

The Emperor's New Clothes

Why rich countries want a WTO investment agreement

Despite an overcrowded agenda and the lack of progress on matters crucial to development, rich countries, especially members of the European Union, are pushing for the launch of investment negotiations at the ministerial meeting of the World Trade Organisation in Cancun in September 2003. When properly regulated, foreign investment can contribute to sustainable development. However, the proposed WTO agreement on investment will establish rules that developing countries do not need and cannot afford, enhancing investors' 'rights' while undermining governments' capacity to pursue pro-development policies. This is why Oxfam calls on WTO members to reject the launch of investment negotiations in Cancun.

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Executive summary

At the ministerial conference of the World Trade Organisation (WTO) in Doha in 2001, rich countries promised that the new round of WTO negotiations would resolve issues of interest to developing countries and produce new, pro-development trade rules. Against the will of many developing countries, the European Union insisted upon discussing the inclusion of four new issues (also known as Singapore Issues), including investment, on the WTO's agenda.

While EU members and other rich countries are still failing to fulfil their promises, as proven by the continuing deadlock of agricultural negotiations, they are nonetheless pressuring developing countries to accept investment rules they do not need and cannot afford.

In the context of an overcrowded agenda, this push for investment negotiations distracts WTO members from more important issues and puts immense strain on developing-country negotiators, who do not have enough time or information to make informed decisions on the four new negotiation issues.

For the foreseeable future, the WTO's mandate will remain narrowly focused on liberalisation. Rich countries will continue to use their power in this institution to promote the rights of investors, at the expense of developing countries' interests. As it stands, the WTO is not an appropriate forum for multilateral investment negotiations. Such negotiations would result in a multilateral legal framework whose impact on developing countries' sustainable development could be very damaging.

These are the reasons Oxfam is against the launch of negotiations on a WTO investment agreement. WTO members should refrain from any action that would lead to the launch of negotiations at the Cancun ministerial meeting, including agreeing to procedural modalities with a target date for completion of the negotiations. Oxfam believes that WTO members should concentrate instead on negotiating pro-development rules on agriculture, intellectual property rights, Special and Differential treatment, and other existing agenda items of interest to developing countries.

The role of FDI and development

As shown by the experience of many developing countries, foreign direct investment (FDI) has the potential to make an important contribution to sustainable development. But whether it is beneficial or detrimental to development very much depends on the type and quality of investment and the regulatory environment in the host country. The key questions for sustainable development are *what kind of investment and how poor people will benefit*.

WTO investment rules and development: a tenuous link

Proponents of an agreement have suggested that a WTO investment agreement will help developing countries to attract more investment. However, the causal link between liberalised investment rules and increased FDI is a tenuous one. There is no evidence an international agreement will generate more investment, let alone good-quality investment. In fact, rules are just one of the many factors determining investment decisions.

Moreover, a consideration of how such an agreement will promote better-quality investment to the poorest countries remains largely absent from current proposals by rich countries. Instead of promoting better investment practices, the application

of the core WTO national treatment principles to investment will most likely reduce the capacity of developing countries to regulate foreign investment in the interests of sustainable development, while failing to oblige investors to behave in a socially responsible manner.

Not only will such a model fail to respond to developing countries' needs for financing for development, but it will increase risks of financial instability, failed industrialisation, and harmful impact of FDI on the environment, human development, and working conditions.

EU's Investment for Development Framework: a slippery slope

The EU has argued that the proposed investment agreement at the WTO is very different from the discredited OECD negotiations on a Multilateral Agreement on Investment (MAI). The EU's proposals, at least in their current form, are indeed less ambitious.

However, rules currently proposed by the EU are still a major step in the wrong direction. Despite the apparent flexibility provided by a GATS-type approach, the impact of the proposed rules and negotiation process will be to reduce the flexibility of developing countries to regulate foreign investors. Moreover, the EU's proposal fails to introduce binding obligations on investors and their home countries.

The precedent of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) clearly shows that limited mandates can expand as negotiations proceed. The current negotiations on TRIPS and public health also demonstrate that the EU will most likely accommodate US concerns as they arise in the future. In the case of investment, multilateralising US standards of investor protection would be disastrous for development.

Power politics at the WTO

WTO ministers have agreed that in Cancun 'negotiations on the Singapore issues will only take place after explicit consensus has been reached over the modalities'. Many developing countries are saying they do not want negotiations on the Singapore issues to be initiated at Cancun. Unfortunately, the EU and other developed countries continue to push for the opposite.

Due to the current lopsided balance of power at the WTO between rich and poor countries, developing countries will be under enormous pressure to accept negotiations on the Singapore issues. As they did in Doha, rich countries might use heavy-handed tactics in Cancun in presenting investment and the other Singapore issues as crucial elements of a negotiation package, or by threatening to frustrate progress in key issues for developing countries, such as agriculture and TRIPS and public health.

