only meager FDI inflows. There is no evidence that an MIA at the WTO will lead to greater foreign investment for the poorest and most marginalised countries, let alone that they will be the ones “to benefit the most”. By contrast, there is an extensive literature stretching back over several years which indicates that an MIA will not lead to increased FDI flows to the poorest countries. UNCTAD concluded, on the basis of its assessment of the impact of GATS commitments on foreign investment: “There is no empirical evidence to link any significant increase in FDI flows to developing countries with the conclusion of GATS.” (UNCTAD 2000a: 172) The World Bank reports similar findings for bilateral investment treaties (BITs), which – despite being typically more ambitious than multilateral agreements – have also had minimal effect in increasing FDI flows. It is well established that the key determinants of FDI flows to the poorest countries are economic and
infrastructural determinants. UNCTAD’s comprehensive analysis of the constraints on capital flows to LDCs highlighted in particular the costs of asset development, vulnerability to shocks, lack of business support services, weak physical, social and administrative infrastructure and the typically small scale of projects in the poorest countries (UNCTAD 2000b: ch.3)

By contrast, surveys conducted in order to identify key investment determinants in the poorest countries reveal that regulatory and legal frameworks do not constitute a major obstacle to investment decisions – particularly in light of the considerable liberalisation of FDI regimes in recent years. One survey of investment determinants across 30 African countries identified the regulatory and legal framework as having a negative impact on investment decisions in under 5% of cases (UNCTAD 1999: 51). Another confirmed that while foreign investors in Africa see the existence of a reform programme with the World Bank or IMF as a sign of stability, “they do not rank this as an important factor in investment decisions” (Bhinda et al. 1999: 55).

As a result of this accumulated evidence, there is a strong consensus that an MIA at the WTO is unlikely to lead to increased FDI flows to the poorest countries. The UK Government and others should therefore abandon their unsubstantiated claims to the contrary.

b) Non-discrimination is not a successful development strategy: Most economic historians agree that during the earlier stages of development, countries from the UK right through to more recent examples such as Finland, China and Malaysia have systematically discriminated between domestic and foreign investors in their industrial policy. They have used a range of instruments to build up national industry, including limits on ownership, performance requirements on exports or local employment, insistence on joint ventures with local firms and barriers to brownfield investments. Only when domestic industry has reached a certain level of sophistication, complexity and competitiveness do the benefits of non-discrimination and liberalisation come to outweigh the costs. As a result, countries generally move towards a greater degree of non-discrimination and liberalisation as they develop, as seen most clearly in the case of countries such as Taiwan and South Korea. In that sense, liberalisation is better seen as an outcome of development, not a cause.

As noted by Professor Dani Rodrik, "There is no convincing evidence that trade liberalisation is predictably associated with subsequent economic growth. The only systematic relationship is that countries dismantle trade restrictions as they get richer. (Rodrik, 2001) Non-discrimination, and in particular national treatment, has historically seldom been part of successful development strategies.
c) **GATS-style flexibility is a myth:** Following the language of the Doha Ministerial Declaration, EU submissions to the WTO make reference to using a ‘GATS-style approach’ to a new WTO investment agreement, claiming that this will provide flexibility for developing countries to protect national development policies in the face of non-discrimination disciplines. However, GATS is not a model of flexibility. It is in fact undermining the ability of developing countries to use appropriate policies to achieve development (Hardstaff, 2003). Experience with GATS clearly shows that a ‘GATS-style positive list approach’ does not guarantee the flexibility developing countries need to pursue appropriate policies. In fact, over time, GATS guarantees a steady reduction in flexibility. As the Indian Ambassador to the WTO highlights in raising concerns over a proposed investment agreement, “As our experience with services has shown, great pressure would be brought to bear on developing countries to give greater – and still greater – market access to developed countries in these areas in subsequent stages.” (Permanent Mission of India, Geneva, 2003). Given the explicit proposal that a WTO investment agreement should be based on the same approach as that used in GATS, it is clear that the proposed MIA will also fail to provide the flexibility developing countries need to protect their national development policies and to ensure that FDI works to the benefit of their economies and their peoples.

