

Multilateral Rules on Investment: Lessons from the Periphery

Pierre Sauvé
OECD Trade Directorate, Paris¹
Pierre.sauve@oecd.org

Paper prepared for:

*The Evolving WTO Regime and Regional Economic Cooperation:
Implications for Northeast Asia*

Seoul, Korea

13-14 September 2002

¹ The views expressed in this paper are those of the author and should not be attributed to the Organisation for Economic Co-Operation and Development or its member countries. The paper draws in part on work currently underway in the OECD Trade Committee on the treatment of investment and services in regional trade agreements. The author is grateful to Michael Gestrin, Mark Koulen and Richard Newfarmer for helpful comments and discussions.

1. Background Considerations

This paper surveys investment provisions in regional integration agreements (RIAs) with a view to highlighting whether and how these have gone beyond WTO norms on investment. It is generally acknowledged that the Uruguay Round went further than any previous GATT round in placing investment issues on the multilateral trade agenda. Concurrently, the pace of developments with respect to the negotiation of rules on investment at the sub-multilateral level also accelerated during the early 1990s.

This dual evolution of the international policy framework for international investment reflects the growing recognition of the role investment has come to play in international economic development and integration. Just as trade was perceived as one of the key drivers of global economic growth during the post-War decades, foreign investment has since the 1980s come to be perceived as an important 'new' mode of global economic linkage. Statistics indicating that flows of foreign direct investment began outstripping both global trade and GDP growth rates in the 1980s only reinforced the perception that it was time for the international policy framework to catch up with the new international economic landscape.

This review of investment provisions in RIAs reveals that one of the attractive features of negotiating investment rules at the sub-multilateral level is the flexibility and selectivity that countries with historically similar approaches to investment issues can bring to the process of negotiation. This is an important point because it suggests that any negotiation of investment rules at the multilateral level would have to take into account the diversity of experience with -and the practice of - international investment policy that has evolved at the regional level.

Several themes emerge from this short survey of investment provisions in RIAs. First, the extent to which signatories to an RIA attempt to establish ambitious investment rules, with a broad definition of investment, disciplines on TRIMs that go beyond the illustrative list of prohibited measures found under the WTO's TRIMs Agreement and binding dispute settlement mechanisms (both state-to-state and, importantly, investor-state), *inter alia*, would seem to be largely a function of the countries' previous experience with a liberal investment regime. Most countries that have entered into agreements containing high-standard rules on investment have either already been liberalising their investment regimes unilaterally or have been experimenting with investment rules in prior agreements (e.g. a number of agreements recently negotiated by the NAFTA signatories

contain provisions almost identical to NAFTA's chapter 11). Where countries have only recently begun to liberalise their investment regimes and where these have traditionally been highly restrictive, the preference has typically been for less encompassing agreements covering limited rights of establishment (and often conferring only post-establishment rights subject to restrictions) and the movement of capital. In other words, the negotiation of investment rules in RIAs could be characterised as taking place at the investment policy margin. Countries at similar levels on the investment liberalisation 'trajectory' can scale their investment rule-making ambitions in line with historical local norms on international investment.

A related point concerns the objectives of investment rules. In most cases these are aimed at improving economic efficiency. This is indeed the stated purpose (often explicitly couched in preambular language) of investment rules at the WTO and in most RIAs. However, some provisions in RIAs are more specifically geared towards the attainment of development objectives, especially as concerns the promotion of local (national) firms. This is the case both in agreements that distinguish between the rights of local and third-party investors as well as those agreements that provide discriminatory incentives and preferences to regional enterprises.

Another theme to emerge from this survey concerns the apparent convergence of investment provisions in RIAs towards what might be described as an implicit international standard. Such a development may ultimately facilitate the attainment of a WTO regime for investment. Such convergence is occurring through two main channels. The first channel is through 'side-BITs', separate agreements on investment but nonetheless in the context of wider processes of trade and economic integration and co-operation.² What this suggests is that the traditional design of BITs is shifting beyond the sole protection of FDI from developed to developing countries to complementing broader and deeper liberalisation initiatives.

The second channel is through the proliferating set of RIAs that closely resemble or build upon NAFTA investment provisions. Indeed, just as most BITs are based upon model agreements (US, European or Canadian FIPA models come to mind), the NAFTA investment provisions have in many instances become a sort of 'model RIA investment chapter'. The trend therefore seems to be towards a more consistent treatment of investment in RIAs, both in terms of the

² In the context of a discussion of investment provisions in RIAs, this is an important development insofar as it becomes necessary to look beyond the content of RIAs themselves to determine whether they 'contain' investment provisions.

tendency of RIAs to include rules on investment (or side-BITs) and in terms of their content (e.g. broad definitions of investment, extensive disciplines on expropriation and related investment protection issues, mechanisms for the progressive liberalisation of restrictions to entry and post-entry operations, and dispute settlement mechanisms featuring both state-to-state and investor-state forms of binding arbitration..

Such a process of convergence is especially significant to the extent that most BITs and NAFTA-based RIA investment provisions do not result in the sort of preferences that RIAs typically give rise to with respect to trade. Indeed, because the rule of origin test adopted in RIA investment chapters typically takes the form of a liberal "substantial business operations" test, third party investors enjoy the same rights as investors based in the RIA area when they have a substantial presence in one member and, through this presence, make an investment in another signatory to the RIA. Therefore, for example, a Japanese affiliate based in Canada making an investment in the United States or Mexico enjoys the same rights under the NAFTA as a Canadian-based firm making a similar investment. To the extent that BITs and RIA investment provisions have increasingly come to reflect similar (high) standards, the spread of such agreements can be seen as resulting in the de facto plurilateralisation of investment rules -- as long as these do not discriminate against third party investors.

However, the current patchwork of investment provisions can give rise to certain difficulties.). Although the most important determinants of investment activity remains the country's political stability, productivity and overall macro economic policy stance, RIAs can affect investment patterns, whether through enhanced growth opportunities in an expanded market or through the maintenance of a number of investment-related trade measures whose effects can be discriminatory for third country operators (e.g. the maintenance of anti-dumping regimes within an RIA, sector-specific discriminatory rules of origin).

Finally, the growth of RIAs (and BITs) featuring investment disciplines has gone hand in hand with a noticeable rise in judicial activism in the investment field. For example, between 1972 and 1999, 69 disputes were registered with ICSID, for an average of two and a half per year. Between January 2000 and February 2002, 29 disputes were registered, an average of about 13 per year. The WTO dispute settlement mechanism has likewise experienced heavy traffic. It should be noted however that the increasing number of disputes may reflect the fact that the international mechanisms for the settlement of disputes are gaining credibility among economic operators by providing a set of clear and predictable rules.

2. A patchwork quilt: the current international framework for trade and investment

The absence of a coherent framework for international investment has become apparent as investment, more than trade, has in recent decades been the driving force of deepening integration in the world economy. As with multilateral competition policy disciplines, the tale of the absent investment regime has a long history, one that starts with the failure to establish the International Trade Organisation (ITO) at the end of the 1940's. The Havana Charter had proposed the inclusion of investment as well as trade provisions, though the former were quite limited in scope owing to fears of many countries, particularly developing ones, of foreign control over natural resources and strategic industries.³

³ See S. Ostry (1997), *op. cit.*; see also M. Hart, "A Multilateral Agreement on Foreign Direct Investment: Why Now?", in P. Sauvé and D. Schwanen, eds. (1996), *Investment Rules for the Global Economy: Enhancing Access to Markets*, Policy Study 28, Toronto: C.D. Howe Institute, pp. 36-99.

