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Briefing Paper

Trade and Investment in the Multilateral Trading System: A Look at the Past and Proposed new Approach

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Summary

This briefing paper provides a historical recollection of trade and investment in the multilateral trading system. It also highlights approaches taken under regional trade arrangements so as to reflect on recent trends on the issue. It includes contemporary views with regard to investment facilitation, which highlights WTO Members' proposals and differing views in this regard.

Background

The issue of addressing investment in the multilateral trading system has long been debated, the central question being whether the World Trade Organization (WTO) is the requisite forum, or would another forum be more suited to address investment outside the multilateral trading system.

Attempts to deal with investment in the multilateral trading system can be traced back to the 1948 draft Havana Charter that set out to establish the International Trade Organization (ITO). The Charter under its economic development chapter provided for treatment of foreign investment on the premise that: international investment could be of great value in promoting economic development and consequent social progress; international flow of capital would be stimulated to the extent that Members afforded nationals of other countries opportunities for investment and security for such investments; and promotion of co-operation between national and foreign enterprises so as to foster economic development.¹ The Charter proposed national treatment and most favoured nation treatment to investors, however it was not ratified and the General Agreement on Tariffs and Trade (GATT) was maintained to govern the multilateral trading system. Investment was not included in the GATT.

Subsequently, addressing investment was done through bilateral investment treaties (BITs) which became the popular means to ensuring investment protection especially in the period when many developing countries, upon obtaining independence from colonial rule resorted to nationalisation measures.² There were other efforts at a multilateral approach to investment such as the OECD negotiations for a Multilateral Agreement on Investment that aimed for investment liberalisation, protection of investors and a dispute resolution

mechanism. Despite the initial consensus amongst OECD members, agreement was never reached.³ In the WTO, at the 1996 Ministerial Conference held in Singapore, investment was proposed amongst the negotiation issues but was not adopted. Instead a Working Group on the Relationship between Trade and Investment (WGTI) was mandated to examine the relationship between trade and investment issues, as well as to carry out exploratory work in that regard. The WGTI undertook substantive work under its mandate, until 2004 when WTO Members decided that investment would not be included in the DDA negotiation.⁴

However, following the WTO 10th Ministerial Declaration in Nairobi wherein it was provided that some members expressed the desire to address other issues beyond those in the DDA, investment has been raised for possible consideration at the WTO. This note analyses the relationship between trade and investment, as deliberated by the WGTI in WTO, and then reviews the contemporary approach being proposed to deal with investment in the WTO, highlighting the varying points of view from the membership.

Overview of WGTI Work

During its tenure, the WGTI explored the links between trade and investment in the context of development and economic growth, with a view to establishing how such links could be leveraged towards overall economic development and growth through targeted policies in the WTO. In doing so, the WGTI analysed Foreign Direct Investment (FDI) flows as well as international regulatory instruments in order to determine their net effect on trade.⁵

FDI was categorized in two broad forms i.e. horizontal and vertical FDI. The former referred to duplication of production units overseas, while the

¹ United Nations Conference on Trade and Employment. Held at Havana, Cuba, 1948 Final Act and Related Documents. Article 12

² Kavaljit Singh, Multilateral Investment Agreement in the WTO Issues and Illusions Asia-Pacific Research Network

³ Ibid

⁴ Doha Work Programme decision Adopted by the General Council on 1 August 2004 WT/L/579 (paragraph 1 (f))

⁵ WT/WGT/W1

later referred to cases where a specific part of the production process of a good is moved to another country so as to lower costs or improve the process. The situations usually determining the kind of FDI were found to be that when trade barriers were high and exporting goods wasn't cost effective, horizontal FDI would be preferable. In addition countries with large markets were found to be an incentive for horizontal FDI given that pay offs from sales would be higher than other costs such as those related to transportation. Although the impact of horizontal FDI is unclear on total trade, it was never the less found to be a means of involving countries in world trade through opening of new markets, especially as multinational enterprises continue to seek new production centres.