d) **An MIA at the WTO would not be a balanced agreement:** Proposals in favour of an MIA at the WTO envisage a new set of disciplines and obligations on host countries, bound and enforced through the mechanisms of the WTO. By contrast, there is no mention of the parallel responsibilities of investors and their home governments. This imbalance threatens to undermine national and international attempts to hold foreign investors to account for their activities – and in particular TNCs. In part, this imbalance is because the WTO is a negotiating forum for nation states, and has no jurisdiction over investors. This highlights further why the WTO is not an appropriate forum for dealing with investment issues, which require a different set of instruments and expertise from those established under the trade mandate of the WTO. Relations between TNCs and host countries are in many cases already tilted in favour of the investor, not the potential development benefit of the investment. A new set of obligations on host countries bound and enforced through the WTO would tilt the balance still further, and make it increasingly difficult either to defend the domestic economy from the worst abuses of foreign investors, or to use FDI to its maximum development advantage. Instead of pursuing an MIA at the WTO, any energy which the international community can spend on a set of multilateral...
investment rules should be directed towards a binding framework of regulations
governing the activities of TNCs.

c) **An MIA would not see the end of bilateral investment treaties:** Proponents of an
MIA at the WTO argue that it will free developing countries from having to
negotiate a plethora of BITs, in which they will be at a greater disadvantage because
of unequal bargaining power. This argument is flawed for a number of reasons.
Firstly, there is no evidence that WTO agreements act as a brake on bilateralism. The
multilateral system became much more powerful in the 1990s, yet the EU and USA,
among others, vigorously pursued new bilateral and regional economic agreements.
Any MIA to be negotiated at the WTO would leave uncovered many aspects of
investment currently included in BITs, and there would be a continuing demand for
bilateral treaties to make up the shortfall. In agreement with other commentators that
envisage a continued growth in the number of BITs even alongside an MIA (e.g.
UNDP 2003: 251), the World Bank concedes: “In the case of the WTO, the Doha
Ministerial Declaration reflects a significantly more-limited approach that clearly
does not view a multilateral framework on investment as a substitute for bilateral
and regional arrangements.” (World Bank 2003: 127) Indeed, it is very hard to
imagine the WTO agreeing to rules which genuinely discourage bilateral agreements
by placing a limit on the demands that industrialised countries can make of
developing countries, e.g. regarding deregulation.

d) **A new set of complex negotiations might break the Doha camel’s back:** The launch
of the Doha negotiating agenda was hailed as a breakthrough for multilateralism, and
a breakthrough for developing countries, which stood to gain great benefits from
new agreements on a range of issues. Now, the WTO is facing a major crisis as it
attempts to negotiate that agenda. Deadlines on agriculture, special and differential
treatment, TRIPS and implementation have all been missed. Lack of political will
among developed countries, lack of capacity in developing countries, and the sheer
size and complexity of the agenda have led to extremely slow progress and now
threaten complete breakdown. This would jeopardise any gains that developing
countries might make from a favourable conclusion to the round. It is quite clear that
most developing countries are opposed to expanding the WTO agenda to include
negotiations on the new issues. At Doha, 29 developing countries explicitly
mentioned the new issues in their statements. Of these, 22 opposed their inclusion in
the Doha agenda, while only three spoke in favour of their inclusion (Mexico, South
Korea and Venezuela). At the meeting of the WTO’s Trade Negotiations Committee
in Geneva (2-3 April 2003), both the Africa group and the LDCs group at the WTO
reaffirmed their opposition to the launch of negotiations on these issues.
g) A WTO investment agreement will also not address the trail of environmental destruction and resource expropriation associated with many forms of FDI and could prevent much needed improvements in resource management and local participative decision making for sustainable development. The UK Government and European Commission argue that FDI is unequivocally good for sustainable development. By extension they seem to be saying that any WTO agreement aimed at restricting governments’ ability to regulate investment, allowing greater freedom for foreign investors, will promote sustainable development. Unregulated FDI may be more likely to worsen poverty than to improve it and that a WTO investment agreement will not necessarily bring any more or any better FDI. A WTO agreement would do little to help and would probably harm the prospects for sustainable development on three main levels. The first is in the overall pattern of production and consumption, the second is at the level of policy making and standards and the third is about the performance of individual investors.