The patchwork quilt of differing bilateral treaties, regional arrangements and limited plurilateral or multilateral instruments relating to cross-border investment that has emerged in recent decades stands in sharp contrast to the comprehensive system of norms and principles governing international trade. The absence of a coherent international framework is all the more surprising in light of the sea-change in attitudes favouring investment regime liberalisation that has taken root in developed, developing and transition economies alike in recent years. In its wake, the world has witnessed an unprecedented wave of foreign direct investment regime liberalisation, much of it unilaterally decreed.

The past two decades has indeed witnessed significant changes in national and international policies towards foreign direct investment (FDI). These changes have been both cause and effect in the ongoing integration of the world economy and the changing role of FDI in it. Between 1991 and 2000, a total of 1185 regulatory changes were introduced in national FDI regimes, of which 1121 (or 95 percent) were in the direction of creating a more favourable environment for FDI (UNCTAD, 2001). Even at the lowest point during the last decade - 1996 - the trend was still six steps forward for every step backward. As Table 1 shows, during 2000 alone, a total of 150 regulatory changes were made by 69 countries, only three of which (or 2 percent) were less favourable for foreign investors (UNCTAD, 2001). Such developments, which suggest the virtual absence of policy backsliding once countries embark on an FDI liberalisation path, paradoxically beg the larger question of the rationale for, and potential value-added from, a multilateral framework for investment.

Table 1. National regulatory changes in FDI regimes, 1991-2000

Item	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Number of countries that introduced changes in their investment regimes	35	43	57	49	64	65	76	60	63	69
Number of regulatory changes	82	79	102	110	112	114	151	145	140	150
Of which:										
More favourable to FDI ^a	80	79	101	108	106	98	135	136	131	147
Less favourable to FDI ^b	2	-	1	2	6	16	16	9	9	3

Source: UNCTAD, based on national sources.

^a Including liberalizing changes or changes aimed at strengthening market functioning, as well as increased incentives.

^b Including changes aimed at increasing control as well as reducing incentives.

3. Not exactly starting from scratch: existing legal and institutional arrangements governing foreign investment

The recent years have witnessed a rich variety of rule-making responses on investment-related matters. Existing intergovernmental arrangements on foreign investment feature a range of bilateral, regional, plurilateral and multilateral instruments that differ in their legal character, scope and subject matter. Binding agreements exist mainly at the bilateral, regional and plurilateral levels, while instruments at the multilateral level are, with the obvious exception of the WTO agreements, mostly of a non-binding nature. Some arrangements are devoted exclusively to foreign investment. Others treat foreign investment as part of a wider set of issues relating to economic co-operation and integration. The subject matter of existing arrangements covers a broad spectrum of issues, including admission and treatment of foreign investment, investment protection and promotion, aspects of corporate conduct, taxation, competition and jurisdictional matters, and dispute settlement procedures.

The discussion that follows makes clear how, compared to competition policy, the scope of whose internationalisation remains significantly more limited, the international community is hardly starting from scratch when it comes to collective action responses on investment policy, both within and outside the WTO system. There is, accordingly, a wealth of experience and lessons (and failures) to learn from and distil in charting the

future course of policy and rule-making. There is, as well, a range of policy instruments and institutional alternatives already at the disposal of developing countries in the absence of an integrated multilateral framework for investment.

(i) Developments at the bilateral level

At the bilateral level, key investment concepts, principles and standards have been developed through the conclusion of treaties for the protection and promotion of FDI. Bilateral investment treaties (BITs) form a core element of the evolving international framework for FDI. The recent years has witnessed a literal surge in investment treaty-making activity at the bilateral level. The number of BITs quintupled during the 1990's, reaching 1941 by end-2000. During 2000 alone, 78 countries concluded 84 BITs. For much of the post-war period, BITs have tended to be negotiated on a North-South basis. More recently, however, there has been strong growth in the number of BITs entered into by developing countries. Thus, in the year 2000, the single largest number of new treaties was between developing countries, which accounted for 43% of new BITs (UNCTAD, 2001). Similar growth is in evidence as regards bilateral treaties for the avoidance of taxation agreements.

BITs typically contain broad, open ended, definitions of foreign investment, inclusive of non-equity forms, various types of investment assets (including portfolio investments) as well as intangible assets such as intellectual property. Investors covered are companies and individual nationals conducting substantial business operations in a host country. While BITs encourage governments to facilitate and welcome FDI, they generally avoid a direct regulation of the right to establishment, referring this matter to national laws (and thus recognising implicitly the right of host countries to regulate the entry of FDI). Most BITs also do not explicitly address ownership and control issues. On the other hand, some operational restrictions are often covered, for instance with regard to the admission of key managerial personnel. However, only a few BITs discipline the use of performance requirements.

Most BITs prescribe national treatment, MFN and fair and equitable treatment, and treatment according to customary international law. Such standards of treatment are typically stated in broad terms and are often qualified by a number of reservations or derogations. In addition, BITs prescribe specific standards of investment protection on, notably, the transfer of funds, expropriation and nationalisation and the settlement of disputes both between the treaty partners and between investors and the host state. Provisions for so-called investor-state arbitration normally refer to pre-existing arbitration rules, notably those under the

International Centre for the Settlement of Investment Disputes (or ICSID, affiliated to the World Bank), UNCITRAL or the International Chamber of Commerce (ICC).

The importance of BITs stems not only from the sharp increase in their use, but also from the fact that many recent regional and plurilateral investment arrangements incorporate concepts and standards derived from such treaties. Intended to promote investment between the treaty partners through their protection and predictability-enhancing features, BITs are touted as sending important signals concerning a country's investment climate and the permanency of its recent policy changes towards FDI.

(ii) Developments at the regional and plurilateral levels

Investment rule-making has also become a central feature of the proliferating set of regional integration agreements concluded since the late 1980's in all parts of the world. At the regional level, a distinction can be made between, on the one hand, arrangements that cover only foreign investment and, on the other, those that integrate rules on foreign investment into a broader framework of rules aimed at promoting economic cooperation and deeper integration. Examples of the latter include the Treaty establishing the European Community, the North American Free Trade Agreement, the free trade agreement linking Mexico, Venezuela and Colombia (G3) or the recently concluded free trade agreement between Singapore and the members countries of the European Free Trade Association (EFTA). Examples of the former include the OECD Codes of Liberalisation of Capital Movements, the Colonia Protocol on the Promotion and Reciprocal Protection of Investments within MERCOSUR and the APEC Non-Binding Investment Principles.

Relative to BITs, these agreements show greater diversity. The main objective typically pursued at this level is the liberalisation of restrictions to entry and establishment of FDI, followed by the elimination of discriminatory operational conditions. Protection and promotion dimensions are of more recent vintage. FDI liberalisation proceeds mainly through a gradual elimination of existing restrictions, a system of reporting on existing regulations and changes to ensure transparency of measures and monitoring mechanisms to follow up on the implementation of schedules for further liberalisation.

A pattern emerging in a growing number of regional agreements is to combine in one instrument (chapter) an expanded set of disciplines governing both the liberalisation and protection of FDI, complimented with

dispute settlement provisions that mirror those found in BITs (i.e. providing for both state-to-state and investor-to-state settlement of investment disputes).