In order to restore trust and confidence in the current so-called 'development round', rich countries should focus on the other, much more pressing, items outstanding on the agenda. Developing countries, as they did in the case of TRIPS and public health, should remain united in their opposition to the Singapore issues, and not yield to the rich countries' pressure.

Conditions for more sustainable investment practices

Given the lack of any benefit to developing countries of a WTO investment agreement, and given the potentially devastating effects that such an agreement

could have on their power to regulate investors, developing countries should categorically oppose the launch of investment negotiations at the Cancun ministerial meeting.

At the domestic level, host countries need to reform their regulatory framework to ensure foreign direct investment contributes to sustainable development.

At the multilateral level, the debate must now take a new direction. Its starting point should be to increase the quantity and improve the quality of investment in developing countries. The current drive by developed countries to sign bilateral and regional free-trade agreements with the developing world should be re-examined in the light of the same principles.

The idea of a pro-poor investment treaty in the UN, or a free-standing agreement, should be further explored. What is needed first and foremost is the demonstration of a political commitment, in particular from the rich countries, to redress the current imbalances between the rights and responsibilities of companies. Given the plethora of existing pro-investor agreements, the emphasis should be on creating binding obligations on companies to ensure that they behave in a manner consistent with international human rights and development objectives.

Finally, existing investment-related rules at the WTO should be reformed to allow governments the freedom to regulate foreign investment in a pro-development manner.

Introduction

At the insistence of the European Union and other industrialised countries, developing countries agreed at the ministerial meeting of the World Trade Organisation (WTO) in Doha in 2001 to start discussing the modalities of potential negotiations on investment, competition, trade facilitation, and government procurement. In September 2003, at the WTO Ministerial in Cancun, Mexico, WTO members will have to decide whether to launch negotiations on a crucial area for development: investment.

OXFAM believes in a rules-based multilateral trading system. However, as long as the WTO remains dominated by rich-country interests and narrowly focused on trade liberalisation, Oxfam can see no merit in launching investment negotiations at the WTO. The evidence in this paper shows WTO negotiations on investment would result in unbalanced rules that would create a disaster for equitable development.

Rich countries, which less than two years ago promised to make this new cycle of negotiations a development round, have broken all their promises. Deadlines have been missed in key areas such as agriculture, Special and Differential Treatment, and Trade-Related Aspects of Intellectual Property Rights (TRIPS). Nonetheless, rich countries are still pushing to start negotiations on new issues, including investment. Worse, they have failed to demonstrate how such negotiations would lead to more and higher-quality investment flows into developing countries. In this context, adding complex issues such as investment will put unnecessary strains on an already fragile negotiation process, increasing the risk of total breakdown of discussions in Cancun and further loss of credibility of the WTO.

This paper will start by examining the relations between foreign direct investment (FDI) and development, and assessing the current situation in terms of existing bilateral, regional, and multilateral regulations on investment. The next section examines the likely impact of the proposed investment agreement at the WTO on development. The concluding section makes proposals for pro-development FDI rules.

The role of FDI in development

According to the United Nations Conference on Trade and Development (UNCTAD), more than 65,000 transnational corporations are currently driving the global expansion of FDI, through the creation of more than 850,000 foreign affiliates.¹

Foreign investment has the potential to make an important contribution to development. For instance, FDI can provide developing countries with greater access to technology, research and development (R&D), and marketing expertise, which are key elements in successful industrialisation. This in turn can help to generate much-needed finance, employment, and foreign exchange. FDI can also provide greater access to international financial markets, which is crucial for countries whose domestic savings and Official Development Assistance flows are insufficient to cover their development needs.

The experience of China since the 1980s illustrates the role FDI can play fuelling economic growth. In its drive to revive a stagnant economy, China introduced a new economic regime in 1978, aiming to attract foreign investment in order to stimulate growth. In less than two decades, the country has quadrupled its GNP and is among the top recipients of FDI in the world.² By 2000, foreign firms accounted for almost half of China's exports. FDI has had both positive and negative impacts, but overall the government has succeeded in controlling foreign investment and using it for its macro-economic objective of integrating with global markets.³ For instance, China's car-manufacturing industry has taken off since the 1980s, largely through joint ventures with foreign firms. Thanks to government regulation, Chinese automobile firms have also become major players in a booming domestic market.

Nevertheless, despite its spectacular economic growth, China faces many acute problems in achieving sustainable development. Inequity, environmental degradation, and unsatisfactory social development are among the growing threats to poverty-reduction initiatives.