Having established the significance of the linkage between trade and investment, the WGTI considered the scope of investment issues that could be considered in the WTO, these were mainly with regard to technological development, transparency, non-discrimination, and dispute settlement.

It was noted that technology transfer, an important issue especially for the developing and least developed countries, could be facilitated through joint ventures, licensing, international trade, patents as well as through capital connected FDI. Technology transfer facilitates spill-over effects in the host country, as local firms can either innovate or replicate the technology so as to remain competitive. Targeted policy that provides for technology transfer would be critical in ensuring that foreign firms do not crowd out local firms. The WGTI further noted that technology transfer could be a means of enhancing human capital, including management skills, given that such transfer would involve employee training, and skills for operating advanced technology. Other aspects such as modern marketing and management technics can also be easily observed and replicated by local firms, thereby improving their efficiency.

With regard to transparency, the WGTI found that this was a critical aspect in ensuring investor confidence. To this end, the following guidelines

were considered:

- Information on relevant laws and policies must be made publicly available for investors and corporations
- There should be a notification system to ensure all parties are aware of changes in laws, regulations, and policies
- There should be uniform enforcement of regulations, laws and policies.

It was observed that transparency could in fact contribute immensely towards attracting investors, Hong Kong being an example of a country with a very high degree of transparency, which contributed to its status as a global trade power. In the WGTI there was general consensus that transparency is beneficial to all parties in investment, however it was also acknowledge that many developing countries and especially the least developed countries are resource constrained and may not be in position to establish the requisite transparency mechanisms. It was therefore considered important to take into account their situation when setting transparency requirements.

On non-discrimination, the WGTI noted that this fundamental principle of international trade would benefit trade if extended to investment. It was never the less acknowledged that exceptions would be provided for the developing and least developed countries. Such exceptions could be classified as follows:

- Systemic exceptions that would exempt strategic sectors so as to incentivise domestic firms within the sector to grow, these would be for a defined timeframe after which the sector could be liberalised
- General exceptions allowing for national measures to maintain laws and regulations in the public interest
- Country specific exceptions for developing and least developed countries so as to allow

for development and acquisition of the necessary infrastructure and capacity to comply with the agreed obligations

- Ad-hoc exceptions to be granted where there were legitimate limitations faced by a member country.

It was generally understood that with the above categories of exceptions countries would be in position to comply with the non-discrimination principle, while taking into account their strategic and policy needs.

Dispute settlement with regard to the trade-investment relationship was another critical issue deliberated upon in the WGTI. Some members were of the view that with respect to investment, the dispute settlement mechanism should provide for granting investors compensation in cases where a host country was found to have reneged on its obligations. However the majority of members insisted that the current WTO dispute settlement mechanism that provides for only state to state disputes (including remedies to state parties) should be maintained. Further that given no agreement had been reached on the definition of investment, as well as the asymmetry between developed and developing countries, a dispute settlement mechanism providing for investor remedies within the WTO should not be considered.

The WGTI also considered the idea of a multilateral framework on investment, however in 2004 members decided that investment would not be included in the DDA agenda.

Contemporary Approach to Trade and Investment in WTO

Following a provision in the WTO 10th Ministerial meeting to the effect that while work on the DDA issues where results were yet to be achieved, should be prioritized, some members wished to identify and

discuss other issues for negotiations;⁶ trade and investment has been proposed by certain members.