The structure of the most advanced regional free trade and integration agreements reflects the interrelations between investment, trade, services, intellectual property rights, competition policy and the movement of business people. Other important issues dealt with in some regional agreements relate to technology transfers, environmental protection, taxation, conflicting requirements, and standards for the conduct of multinational enterprises.

An important development to note at the plurilateral level concerns the decision of OECD countries to craft a Multilateral Agreement on Investment (MAI). Following several years of preparatory work, negotiations on the MAI began in May 1995 with a view to reaching agreement by May 1997 on an agreement featuring high-standards provisions on investment protection and liberalisation matters. The MAI negotiations, which were abandoned in the Fall of 1998, revealed the complexity of negotiating far-reaching investment disciplines among countries with highly developed regulatory regimes and significant two-way trade and investment relations. Such a failure is a sobering reminder of the difficulties that attempts to craft an ambitious set of investment disciplines in the significantly more diverse context of the WTO could likely encounter.

(iii) *Developments at the multilateral level*

Some of the most significant advances in multilateral rule-making on investment were made during the course of the Uruguay Round and are found in the WTO. While the current treatment of investment under the WTO lacks overall coherence, several WTO agreements already deal, directly or indirectly, with investment issues. These include the Agreement on Subsidies and Countervailing Measures (ASCM), the Agreement on Trade-Related Investment Measures (TRIMs Agreement), the General Agreement on Trade in Services (GATS), the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement), the plurilateral Government Procurement Agreement (GPA), and the Dispute Settlement Understanding (DSU).

Meanwhile, an important pedagogical journey began with the establishment at the WTO's First Ministerial meeting in Singapore in late 1996 of a Working Group on the Relationship between Trade and Investment. As is discussed below, progress in the Working Group played a major role in underpinning the decision, taken at the WTO's December 2001 Ministerial gathering in Doha, Qatar, to launch negotiations on investment by the time of the WTO's Fifth Ministerial meeting, to be held in Cancun, Mexico in September 2003, subject to agreement on negotiating modalities.

That the WTO already embodies certain investment-related disciplines holds an obvious and important implication, particularly in the wake of the decision taken by trade Ministers in Doha to aim to craft a multilateral set of

investment rules. Any expansion of investment disciplines at the WTO will have to be shaped to 'fit into' the architectural space that currently exists for such rules. Conversely, this architectural space will probably need to be re-shaped in some instances to accommodate any new multilateral investment disciplines at the WTO.

The post-Uruguay period has also seen a number of important (and non-WTO) efforts at international co-operation that could have positive overall effects on domestic investment climates. This has notably been the case in the realm of bribery and corruption (OECD, OAS); the conduct of multinational enterprises (OECD Guidelines on Multinational Enterprises, UN Global Compact); corporate social responsibility and corporate governance (OECD, World Bank); as well as best practices in investment promotion activities (UNCTAD, World Bank).

4. Characterising the Diversity of Developments at the Periphery

As the above section has documented, at the sub-multilateral level, investment issues have been addressed through RIAs, bilateral investment treaties (BITs) and a range of plurilateral arrangements specifically aimed at dealing with investment issues. Where investment protection is concerned, RIAs are not typically the main vehicle for negotiating international investment rules. Rather, BITs constitute the most popular instrument in this regard. Whereas the number of BITs reached 1941 at the end of 2000, close to 200 RIAs are currently in force and only a small (albeit growing) minority of these deal with investment issues.⁴ Given the focus of this survey on how RIAs deal with investment issues, it is important to keep in perspective that these only represent one of several institutional settings at the sub-multilateral level in which investment-rule making has taken place.

Rules on investment have been linked to wider processes of trade and economic integration and cooperation in various ways. The following sub-sections deal respectively with: i) agreements that focus on the right of establishment and the free movement of capital, ii) agreements that build upon treatment and protection principles typically found in BITs, iii) agreements that distinguish between the rights accorded to local and third-party investors and iv) agreements that include provisions on the status of regional enterprises.

This classification of RTAs according to general characteristics is imperfect insofar as the complexity of many agreements means that they could be included in several

⁴ Although, as noted, many of these now have 'side-BITs'.

categories. Indeed, the only perfectly exclusive categorisation of agreements is at the level of the individual agreements themselves since no two agreements are exactly alike. However, in order to give the discussion some structure and to avoid simply listing agreements and their investment provisions a rough characterisation according to broad objectives aims at rendering the ensuing discussion more reader-friendly.

Finally, all of the agreements discussed below constitute examples of efforts to go beyond existing provisions on investment at the WTO, either in terms of substance or objectives. Indeed, even the most modest rules on investment found in RIAs usually contain some sort of provisions on the right of establishment, something that does not exist in any WTO agreement.

(i) Rules on right of establishment and the free movement of capital

Early efforts at introducing rules on investment at the regional level emphasised the issues of establishment and the free movement of capital. One of the most comprehensive examples of this approach was the *Treaty Establishing the European Community* (1957) (revised by the Treaty of Amsterdam which entered into force on 1 May 1999). The EC Treaty addresses investment primarily through provisions on freedom of establishment and free movement of capital. Article 52 of the original treaty prohibits restrictions on the freedom of establishment of nationals of a member State in the territory of another member State and on the setting up of agencies, branches or subsidiaries by nationals of any member State established in the territory of any member State.⁵ Freedom of establishment includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings under the conditions laid down for its nationals by the law of the country where such establishment is effected. By virtue of Article 58⁶, this right of establishment applies to companies or firms formed in accordance with the law of a member State and having their registered office, central administration or principal place of business within the Community.

⁵ The reference in the original text to the progressive abolition of restrictions on the right of establishment in the course of the transitional period was deleted and replaced by the concept of prohibition in amendments made by the Treaty of Amsterdam, Article 43. *Official Journal of the European Communities*, No. C 340, 10 November 1997, p.61

⁶ Treaty of Amsterdam, Article 48.

Since the end of the transitional period on 31 December 1969, Article 52⁷ has been directly applicable in the sense that it can be invoked by individuals before the national courts of member States. EC Treaty rules on freedom of establishment are not only addressed to the member States but also require the adoption of measures by the Community institutions with respect to a wide range of matters specified in Articles 54 and 57 in order to facilitate the implementation of the freedom of establishment.⁸ Pursuant to these provisions, directives have been adopted *inter alia* with respect to standards in specific sectors, company law, government procurement, and the mutual recognition and acceptance of diplomas, certificates and other evidence of formal qualifications.

With respect to movement of capital, Article 73(b) of the EC Treaty, which was added by the 1992 Treaty on European Union, provides for the prohibition as of 1 January 1994 of restrictions on movements of capital and payments between the member States and between the member States and third countries.⁹ Capital movements covered by this provision include direct investments, defined as investments of all kinds which serve to establish or to maintain lasting and direct links between the person providing the capital and the undertaking to which the capital is made available in order to carry on an economic activity. This general prohibition is subject to "grandfather" and transition clauses in respect of certain existing restrictions, exceptions (e.g. relating to taxation and prudential measures) and a safeguard clause applicable in case of difficulties for the operation of economic and monetary union caused by capital movements to or from third countries.