Available empirical evidence clearly shows there is no automatic correlation between FDI, economic growth, and sustainable, equitable development. A study using data from the IMF and the World Bank found that 'FDI inflows do not exert an independent influence on economic growth'.⁴ This is in part due to the fact that FDI, despite its impressive growth, still represents a small portion of total investment, in developing countries as well as in richer ones. According to the World Bank, FDI flows to developing countries amount to about \$160 billion. This sum is still relatively small, compared with all domestic investment in developing countries, now totalling about \$1 trillion.⁵

The absence of an automatic link between foreign investment and growth also relates to the quality and type of investment and the domestic regulatory environment. Whether FDI contributes positively to development often depends on the ability of the national government to adopt a sound and equitable regulatory framework.

On the other hand, foreign investors are interested in the maximisation of profits in a relatively constraint-free business environment. While weakening investor regulations may be beneficial from the perspective of a multinational company, it is often damaging from the perspective of national development. This is why many developed and developing-country governments have resisted corporate pressure to deregulate foreign investment.

If not adequately regulated, FDI can compound economic, financial, and social problems. For example, FDI deregulation can exacerbate balance-of-payments problems and financial instability created by repatriation of profits, high levels of input-related imports, and transfer pricing. Many multinational companies use developing countries as assembly or distribution points, with limited backward linkages or technology transfer to the local economy. The activities of multinational companies in developing countries may also have adverse impacts on environment and labour rights.

This does not mean that domestic regulations are a panacea for development. In the absence of good governance and sound civil-society participation, domestic regulations can result in adverse development outcomes, such as the concentration of the benefits of FDI and prosperity in the hands of élites.

However, the introduction of WTO investment rules would not address the problem of governance. In fact, it would limit the ability of governments to introduce a pro-development regulatory framework for investment.

The current state of play

A brief examination of the current state of play of international investment regulations shows the disturbing proliferation of binding pro-investor agreements and a paucity of binding responsibilities for investors.

The multiplication of pro-investor rights agreements

According to UNCTAD, there were approximately 2,100 bilateral and regional treaties covering investment in 2001, many of them involving developing countries.⁶ While earlier Bilateral Investment Treaties (BITs) included economic cooperation clauses aimed at fostering development in the host country, treaties signed during the 1990s were largely directed towards reducing risk and costs for foreign investors.⁷

Bilateral and regional investment agreements promoted by the USA all aim to provide transnational corporations (TNCs) with the highest standard of investor protection. The 2002 US-Chile Free Trade Agreement, for example, which has been presented as a model for future US BITs, severely limits the ability of the Chilean government to regulate the activities of foreign investors.⁸ For instance, the agreement restricts the freedom of the government to impose capital controls in financial crises. It also includes the concept of 'regulatory expropriation', which was first introduced in the North America Free Trade Agreement (NAFTA) and which has had a negative impact on Mexico's capacity to pursue pro-development policies (See Box 4).

One-sided investment liberalisation and protection rules have also been introduced into the WTO. During the Uruguay Round of (GATT) trade negotiations (1986-1993), powerful business interests and Northern governments managed to get three agreements included as elements of the WTO trading regime. The TRIMs, GATS, and TRIPS agreements are considered 'the first milestones on a road in the wrong direction, which the EU and others now want to build up even further'.⁹

- Based on US-style patent and copyright rules, the TRIPS agreement prevents much-needed technology transfer to developing countries by ensuring corporate control of knowledge and technology through globally enforced minimum standards, including twenty-year patents.
- Applying the principle of national treatment to investment measures having an impact on trade, the 1995 agreement on TRIMS (Trade-Related Investment Measures) curtailed the freedom of governments to demand that foreign investors use a minimum percentage of local content as inputs, export a minimum percentage of their production, or limit the level of profit repatriation.

- Since investment is one of the four modes of delivering services, the GATS agreement requires members to treat foreign services providers no less favourably than domestic providers.

In 1997, rich-country governments attempted to consolidate and build on these rules by creating a new Multilateral Agreement on Investment (MAI) under the auspices of the Organisation for Economic Cooperation and Development (OECD). The main objective of the MAI was to remove all or most of the remaining restrictions on foreign investment, and ensure that governments treated foreign investment no less favourably than they treated domestic investment. The definition of investment for the negotiation of this agreement was very broad, including intellectual property and portfolio investment, 'beyond the traditional notion of FDI to cover virtually all tangible and intangible assets, applying both to pre-establishment and post-establishment'.¹⁰ The agreement also included a proposal for investor-to-state dispute mechanisms and a broad definition of expropriation.¹¹

After an initial period of negotiations in secret, a draft of the MAI, modelled on NAFTA's chapter 11 investment rules, was made public in February 1998. However, OECD governments failed to reach an agreement after widespread protests initiated by NGOs, a growing list of more than 600 exceptions put forward by OECD governments, and the French government's refusal to sign the agreement, in order to protect its cultural sector.

