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Note

Negotiating Trade and Investment in the WTO

A Historical Review of Multilateral Negotiations to Regulate Foreign Investment

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Summary

Free Trade Agreements (FTAs) and regional integration arrangements are increasingly covering trade and investment. It is likely that such issues would be explored for negotiations within WTO. This brief note takes a historical review of negotiations to regulate foreign investment at the multilateral level. The overarching objective is to provide the context for any future negotiations in this regard at the WTO.

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Introduction

Trade and Investment was among the "Singapore issues" originally included in the Doha Development Agenda but were not adopted at the 2003 Cancun Ministerial Conference. Amongst the issues which included Competition, Government Procurement and Trade facilitation; Investment seemed the most contentious especially given that despite existence of numerous Bilateral Investment Treaties (BITs), attempts to establish a multilateral investment agreement had not succeeded. However, the current trend is that Free Trade Agreements (FTAs) and regional integration arrangements are increasingly covering trade and investment, and that at the last WTO Ministerial Conference of 2015, some Members indicated the need to explore negotiations on new issues, it is likely that such issues would include trade and investment.

This brief note takes a historical review of negotiations to regulate foreign investment at the multilateral level. The overarching objective is to provide the context for any future negotiations in this regard at the WTO, more so from a developing and least developed countries point of view.

Multilateral Investment Regulation

Efforts to establish a multilateral agreement on investment date back to the 1948 draft Havana Charter to establish the International Trade Organization, which was meant to be the third of the so called Bretton wood Institutions i.e. the World Bank and International Monetary Fund created to address post World War II economic cooperation. The Charter provided for foreign direct investment issues.

Proposals on the Charter spelt out extensive rights for investors such as obligations of host countries to extend national treatment (NT) and most favoured nation (MFN) treatment. However, some countries were opposed to such measures since they did not wish to extend neither NT nor MFN to certain countries. Another contentious issue was the opposition by US corporations to provisions under the Charter that provided for regulating anti-competitive policies of private business. Charter provisions did not extend to issues such as dispute settlement or performance requirements. Despite the United States having been the main

demander of the Charter, their Congress refused to ratify it and the ITO was replaced by the General Agreement on Tariffs and Trade (GATT). The GATT did not take on investment issues in all the negotiations rounds during its existence. It was only at its last round of negotiations (the Uruguay Round) that Trade Related Investment Measures (TRIMs) agreement was introduced within the multilateral trading system.

It is argued that failure to establish the International Trade Organization resulted in proliferation of bilateral investment agreements (BITS) as a means of regulating and protecting foreign investments. This was especially in an era when many developing countries, upon obtaining independence from colonial rule, put in place nationalization measures. The World Bank also set up the International Centre for Settlement on Investment Disputes (ICSID) in a move to facilitate settlement of disputes between governments or between investors and governments.

In a bid to further investment and related issues, the large foreign investment exporting countries initiated dialogue at the Organization of Economic Cooperation and Development (OECD) whose membership during the 1960-70's was constituted by developed countries. This dialogue never the less, did not extend to rights and obligations of foreign investors. Later attempts to establish investor protection and related issues within the OECD framework were also unsuccessful.

In the 1970's there was an important development related to the role of foreign investment, which was raised by developing countries in the United Nations. This was with regard to meddling of foreign investors in the domestic political affairs of their host countries, which resulted in establishment of the United Nations Commission on Transnational Corporations and the Center on Transnational Corporations (UNCTC) with the mandate to conduct research on investment issues towards a UN Code of Conduct on Transnational Corporations. The aim was to limit corporate power through provision of guidelines controlling their activities in host countries. The eventual 1986 draft of the UN Code provided for extensive regulation of the entry and operations of transnational corporations in the host country, which did not go well with some UN member countries and was not approved, subsequently the UNCTC was dissolved. The United Nations Conference on Trade and development (UNCTAD) has since taken on work related to Transnationals Corporations.

In the GATT, TRIMs and GATS which are part of the Uruguay Round of negotiations outcome marked the successful inclusion of

investment issues in the multilateral trading system. These were proposed by developed countries at a time developing countries were also liberalizing investment rules following IMF imposed initiatives in the form of Structural Adjustment Programmes (SAPs).

At the multilateral level, in the 1990's developed countries re-initiated investment negotiations under the OECD, since most developing countries were not supportive of such an agreement. The US led the process for negotiating a Multilateral Agreement on Investment (MAI) that called for investment liberalization, protection of investors and a dispute resolution mechanism. However, negotiations later broke down despite the general consensus of such an agreement amongst the OECD members. Later developments such as the US Helms-Burton Act that empowered US citizens and Corporations whose property was expropriated by Cuba to claim damages against anybody transacting in their former property; as well as the demand for exemption from national treatment for culture raised by France, led to collapse of the negotiations.

Efforts to establish a multilateral agreement on investment reverted to the World Trade Organization (WTO), which had been established following the Uruguay round, to replace the GATT. At the 1996 WTO Ministerial Conference held in Singapore, developing countries resisted introduction of investment as a negotiation issue. The compromise was to set up a Working Group on Trade and Investment (WGTI) with the mandate to examine the relationship between trade and investment issues, as well as carry out exploratory work in that regard.