Agreements involving countries that have historically restricted capital movements have also tended to emphasize establishment and capital movement issues but much less comprehensively than the EC Treaties. For example, the *Europe Agreements* concluded in the early and mid-1990s between the European Community and Central and Eastern European countries, also focus primarily upon establishment issues by providing for national treatment with regard to the establishment and operation of companies and nationals. The term "establishment" is defined in each of these Agreements as meaning the right to take up and pursue economic activities by means of the setting up and management of subsidiaries, branches and agencies.

The *Treaty Establishing the Caribbean Community (CARICOM)* (1973), as amended by a Protocol adopted in July 1997, prohibits the introduction by member States of any new restrictions relating to the right of establishment of

⁷ Treaty of Amsterdam, Article 43.

⁸ Treaty of Amsterdam, Articles 44 and 47, respectively.

⁹ Treaty of Amsterdam, Article 56.

nationals of other member States (Article 35b). Member States are also required to remove restrictions on the right of establishment of nationals of other member States, including restrictions on the setting up of agencies, branches or subsidiaries by nationals of a member State in the territory of another member State (Article 35c).

Likewise, the Treaty Establishing the African Economic Community (1991) and the Treaty Establishing the Common Market for Eastern and Southern Africa (COMESA) (1993) include among their objectives the removal of obstacles to the free movement of capital and the right of residence and establishment.¹⁰ Finally, the Revised Treaty of the Economic Community of West African States (ECOWAS) (1993) includes among its objectives the establishment of a common market involving, inter alia, the removal of obstacles to the free movement of persons, goods, services and capital and obstacles to the right of residence and establishment (Article 3(2)). The Treaty Establishing the Economic and Monetary Union of West Africa (1996) provides for freedom of nationals of one member State to provide services in the territory of another member State and proscribes restrictions on movement of capital.

(ii) Rules building on treatment and protection principles of bilateral investment treaties

A number of RIAs have gone beyond issues relating to establishment and the free flow of capital. For example, the *North American Free Trade Agreement* (NAFTA) (1994) contains generic provisions on investment in Chapter 11¹¹. "Investment" is defined in Article 1139 through a broad list of assets along with a negative list of certain claims to money, including claims arising from commercial transactions, which are not considered to be investments. Each Party is required to accord the better of national treatment and MFN treatment to investors of another Party, and to investments of investors of another Party, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments (Articles 1102-1104).¹²

¹⁰ See, respectively Article 4(2)(i) of the Treaty Establishing the African Economic Community and Article 4(4)(c) and 4(6)(e) of the COMESA Treaty.

¹¹ In addition to Chapter 11, separate provisions dealing with investment issues are contained in Chapter 14 on financial services, Chapter 15 on competition, monopolies and state enterprises, and Chapter 16 on temporary entry for business persons.

¹² The NAFTA adopts the negative list approach such that the actual coverage of the agreement's investment provisions is determined by

The provisions of the NAFTA concerning performance requirements apply to both investments of investors of a Party and investments of investors of a non-Party. Article 1106(1) proscribes the imposition or enforcement of mandatory requirements and the enforcement of any undertakings or commitments: (1) to export a given level or percentage of goods or services; (2) to achieve a given level or percentage of domestic content; (3) to purchase, use or accord a preference to goods produced or services provided in the territory of a Party or to purchase goods or services from persons in its territory; (4) to relate the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with investment; (5) to restrict sales of goods or services produced or provided by an investment in a Party's territory by relating such sales to the volume or value of exports or foreign exchange earnings of the investment; (6) to transfer technology, a production process or other proprietary knowledge; and (7) to act as the exclusive supplier of the goods produced or services provided by an investment to a specific region or world market. With the exception of the first and the last two requirements, these requirements are also prohibited if applied as conditions for the receipt of an advantage (Article 1106(3)).

NAFTA Articles 1115-1138 provide for international arbitration of disputes between a Party and an investor of another Party. An investor may submit to international arbitration a claim that another Party has breached an obligation under Chapter 11 or under certain provisions of the chapter on monopolies and state enterprises and that the investor has incurred loss or damage by reason of, or arising out of, that breach. Article 1122 contains the unconditional consent of the Parties to the submission of a claim to arbitration. The investor can elect to proceed under the International Centre for Settlement of Investment Disputes (ICSID) Convention, the Additional Facility Rules of ICSID or the United Nations Commission of International Trade Law (UNCITRAL) Arbitration Rules. Detailed rules are contained in these provisions on matters such as the constitution of arbitral tribunals, consolidation of claims, applicable law, nature of remedies, and finality and enforcement of arbitral awards.

A number of more recent RIAs (and proposed RIAs), especially those involving NAFTA signatories, have been broadly modelled after the NAFTA with respect to investment rules. This is the case, for example, in the Canada-Chile Free Trade Agreement (1997) and in the draft text for the Free Trade Area of the Americas. A structure and content broadly

the exceptions and reservations contained in the annexes to the agreement.

similar to that found in the NAFTA investment provisions is also reflected in the Vaduz Convention, the revised Convention establishing the European Free Trade Association¹³ (2001) and the Japan-Singapore New Economic Partnership Agreement. One interesting point to note is that some recent bilateral RIAs do not cover investment for the stated reason that a BIT already exists between the signatories. This is the case, for example, in the Canada-Costa Rica Free Trade Agreement (2000).

Other RIAs have sought to incorporate BIT-like provisions on investment but have eschewed the strict enforcement standards (e.g. binding dispute settlement mechanisms) and the levels of protection and liberalisation found in agreements like the NAFTA. In the context of the Asia-Pacific Economic Cooperation (APEC), norms of a legally non-binding nature relating to the admission, treatment and protection of foreign investment have been adopted in the *APEC Non-Binding Investment Principles* (1994). Principles of a general nature state that Member economies will ensure transparency with respect to laws, regulations and policies affecting foreign investment; extend MFN treatment to investors from any economy with respect to the establishment, expansion and operation of their investments; and accord national treatment to foreign investors in relation to the establishment, expansion, operation and protection of foreign investment, with exceptions as provided for in domestic laws, regulations and policies. More specific Principles provide that Member economies will not relax health, safety and environmental regulations as an incentive to encourage foreign investment; minimise the use of performance requirements that distort or limit expansion of trade and investment; and permit the temporary entry and sojourn of key personnel for the purpose of engaging in activities connected with foreign investment, subject to relevant laws and regulations.

A number of regional and plurilateral agreements exist which, instead of directly incorporating the full range of investment protection and dispute settlement provisions typically found in bilateral investment treaties, envisage the conclusion of such bilateral treaties between the parties. Although not part of the RIAs themselves, these 'side-BITs' are explicitly recognised as contributing to the wider process of liberalisation between the parties. An example of this approach is the Cotonou Agreement between the European Union and the ACP Countries.¹⁴ This agreement sets forth general principles regarding the treatment of foreign investment, such as the requirement to accord fair and equitable treatment, and envisages that more specific

¹³ The original Stockholm Convention was signed in 1960.