At the big picture level a WTO agreement would probably serve to perpetuate the pattern of rich industrialised countries consuming more than their fair share of land, water, wood, minerals and resources. None of the proposals for a WTO investment agreement address the need for collective action to limit the race to the bottom, to raise environmental, labour and other standards, or to stop bad practices being concentrated in the areas where people have the least capacity to fight back. Instead the proposals would make it more difficult to address the sustainable development challenges the world faces for example, by including expropriation measures, and by limiting the policy space of host countries, or by giving more power to already powerful multinational companies.

7.2 MAI: An evaluation

This section presents an evaluation of MAI by listing the benefits that can be derived if such agreements are put into practice (Table 1). We also consider the flaws that need to be rectified.

Table 1: An Assessment of Multilateral Agreements on Investment

<table>
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<th>S. no.</th>
<th>ADVANTAGES</th>
<th>SPECIAL CONSIDERATION</th>
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<tr>
<td>1.</td>
<td>There are considerable advantages to foreign, domestic and expatriate investors of ‘locking in’ a developing country to an international regulatory regime, in terms</td>
<td>However, poor countries have special problems in terms of strength of public institutions and private enterprise which must be addressed in practice.</td>
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of reduced uncertainty leading to more and better investment. There would be additional benefits of ‘formalising’ trans-border relationships with firms, particularly in combating fraudulent firms, corrupt concessions, money laundering and tax evasion.

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<td>2. The transparency requirements in the MAI will strengthen market institutions in developing countries, as will the dispute settlement procedures.</td>
<td>Both could be very costly for poor countries</td>
</tr>
<tr>
<td>3. The restrictions in the MAI on performance requirements and other controls do not constitute a serious disadvantage for developing countries, and there is a wide margin for exceptions.</td>
<td>NA</td>
</tr>
<tr>
<td>4. The advantages of investor protection mechanisms in the MAI are primarily conceived in terms of increasing the credibility of government commitments, which then encourages foreign firms to undertake long-term fixed investments from which they cannot easily withdraw.</td>
<td>In the case of developing countries, the existence of such a commitment to foreign firms also enhances the security of domestic investors who hold their capital abroad (or may even be non-resident) encouraging them to repatriate these funds. These mechanisms hence should be emphasized.</td>
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<tr>
<td>5. The current draft text of the MAI does not contain explicit development objectives, but the scope and application provisions of the MAI - which define investors and investment - are appropriate in principle as they do no more than attribute the same treatment to foreigners as to domestic investors.</td>
<td>However, in many developing countries there are key sectors (such as mining) where large foreign firms have no domestic equivalents, which makes this concept somewhat ambiguous.</td>
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<td>6. The MAI provisions on expropriation do not represent a real constraint on sovereignty - particularly since public interest objectives allow for expropriations so long as these are not discriminatory. Never the less, it would still be possible for governments to impose across-the-board restrictions on investment under the MAI, so long as they apply to both domestic and foreign investors. Hence, the MAI will not substantially affect the domestic regulatory environment.</td>
<td>This may be positive for countries where the levels of institutional development and investment climate are reasonable by international standards. It may be of little help to the Low Income Countries (LIC) unless they receive considerable international support in order to reform and strengthen their domestic legislation and regulatory institutions.</td>
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<td>No.</td>
<td>Paragraph</td>
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<td>7.</td>
<td>The loss of sovereignty in the conduct of economic policy appears to be minimal or non-existent under the MAI, on the assumption that the feasible range of policy options are all based on making markets work effectively rather than replacing the market with the state.</td>
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<tr>
<td>8.</td>
<td>Given that borrowers in developing countries (particularly LICs) are credit rationed in the international and domestic capital markets, liberalisation of cross-border financial sector investment would be beneficial.</td>
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<td>9.</td>
<td>The provisions for general exceptions are of crucial significance to the eventual accession of developing countries to the MAI. The general exceptions would allow countries afflicted by military or civil conflict to remain within the Agreement. More importantly, they would allow developing countries to suspend whichever provision of the MAI is believed to seriously affect public order - identified in the text as being the protection of ‘the fundamental interest of society’.</td>
</tr>
<tr>
<td>10.</td>
<td>The performance requirement provisions of the MAI are not as far reaching or as negative as some commentators have claimed. Overall, the impact on developing countries, many of which have already embarked on the unilateral abolition of restrictions to foreign investment, are likely to be positive. Moreover, empirical evidence suggests that enlarging the technical and managerial skills of the domestic labour force is not only a necessary but also perhaps the most cost effective way to ensure technology transfer.</td>
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8.0 MAI: The Road Ahead