The WGTI studied and discussed issues of trade and investment from 1996 to 2004, specifically covering the following:

Implications of the relationship between trade and investment for development and economic growth, including:

- Economic parameters relating to macroeconomic stability, such as domestic savings, fiscal position and the balance of payments;
- Industrialization, privatization, employment, income and wealth distribution, competitiveness, transfer of technology and managerial skills;
- Domestic conditions of competition and market structures.

The economic relationship between trade and investment:

- The degree of correlation between trade and investment flows;

- The determinants of the relationship between trade and investment;
- The impact of business strategies, practices and decision-making on trade and investment, including through case studies;
- The relationship between the mobility of capital and the mobility of labour;
- The impact of trade policies and measures on investment flows, including the effect of the growing number of bilateral and regional arrangements;
- The impact of investment policies and measures on trade;
- Country experiences regarding national investment policies, including investment incentives and disincentives;
- The relationship between foreign investment and competition policy.

Stocktaking and analysis of existing international instruments and activities regarding trade and investment:

- Existing WTO provisions;
- Bilateral, regional, plurilateral and multilateral agreements and initiatives;
- Implications for trade and investment flows of existing international instruments.

On the basis of the above:

- Identification of common features and differences, including overlaps and possible conflicts, as well as possible gaps in existing international instruments;
- Advantages and disadvantages of entering into bilateral, regional and multilateral rules on Investment, including from a development perspective;
- The rights and obligations of home and host countries and of investors and host countries;
- The relationship between existing and possible future international cooperation on investment policy and existing and possible future international cooperation on competition policy.

The work covered by the WGTI will no doubt set the foundation of any future negotiations on trade and investment in the multilateral trading system, given that a divergent range of issues have been discussed in detail, and members' views taken on board.

III. Pros and Cons for a Multilateral Investment Agreement

Proponents of a multilateral investment agreement argue that it would create channels through which modern, advanced technology could be disseminated through spill-over effects of FDI in the host country. The spill-over would depend on the characteristics and policies of host economies which should ideally not fetter FDI through measures such as performance requirements.

Others are of the view that although the above assertion may be true in the case of some investments, it cannot be generalized. In assessing benefits from liberalizing FDI, economic, social and environmental costs should be taken into account especially so as to ensure sustainable development.

Further, there's so far no conclusive proof that investment agreements influence or boost foreign investment destination. In fact there are instances where huge foreign investment has been made in a country without any form of investment or related agreement between the originating and host countries (US are among the biggest foreign investors in India and yet the two countries have no BIT). Generally, the flow of foreign investment is more dependent on the size of markets, infrastructure in place, stability in a country, as well as location among other similar considerations. This could be the reason that concentration of foreign investment in developing countries is evidenced in countries such as India, China, Brazil, South Africa, Mexico, Indonesia and other similarly situated countries; while other developing countries, despite entering BITs and regional arrangements covering investment and trade, have not attracted or enhanced their foreign investment portfolios.

Another often advanced reason for a Multilateral Investment Agreement is that it facilitates and/or enhances economic growth and development. In fact, there has not been any direct linkage between FDI and economic growth. On the contrary, it is argued that without performance requirements and other requisite regulations, benefits from FDI inflows may not be realized.

The nature of FDI inflows determines the gains that a host country can hope to gain from it. For instance, if the bulk of such investment is targeted at natural resource exploitation – as is often the case in most developing countries especially sub-Saharan Africa, benefits from transfer of technology and skills would be limited. Similarly, where the investment is directed to capital intensive sectors, it would be

unlikely to help with addressing employment challenges in the host country.

Ideally, for FDI to positively impact on the host country's economic growth, it should complement domestic capital, however the trend has been that in most developing countries, foreign investment displaces domestic investment. This has resulted in foreign investment crowding out national savings to the detriment of the host country. The Baltic States are an example of where liberalizing investment in the financial sector drove out local banks, with the foreign investors in the sector taking over more than 90 percent of the market share in banking. Similar trends can already be observed in Sub-Saharan Africa. The main challenge of foreign banks taking over in the host country is that they may often not be aligned to national development goals such as promoting small and medium enterprises. Their preference is to deal with transnational corporations and other less risky ventures within the country, leaving local enterprises without recourse to much needed financial access required to operate and grow.

Typically investment agreements come with very strong investment protection clauses that may hinder the host country's policy space in regulating certain sectors for the public good. Moreover, such protection is backed up by dispute settlement provisions. The experience so far with regard to dispute settlement in investment cases has been controversial and often impedes the host country's regulatory autonomy.

Way Forward

From the foregoing, in the event of a multilateral investment agreement being negotiated in the WTO, the following issues should be taken into account in the interest of developing and least developed countries:

- Host countries should reserve the right to regulate both pre and post entry processes for foreign investors, which would suit their development strategies and priorities.

- Host countries should have the autonomy to screen foreign investors, and regulate on issues such as mergers, minimum capital requirements, ownership requirements, and compulsory joint ventures with local partners etc.

- Performance requirements should also be an option that host countries could utilize to ensure that foreign investment benefits their development interests.

- Exceptions in National Treatment should be an option for host countries, which is an important tool for strategic development of certain sectors of their economy by protecting them from more competitive foreign investments.

- Importantly, the dispute settlement mechanism for investment issues should retain the WTO modus of state to state, rather than the practice in BITs and regional trade agreements that allows for investor – state dispute settlement.

All in all, negotiations on investment in the WTO would require a careful approach so as to ensure that host countries policy space to attain sustainable development is not hampered by binding commitments with regard to foreign investments.

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