¹⁴ Signed in June 2000.

regulation of policies on foreign investment will be dealt with through the negotiation of bilateral agreements between the Contracting Parties. Already in the Lomé Convention VI, which the Cotonou Agreement replaces, a Joint Declaration in Annex LIII of the Convention provided that the Contracting Parties would undertake a study of the main clauses of model bilateral investment agreements. Various recent agreements of the European Union with third countries also refer to the possible conclusion of bilateral investment treaties between member States of the European Union and the third countries in question.¹⁵

(iii) Rules that distinguish between local and third-party investors

Investment rules on establishment, the free flow of capital and those that build upon issues usually covered in BITs all have as their underlying purpose the promotion of a more efficient international allocation and use of capital. However, not all investment rules in RIAs have economic efficiency as their prime objective. Some agreements contain investment provisions whose aim is more developmental in nature. For example, in August 1994, Member States of the MERCOSUR adopted a *Protocol on Promotion and Protection of Investments from States not Parties to MERCOSUR*. The signatories to the Protocol undertake not to accord to investments of investors of third countries more favourable treatment than that provided for in the Protocol. In respect of the treatment of established investments, the Protocol lays down general standards of treatment which are similar to those contained in the Colonia Protocol¹⁶, except that the parties to the agreement enjoy discretion to decide whether or not to accord national treatment and MFN treatment to established investments of investors of third countries. The *Protocol on Promotion and Protection of Investments from States not Parties to MERCOSUR* contains no provisions on performance requirements.

¹⁵ In addition to the Europe Agreements and the Partnership and Cooperation Agreements, references to the future conclusion of bilateral investment treaties appear in, for example, the Cooperation Agreement between the European Community and the Kingdom of Nepal (1995), Article 10; the Interregional Framework Cooperation Agreement between the European Community and its Member States, of the one part, and the Southern Common Market and its Party States, of the other part (1995), Article 12, and the Framework Cooperation Agreement leading ultimately to the establishment of a political and economic association between the European Community and its Member States, of the one part, and the Republic of Chile, of the other part (1996), Article 15.

¹⁶ The Colonia Protocol governs the treatment of regionally based investors and their investments.

Other agreements dealing with investments from third countries have sought to reduce restrictions traditionally aimed at these. For example, in the context of the Andean Community, rules aiming at the harmonization of investment policies of member countries towards investment from third countries were first adopted in 1970. The currently applicable regime appears in *Decision 291 of the Commission of the Cartagena Agreement -Common Code for the Treatment of Foreign Capital and on Trademarks, Patents, Licences and Royalties* (1991). This Decision provides that foreign investors shall have the same rights and obligations as national investors, except as otherwise provided in the legislation of each member country, and eliminates the previously existing requirement to subject foreign investment to an authorization procedure. It also removes restrictions contained in the previous rules on the transfer of funds by obligating member countries to permit foreign investors and sub-regional investors to remit abroad in convertible currency the verified net profits derived from foreign direct investment and the proceeds from the sale or liquidation of such investment. A third important change effected by the Decision is the removal of restrictions on access of products produced by foreign enterprises to the benefits from the trade liberalisation under the Cartagena Agreement. Prior to the adoption of this Decision, such products could benefit from this trade liberalisation only if the foreign enterprise undertook to convert into a joint or national enterprise.

(iv) Rules extending preferences to regional enterprises

Several regional agreements aim at fostering co-operation between firms of member States by establishing a special legal regime for the formation of a regional form of business enterprise. For example, the *Uniform Code on Andean Multinational Enterprises* established by Decision 292 of the Commission of the Cartagena Agreement provides for the formation of Andean Multinational Enterprises. One of the conditions for the creation of such an enterprise is that capital contributions by national investors of two or more member countries must make up more than 60 per cent of the capital of the enterprise. Among the privileges which the Decision requires member countries to grant to such enterprises are national treatment with respect to government procurement, export incentives and taxation, the right to participate in economic sectors reserved for national companies, the right to open branches in any member country, and the right of free transfer of funds related to investments. Likewise, the *Basic Agreement on the ASEAN Industrial Cooperation Scheme* (AICO Scheme) was concluded by members of ASEAN in 1996 to promote joint manufacturing industrial activities between ASEAN-based companies.

5. Collective Action on the Investment Front

Regardless of the negotiating setting (i.e. regional or multilateral), the international investment agenda can be described as breaking down into four core sub-agendas. These relate to: (i) investment protection; (ii) investment distortions; (iii) investment liberalisation; and (iv) international co-operation efforts in areas likely to enhance domestic investment climates and promote good governance.

(i) Protecting investment and investors

A salient feature of international investment arrangements is that they generally embody not only relative treatment standards, such as national treatment and most-favoured-nation treatment, but also absolute, minimum standards of treatment and protection of foreign investment. Should such absolute treatment and protection standards form one component of a WTO framework of rules on investment? Looked at from the periphery, an affirmative answer seems entirely possible.

One argument in support of the creation of a multilateral framework on investment in the WTO is that there are potentially significant economies of scale to be reaped from agreeing on one accepted international standard of investment protection. Such a process would likely promote the adoption of international best practices (arising from the convergence around NAFTA-like norms described earlier) and encourage worldwide harmonization around such a standard. It would also economize on scarce negotiating resources, a problem developing countries are far likelier to encounter than governments from capital exporting countries. A multilateral set of disciplines on investment protection would arguably send a positive signal to potential foreign investors regarding the permanency of policy changes and the expected standard of treatment afforded to foreign investors.

A multilateral regime for investment protection might also likely help to counter-balance the economic and political asymmetries that are rooted in much investment treaty-making activity conducted along North-South lines. Despite the recent rise in bilateral investment agreements concluded among developing countries, the fact remains that the most economically significant agreements – those that encompass the greatest volume of FDI directed towards developing countries – remain those which developing countries conclude with capital exporting countries from the OECD area.

The negotiating asymmetries that are common to such agreements have in some instances led to negotiated outcomes in which host country governments (typically developing countries, as there are virtually no investment protection agreements *among* capital exporting countries) have taken on substantive obligations, notably in the realm of expropriation-related disciplines, towards which governments (and other voices in parliaments and in civil society) in OECD countries have expressed increasing disquiet. Such asymmetrical outcomes have been possible largely because, in practice, the incidence of such rules falls solely on host (e.g. developing) countries, the latter having no significant foreign investments in OECD countries, hence no real capacity to direct the

agreements` provisions against potentially adverse policy measures taken by home country governments.

The case for a multilateral regime on investment protection implicitly assumes that a multilateral framework would embody the kind of protection and treatment principles typically provided for in bilateral investment treaties.¹⁷ However, 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.¹⁸ Some WTO Members do not interpret this omission as precluding consideration of investment protection as a possible element of a multilateral framework.¹⁹

In any case, investment protection has not been the subject of in-depth analysis and debate in the WTO Working Group on the Relationship between Trade and Investment.²⁰

¹⁷ "The objective of WTO negotiations would be to establish a common set of binding multilateral rules providing a simplified, secure and predictable framework for international investment encompassing existing bilateral agreements and practices." "International Investment Treaties and Developing Countries", Trade and Investment Background Briefing No. 9....

¹⁸ Interestingly (and perhaps revealingly in the light both of the failure of the MAI and of recent controversies surrounding the operation of investment protection disciplines under the NAFTA), the issue of investment protection does not expressly figure among the elements enumerated for clarification by the Working Group in the preparatory phase of the negotiations. The last sentence of paragraph 22 provides that "[a]ccount shall be taken, as appropriate, of existing bilateral and regional arrangements on investment." It could perhaps be argued that this provides a basis for considering investment protection matters, but the words "as appropriate" make it clear that there is no presumption that WTO negotiations will build on the rules contained in existing bilateral and regional investment arrangements. Texts that were considered during the preparatory phase for the Seattle Ministerial Conference in 1999 contained more explicit references to investment protection as a matter for consideration.