This section outlines some of the areas that merit attention and need to be addressed while concluding a MAI.

a) The MAI fails to tackle the single most important aspect of international investment taxation, the avoidance of double taxation. Since the tax systems of the major home countries are based on worldwide income taxation principles, their multinational companies are frequently subject to some degree of double taxation. This fact not only deters international investment, but also provides incentives for the use of tax havens to channel cross-border capital flows (through the incorporation of offshore holding companies). The use of these schemes is detrimental to the home country, but it also affects recipient countries through both reduced tax revenues and through distorted investment inflows.

b) The developing countries - and the smaller low-income countries in particular - would require considerable assistance if they are to accede to the MAI or any other agreement of this type. Wide and semi-permanent exceptions are not the solution, because these would undermine the very rigour which creates confidence among investors. The issue is thus one of raising domestic standards rather than lowering international requirements.

c) Such strengthening of domestic standards is a complex, lengthy and expensive undertaking. However, it could bring considerable benefits for foreign as well as domestic firms. In particular, it would involve an overhaul of the system of commercial law - including the courts - and a parallel rationalisation of systems of public registries, accountancy systems, and government regulation. The role of aid donors could be crucial in this regard - providing not just financial support but, more importantly, technical expertise.

d) The development impact of MAI on poor countries could be positive if special provision for their accession is made. There is sufficient flexibility in the existing proposal to accommodate developing country interests. De facto exclusion may lead to negative effects such as loss of productive investment and a risk of competitive lowering of legal, fiscal, labour and environmental safeguards.

e) The treatment of environmental standards in the preamble to the MAI contains an adequate commitment to international norms and should be acceptable. The proposed inclusion of binding labour standards, although perhaps desirable in a general sense, may not be feasible in practice for developing countries and would effectively prevent their accession. These issues need to be addressed.
f) As an essential complement to the MAI, multilateral tax agreements based on the model treaty proposed by the OECD should be established between existing members and acceding developing countries. This is necessary in order to ensure an equitable distribution of the fiscal resources arising from foreign investment.

g) Another major substantial problem of the draft MAI was its treatment of relatively volatile portfolio investment. Due to the broad definition of investment, portfolio gained the same protection and rights as foreign direct investment. The draft treaty text granted full transferability of all payments relating to an investment. A future international agreement on investment could narrow the definition of investment and treat portfolio investment different from FDI.

9.0 Conclusion

To be successful, future negotiators must learn their lessons from the failed OECD-negotiations. In addition to the difficulties arising during these negotiations, one major concern is the fact that certain countries like India do not have an interest to go for a full-scale Capital Account Convertibility. As a part of the G4, India is currently a major player in the trade-related international regulatory framework. It is argued here that the question of a multilateral framework for investment cannot be solved without taking into account the Indian reluctance to a freer investment regime.

The range of investment issues which should be tackled within a multilateral agreement remains a controversial matter. The MAI negotiations have shown that the most contentious issues are the scope of the future agreement, and whether it should include provisions concerning performance requirements, investment incentives and taxation. The multilateral approach has significant advantages over bilateral treaties and regional agreements, as it provides a level playing field for all firms, independent of their origin, and, consequently, improves allocative efficiency. Furthermore, the protection provisions within the MAI would have limited the discretionary powers of governments and, therefore, the MAI would have decreased the influence of interest groups. For these reasons, we believe that as many issues as possible should be regulated on a multilateral level. The potential gains from a multilateral investment regime are worth pursuing over the long-term.

References