The contemporary view is that the approach to trade and investment should be completely divorced from the work undertaken by the WGTI. This is especially because a number of issues such as dispute settlement, pre and post establishment requirements, as well as investment protection requirements remained contentious, hence the abandonment of investment in 2004. Never the less, proponents of the new approach are premised on the fact that the dynamic links between trade, investment and development, require greater coherence in trade and investment policy.⁷ At a workshop organised by WTO delegations of Mexico, Indonesia, Korea, Turkey and Australia (MIKTA), it was observed that WTO in its role as the only international organization dealing with rules of trade presented the ideal forum to discuss investment.⁸

The MIKTA event called for the avoidance of known sensitivities, specifically those to do with investor dispute settlement and investment protections. It was argued that the new approach should consider investment facilitation as a starting point for deliberations amongst Members, and as a means of complimenting the already concluded Trade Facilitation Agreement.⁹ This is also because investment is to an extent already covered though in a piecemeal way across the following WTO Agreements:¹⁰

- The GATS which covers FDI in services (that accounts for two-thirds of global inward FDI stock)
- The TRIMS Agreement and the Agreement on Subsidies and Countervailing Measures, which seek to ensure investment measures are not inconsistent with GATT;
- TRIPS provisions which are relevant to the

⁶ WT/MIN(15)/DEC Paragraph 34.

⁷ JOB/GC/121 MIKTA Investment Workshop Reflections

⁸ Ibid

⁹ Ibid

¹⁰ Ibid

legal environment affecting foreign investment;

- As well as investment related measures considered in the WTO accession negotiations.

Moreover, it was also considered that as opposed to the past, presently developing countries account for an increasing share of inward and outward FDI.¹¹ In addition, that enhancing foreign investment could contribute significantly towards resources required to bridge the development investment gap necessary for developing and least developed countries to achieve the agreed Sustainable Development Goal (SDG) in this respect.¹² To this end, discussions on trade and investment in the WTO could strengthen policy coherence; facilitate trade and investment flows; and mobilise trade and investment for development amongst other attributes.¹³

It is from the foregoing that the current approach advocates for investment facilitation, which would reflect core WTO principles as a basis for further discussions on elements such as: transparency, predictability and non-discrimination in investment policies; efficiency and streamlining of administrative procedures so as to minimise investment barriers; and international cooperation, capacity-building as well as technical assistance.¹⁴ The overarching objective of this approach is to discuss and consider investment facilitation from the lens of linkages between trade, investment and development; with a view of leveraging the WTO to ensure such positive linkages are leveraged for development.

On the other hand, some WTO members are of the view that the 2004 Members' decision to consider investment only upon conclusion of the DDA should be conformed with. The rationale is that issues such as agriculture which is a mainstay for most developing and least developing countries should determine the ambition in WTO

negotiations. Moreover, it is also argued that most countries are cognisant of the need to promote and enhance an enabling environment for investment and have put in place policies, laws, regulations and institutions to this effect. Current trends with regard to investment in most developing and least developed countries are centred on establishment of export processing zones, one stop bureaus for investment facilitation and other such initiatives geared at attracting and lowering cost of investment. From this point of view, negotiating disciplines on investment in the WTO is not a priority.

Others are also of the view that issues ultra vires the DDA such as investment facilitation, will likely perpetuate the divide between the poor and well-off countries since issues of interest to the former remain unresolved, which has hindered their integration in the multilateral trading system. In addition, reversing positions already agreed upon could set a bad precedent in the WTO, a forum reputed for its role in upholding agreed rules and decisions of Members.

Conclusion

Despite several years of discussions and exploratory work undertaken by the WGTFI on the issue of investment, there was no agreement to take up investment in the DDA negotiations. The WTO 10th Ministerial Council Declaration seems to have opened a window for re-introducing the issue. Indeed a new approach that seeks to avoid the contentious areas so as to only deal with investment facilitation along the lines of the recently agreed Trade Facilitation Agreement has been suggested; and also supported by a number of WTO Members. However concerns remain that such a move would inter alia derail prioritization of issues such as agriculture that are more important to majority of the Membership.

Going forward, it is clear that much more needs to be done for the WTO membership to address the

¹¹ Ibid

¹² Ibid

¹³ Ibid

¹⁴ Ibid

investment issue. This could be through undertaking of more research and deliberations on the linkages between trade, investment and

development, and the role of the WTO as a forum to leverage those linkages towards development.

References

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