¹⁹ Thus, for example, in an evaluation of the results of the Doha Ministerial Conference issued on 14 November 2001, the European Commission specifically stated that the European Communities would raise the issue of investment protection and investors' responsibilities during the 2-year preparatory phase. In April 2002, Korea submitted a paper on the definition of "investment" which also explicitly raises the question of whether and how to incorporate investment protection disciplines into a multilateral framework. The submission suggests three possible approaches with respect to the treatment of investment protection in a multilateral framework: exclusion of protection; incorporation of investment protection provisions reflecting the lowest common denominator of the extant bilateral investment treaties with a provision for MFN exemptions for higher levels of protection in bilateral treaties; and the introduction of a general obligation of protection. Working Group on the Relationship between Trade and Investment, Communication from Korea, WT/WGTI/W/114, 15 April 2002, *Scope and Definitions of "Investment"*.

²⁰ A paper submitted by Korea in October 2000 on the difficulty of interpreting the concept of indirect expropriation attracted little

Virtually no attention has been paid to the question of how a body of absolute treatment and protection standards contained in a WTO agreement on investment would cohere with existing WTO rules on trade in goods, services and intellectual property rights; and how WTO dispute settlement proceedings and remedies would apply to disputes involving investment protection issues.²¹

One reason for expressing some measure of caution with respect to investment protection in the context of WTO rules on investment is that inclusion of absolute standards of investment protection and treatment could be seen as symbolic of the pro-business orientation of WTO rule-making. This would likely generate strong pressure for inclusion of legally binding rules on corporate social responsibility.²²

On the other hand, the question must be raised how a WTO multilateral framework on investment can meaningfully contribute to the stated objective of enhancing transparency, stability and predictability if it does not incorporate at least some absolute protection and treatment standards. Merely requiring governments to accord non-discriminatory treatment to foreign investors may not be sufficient to ensure adequate legal security of the regulatory environment facing foreign investors. For example, the issue of the right of transfer of investment-related payments may not adequately addressed through a mere non-discrimination requirement.

Looked at from the perspective of multinational firms, it is debatable whether multilateral responses are likely to provide the highest possible degree of protection to investors (and their investments) from FDI originating countries..²³ Precisely because of the political

attention. Working Group on the Relationship between Trade and Investment, doc. WT/WGTI/W/91, 11 October 2000, Communication from Korea, "Investment Protection: Expropriation and Compensation".

²¹ While it is clear by now that there is no support for the inclusion of investor-state arbitration provisions, WTO rules on investment protection could create complications even when administered through state-state dispute settlement. For example, what would be the nature of the appropriate remedy in an instance of unlawful expropriation of foreign investment?

²² As observed by Charnovitz, "[I]f the WTO decides to write rules on investment, it may prove politically difficult to focus on the rights of investors, while giving no attention to their social responsibilities." Charnovitz, *supra* note....

²³ The absence of a strong rationale for pursuing an ambitious multilateral agenda on investment protection significantly lessens the need to consider providing investors with direct recourse to the multilateral trading system's dispute settlement machinery. Investor-state arbitration, a key component of BITs and of RTA's addressing investment protection and liberalisation in a comprehensive manner and, when properly designed and circumscribed, a good way of taking intergovernmental and foreign policy considerations out of investment disputes, is indeed an unlikely candidate for inclusion in any future WTO agreement on investment. There are both political and technical reasons to believe that this will remain so for the foreseeable future. On political grounds, perhaps the greatest difficulty in justifying the need for investor-state arbitration lies in the fact that it would implicitly affirm, in the continued absence of a commensurate desire on the part of WTO

and economic asymmetries alluded to above, MNCs may be expected to prefer the higher level of investment protection likely to flow from bilateral or regional treaties over potentially weaker disciplines embedded in a multilateral instrument.

Finally, while bilateral investment protection treaties are widely seen as an important means for capital-importing countries to enhance domestic investment climates, there is little empirical evidence to suggest that developing countries reap significant “signaling” effects (in the form of sustained net increases in the level of FDI) from entering into BITs. (see Box 1). Nor is there much evidence to suggest that BITs exert significant impacts on the sectoral composition of foreign investment flows. Meanwhile, evidence is scarce as to the economic significance of the recent proliferation of BITs concluded among developing countries. The potential benefits flowing from such agreements have to be measured against their negotiating, implementation and/or enforcement costs. They must also be measured against the potential signaling properties (and enforcement costs) of a single multilateral instrument.

In sum, despite the absence of an explicit reference in the Doha Ministerial Declaration to investment protection, there is clearly a need for careful analysis of the possible merit and implications of incorporating certain aspects of investment protection and treatment standards in a WTO framework on investment.

Box 1: The Signaling Properties of Bilateral Investment Treaties

A preliminary overview of the literature on bilateral investment treaties reveals a dearth of empirical information on the impact of such agreements on FDI inflows. BITs clearly provide a signal to foreign investors that the host country is serious about conforming to international laws. For example Brazil, the main recipient of FDI in the LAC region, signed 11 bilateral investment treaties between 1994-95, after decades of pursuing policies that were averse to international foreign investment treaties.

But BITs do not seem to attract FDI by themselves. Sub-Saharan Africa, for example, has had difficulties in attracting FDI, though it has tried to improve the environment for FDI by entering into various agreements to protect the interests of investors. This has led to diversification of FDI into non-traditional sectors such as light manufactures and utilities. FDI tends to flow to countries that offer the prospects of a reasonable rate of return, which in turn is a function of the market situation, and other political, social and institutional factors. Countries that have long-term stability (of rules and procedures, and offer equal competitive opportunities) and can provide adequate protection tend to be preferred.

Members to provide equivalent rights to other private stakeholders (e.g. environmental groups or labor unions), the superior rights of holders of capital within the trading system. On technical grounds, quite apart from the thorny (and politically-charged) aspect of how adverse investor-state rulings might affect the delicate balance of benefits brokered between WTO Members under various agreements, one of the main problems would lie in the inability of the WTO's current institutional machinery to accommodate the proliferation of cases that could arise should private party recourse to dispute settlement be allowed.

Summing up, mixed views remain as to whether investment decisions are influenced by the existence of BITs. The existence of such rules could make a difference at the margins to companies' decision to invest -- the discount rate of the expected cash flow related to the envisaged investment is improved when the host country is committed to international rules. BITs can remove legal obstacles to the free flow of investment, and their presence can tilt the balance in investors' location decisions. It must be noted, however, that no evidence indicates that the investors would refrain from investing in a country if that country did not conclude a BIT with their home country. For instance, the US is the biggest investor in China behind Hong Kong, Macao and Taiwan. However a Sino-US BIT has not been concluded yet. Three of the largest five FDI originating countries in Indonesia did not have BITs with Indonesia. Though the major recipients of Japan's FDI are to be found in Southeast Asia and China, Japan has only concluded a BIT with the latter (it signed a BIT with Korea in January 2002).

(ii) Dealing with investment distortions

The investment distortion agenda concerns primarily investment incentives and performance requirements (TRIMs). Its predominant focus therefore lies with investment in manufacturing. The distorting effects of TRIMs have for some time been subject to negotiated disciplines at both the regional and multilateral levels. In general the disciplines on performance requirements, principally tools of developing countries, are greater than those on investment incentives, used most extensively by industrial countries and, to a lesser extent, a growing coterie of developing countries (many of which in South-East Asia).

Some multilateral discipline has come to bear on investment incentives as a result of the Uruguay Round's Agreement on Subsidies and Countervailing Measures (ASCM). The SCM Agreement governs the conditions under which a range of subsidy practices -- including investment incentives -- may be actionable under the WTO. Yet, such disciplines are largely indirect in nature when it comes to investment, apply solely to goods-related transactions (hence only to about one-third of global FDI activity; no equivalent disciplines exist under the GATS), and can be invoked solely in instances where a prejudice to trade in goods arising from an actionable subsidy practice can be demonstrated.

Bringing disciplines to investment incentives would help rebalance the TRIMs agreement in a way that would promote development. However, there continues to be limited political appetite, particularly in countries with federal systems of governance (where investment incentive programmes are actively used as instruments of industrial or regional development) to address the distortive effects of locational competition at the global level. Only a handful of proposals along these lines have been made to date within the WTO Working Party on the Relationship Between Trade and Investment, and investment incentives did not make the short list of issues to which the Working Group is devoting priority attention in the run-up to the Cancun Ministerial.

Moreover, the question arises as to whether the inherently regional dimension of much competition over incentive bidding makes it desirable in the first instance to try to tackle this issue at the multilateral level. Indeed, it may be advisable on subsidiarity grounds to

encourage parties to regional trade and investment agreements to tackle such an issue (OECD, 2001).

Meanwhile, more research is needed to assess the developmental effects of various types of performance requirements, particularly since empirical studies reveal that some performance requirements, notably those linked to export performance or local training requirements, can exert positive developmental effects. Absent some rebalancing through the adoption of multilateral disciplines aimed at curbing the trade- and investment-distorting effects of investment incentive programmes, consideration could be given in the current round to limiting the scope of prohibited performance requirements to those measures – local content rules and trade balancing requirements – specifically identified in the TRIMs Agreement Illustrative List of Prohibitive Measures. While both notifications and disputes under the Agreement have to date have centered on the above two types of measures, the Agreement arguably prohibits a greater range of performance requirements, including possibly measures whose effects on promoting industrial linkages and boosting the longer-term competitiveness of indigenous firms is significantly more benign or indeed positive from a development point of view.

(iii) Investment liberalisation (much ado about services)

Most restrictions – perhaps 80-85 percent – on FDI flows are found in the service economy. And services constitute nearly two-thirds of total investment flows and are arguably the most dynamic aspect of the global economy. One proxy indication of this was the negative lists of reserved (or non-conforming) measures lodged under the NAFTA and the draft negative list drawn up by OECD countries in 1998 in the context of their ill-fated MAI (see Figure1).

The great majority of presence-impeding measures maintained by governments in the investment area (including by developed countries), concern key service industries. This includes telecommunications, broadcasting and related audio-visual services, satellite services, energy services, financial services (especially securities), civil aviation and maritime transport.²⁴ Simply put, the global investment liberalization game is principally about services²⁵ This in fact is the market access dimension of the investment debate.

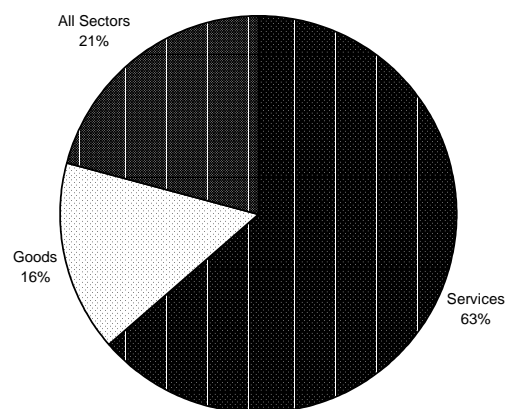
²⁴ For a cogent description of the predominance of services in the NAFTA reservation lists, see Alan M. Rugman and Michael Gestrin (1994), "NAFTA's Treatment of Foreign Investment", in Alan M. Rugman, ed., *Foreign Investment and NAFTA*, Columbia: University of South Carolina Press, pp. 47-79. See also Michael Gestrin and Alan M. Rugman (1993), "The NAFTA's Impact on the North American Investment Regime", *C.D. Howe Commentary* No. 42, Toronto: C.D. Howe Institute, (March).

²⁵ See Hoekman and Saggi (1999), *op. cit.*

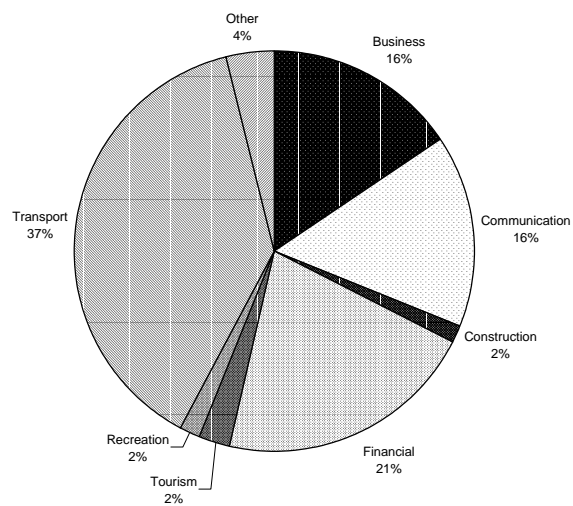
Figure 1

Revealed preferences: Countries shield services from the winds of competition

Distribution of MAI reservations by economic sector



Distribution of MAI reservations in the services sector



Source: Sauvé and Steinfatt (2000), mimeo.

(iv) Governance-related issues

A wide range of non-WTO forms of collective action, some of a legally binding nature, others more hortatory in scope, can yield useful benefits in helping developing countries address weaknesses in their investment climates. Good governance is vital to economic and social progress. In an increasingly globalized economy, reform of governance is no longer an issue of national or local concern. There is now a need for strengthened international cooperation efforts to ensure that growth is sustainable and has a beneficial impact on the greatest number of people. Corporate practices that encourage transparency, accountability and ethical values contribute to sound governance and to battling corruption.

Several initiatives addressing governance-related issues have in recent years been initiated at the national, regional and international levels. All are complementary to the three WTO-centric agendas described earlier. And all can be expected to exert positive overall effects on domestic investment climates. This includes the promotion of heightened *transparency* in investment rule-making; international cooperation on *bribery and corruption*, disciplines on the *conduct of multinational enterprises*; promoting *corporate social responsibility* and corporate governance; as well as adopting best practices in *investment promotion* efforts. All are areas where deepened international co-operation has produced important and innovative results in recent years and where the scope to deepen and broaden such initiatives could usefully complement WTO-based attempts at addressing the trade-investment interface.

Annex

Getting to Yes: The Complexities of Generic Rules on Investment

An agreement on a generic non-discriminatory regime for investment under the WTO extending, subject to permissible reservations, to all areas covered by WTO rules (i.e. goods, services and intellectual property) would constitute a significant achievement. Such an outcome is certainly what Paragraph 22 of the Doha Development Agenda seems to be pointing towards, with doses of variable geometry being envisaged with regard to the definition of investment (limited to foreign direct investment or broadened to other types of assets); disciplines on pre- and post-establishment; and flexible, GATS-like modalities in respect of national treatment and market access commitments.

Incorporating a generic set of investment rules into the WTO framework would, however, entail significant systemic consequences, in that it would significantly expand the scope of WTO coverage to a range of “inside the border” measures. Yet, much as the Doha agenda on investment represents a credible option for WTO members to consider, it is not altogether devoid of problems. For one, its focus on an agenda of generic rule-making on investment appears to assume a degree of architectural overhaul that WTO Members have not yet begun to address in earnest, let alone reached consensus on. Given the complex legal issues and policy sensitivities involved, it is open to question whether such consensus could be achieved before the WTO’s Fifth Ministerial meeting.

It is, indeed, quite unclear how *existing* WTO disciplines would relate to and cohere with any *de novo* set of investment rules. Would the TRIMs Agreement be incorporated by reference? Would its scope automatically be deemed to extend to investment measures affecting trade in services and trade in IPRs? Would the TRIMs Agreement’s scope of prohibited measures be modified, expanded, clarified?

Similarly, how would the treatment of commercial presence in the GATS co-exist alongside a potentially generic set of *de novo* investment disciplines? In particular, how would the definition of commercial presence contained in the GATS (focusing on both matters of pre- and post-establishment) cohere with the adoption of a possibly narrower definition in a new WTO investment instrument?

Much as with NAFTA, the launch of negotiations on investment disciplines in the WTO could provide an opportunity for crafting a separate agreement on the movement of people (alongside generic rules on movement of investment and cross-border trade in services). By giving greater prominence to labor mobility issues, such a revamped architecture of rules would offer greater scope for addressing an issue area where developing countries enjoy strong comparative advantages and offensive negotiating interests. Here again, however, the architectural and negotiating implications of such changes will likely require considerable attention. Indeed, are WTO members prepared to contemplate a GATS covering solely cross-border trade in services, with investment (commercial presence) in services treated alongside in a generic manner? Could a case be made in such circumstances to also treat labor mobility issues (mode 4 of GATS) in a

generic fashion, thereby affirming the equivalence - which is well rooted in economic theory if not in political preference - between movements of capital and labor within the trading system? Would a stand-alone WTO agreement on labor movement increase the likelihood of meaningful commitments of benefit to developing countries? All are questions WTO Members will need to confront and find satisfactory answers in both political and policy terms before a decision to launch a generic rule-making journey on investment can be made.

A modest approach: A GATS-centric approach to investment regime liberalisation

Given these complexities and in light of the preponderance of services to investment liberalisation, rooting the investment liberalisation agenda in *existing* WTO agreements – namely GATS - rather than on new rule-making initiatives may be a more promising approach. Developing countries, in particular might find this attractive, both because they have by now become familiar with the GATS and its *modus operandi* and the fact that the Agreement is arguably the most development-friendly set of disciplines agreed to in the Uruguay Round (OECD, 2002).

From a development point of view, particular attention would need to be paid under a GATS-centric approach to improving the investment climate in host countries by encouraging WTO members to commit (or to pre-commit in a progressive manner) to liberalising entry conditions in the key enabling sectors of finance, telecommunications, transportation (maritime and air), professional services and energy, given their impact on economy-wide performance. All are sectors where developing countries (including in Asia) generally made fewer commitments than their developed country counterparts in the first round of GATS negotiations.

In many instances, the GATS commitments of developing countries were scheduled at a level below the statutory or regulatory *status quo*, i.e. at a level below that already afforded to established foreign operators. Such practices are not likely on balance to send - or be perceived as sending - a reassuring signal to foreign investors. There is, accordingly, much that the current set of negotiations can do to strengthen the investment protection and liberalisation properties of the GATS.

A services-centric push on investment at the WTO can usefully tackle two core issues: making existing rules more "investor-friendly", and achieving a higher degree of investment regime liberalisation than was possible in the first round of services negotiations.

Multilateral Rules on Investment: Lessons from the Periphery

Pierre Sauve

OECD Trade Directorate, Paris

pierre.sauve@oecd.org

Some basic facts about the trade-investment interface

- FDI is today the largest source of external finance in LDCs
- But 10 countries receive >70% of FDI directed to LDCs; 49 LLDCs < 2% of FDI flows
- Pattern of policy change: unilateral liberalisation (9.5 to 1 ratio)
- Explosion of BITs since 1990, many of which between LDCs
- Large number of RTAs with comprehensive investment provisions
- No evidence that BITs generate extra FDI flows

Basic Facts, continued

- 70% of FDI flows are in services
- 4 out of 5 FDI restrictions are in services
- Who discriminates against foreign investors in manufacturing (national treatment plus the norm)?
- Services offer the real theater of investment regime liberalisation: much room for enhanced commitments under GATS; rule changes to lock in the status quo/ratchet autonomous liberalisation

Investment rule-making: 4 sub-agendas

1. Investment protection
2. Investment liberalisation
3. Investment Distortions
4. Good Governance

1. Investment Protection

- Much progress in recent years, in BITs and RTAs (MAI a revealing outlier)
- Nafta model extended in Western Hemisphere/FTAA, with some scaling back on expropriation/investor-state/right to regulate continuum
- Not on Doha agenda
- Challenge: reconciling competing needs of home (investors) and host countries (LDCs)
- Economies of scale in rule-making for LDCs (one stop shopping rather than asymmetrical North-South bargaining)

2. Investment Liberalization

- Much ado about services (70% of flows; 80% of barriers)
- Little more than status quo achieved in most RTAs; often large gap between bound and applied liberalization, but no evidence of policy reversal to date. Is the political economy of FDI liberalization different from that of trade?
- Negative vs. positive listing: negotiating modalities matter in governance, if not liberalization, terms

2. Investment Liberalization (continued)

- Architectural implications: x-b trade in services (modes 1/2 of GATS) + generic rules on investment + generic agreement on temporary entry of people: is WTO ready for such a configuration or will we have parallel rules on investment in services and manufacturing?
- Liberal rule of origin (substantial business operations test) means de facto non-discrimination viz third country investors (Mercosur/Andean Pact exceptions)
- What is the market access agenda in non-services?

3. Investment Distortions

- Much ado about manufacturing
- TRIMs: extensive prohibition in RTAs, but similar scope under WTO (broader than commonly assumed); how development-friendly is the TRIMs Agreement (“End of History” rules)
- Investment incentives: clear revealed preference of policy inaction across all negotiating settings (is regional treatment preferable?; feasible?)

3. Investment Distortions (continued)

- IRTMs: treatment of AD in RTAs; sectoral discriminatory rules of origin in FTAs; tariff escalation; incentives; all distort FDI flows away from what forces of comparative advantage should otherwise dictate
- Not a one way street: there is much LDCs can do to attract better investment, integrate more fully in international production networks via tariff liberalization; streamlining of red tape/administrative barriers in pre-establishment mode; adoption of international standards

4. Good governance

- Towards a GAGG? Need a better acronym!
- Transparency: prior consultations; how to enforce a key issue, via DSU or TPRM?. In or out of WTO? Should a GAGG replace ongoing talks on fairness in public purchasing?
- Bribery/corruption: OAS Convention (how successful?); OECD instrument
- Corporate social responsibility: need to respond to NGO concerns/equity in rule-making; UN Global Compact/OECD MNE Guidelines
- Best practices in investment promotion (WB/UNCTAD)