The lack of investor responsibilities

While the protection of investors' rights has increased world wide, investors' responsibilities have remained at a very low level – both domestically and internationally – or have been weakened by governments aiming to attract FDI into their countries.

To attract more investment, many developing countries have failed to improve, or have weakened, existing domestic regulations that protect labour rights. For example, in the 1970s and 1980s many developing countries, including the Philippines, Sri Lanka, and China, set up export - processing zones (sometimes also called free trade zones) with lower labour standards – including limitations on unionisation – and weaker social obligations for employers, in order to encourage FDI.¹²

Another example of the worldwide competition for FDI is tax incentives. During the last decade, developing countries have systematically lowered their corporate tax rates for foreign investors. This destructive tax competition results in a loss of tax revenues available for development; the figure has been estimated at US\$50 billion.¹³ To give one example, the multinational corporation Anglo American has secured a lower tax rate for a large-scale investment project in Zambia, the Konkol Deep Mining

Project: a tax rate of 25 per cent will be applied, compared with the normal rate of 35 per cent for foreign-owned companies.¹⁴ Even worse for Zambia, Anglo-American has since withdrawn from the country, in response to a fall in copper prices.

The problem of the ‘race to the bottom’ is not caused by foreign investors alone, but also by the actions of governments in developing countries competing for FDI. In some cases, national governments are primarily responsible for failing to uphold international standards. In other instances, governments have failed to deliver the benefits of FDI to the poor.

Meanwhile, the home countries of major investors have refused to impose any binding obligations on their own companies regarding their activities abroad. The OECD Guidelines for Multinational Enterprises remain voluntary for companies, and enforcement by governments is still very weak. For instance, many governments do not even want to oblige their companies to report on their compliance with OECD guidelines or other voluntary commitments, allowing companies to remain opaque about their activities in developing countries.

The WTO agreement on investment: the icing on the cake

In contrast to the OECD MAI, the current push for a WTO investment agreement by the EU, the USA, Canada, Japan, and Korea is presented as a limited endeavour focusing on transparency, and it is marketed as ‘pro-development’.

In reality, a WTO agreement would represent another step towards the full liberalisation of investment flows that was initiated during the Uruguay Round. It would cover every country of economic importance in the world, even those that have resisted bilateral and regional investment agreements, and would cover all sectors, including sensitive sub-sectors such as agriculture and food production (see Box 1).

Box 1: What the EU and the US want in a WTO investment agreement¹⁵	
<u>European Union:</u>	
▪	Scope: Limited to Foreign Direct Investment (direct investment enterprises including investors engaged in these enterprises and direct investment capital transactions)
▪	Most Favoured Nation in the pre- and post-establishment phases (with possible exclusions)
▪	GATs-style approach including: a) a positive list for national treatment and market access commitments at the pre-establishment phase, b) a general standard of National treatment (with possible exclusions) for the post-establishment phase, c) specific additional commitments of national treatment in the post-establishment phase on a positive list basis
▪	Dispute settlement: the current WTO dispute settlement system should apply (state-to-state only)

<ul style="list-style-type: none"> ▪ Free capital transfers. Balance of payments safeguards should only be used in exceptional circumstances
<p>United States:</p> <ul style="list-style-type: none"> ▪ Scope: A broad definition of investment including portfolio investment ▪ Most Favoured Nation in the pre- and post-establishment phases (with possible exclusions) ▪ Negative list approach both for pre-establishment commitments on market access and national treatment and post-establishment national treatment (as in NAFTA and BITs) ▪ Free capital transfers, questions use of BOP exceptions ▪ Higher standards of investor protection, as in NAFTA or a future FTAA, should prevail over WTO provisions

Worse still, under the guise of a pro-development, bottom-up approach, WTO negotiations on investment would initiate a process of gradual liberalisation, which would allow for a succession of WTO negotiating rounds, aimed at obtaining the highest levels of investor protection.

This is clearly the end goal of important corporate lobbies such as the International Chamber of Commerce (ICC), which would like to see multilateral application of the high levels of investor protection included in US Bilateral Investment Treaties (see Box 2).

Other corporate associations, such as the European Union Foreign Trade Association, the European Services Forum, and UNICE, also actively lobby the European Commission for a WTO investment agreement focused on investors' rights.

<p>Box 2: 'WTO rules on investment would benefit the developing world...'¹⁶</p>
<p><i>'WTO rules on investment would benefit the developing world... A multilateral framework of WTO rules on investment would contribute to transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment (FDI).'</i></p>
<p>According to the International Chamber of Commerce (ICC), which represents thousands of companies from 130 countries, the aim of a WTO investment agreement would be 'to increase the quantity of investment, encourage its more efficient allocation and create a level playing field for developing countries seeking to boost inward investment to underpin their economic growth'. This claim was, however, questioned by the Indian representative of the ICC, who disassociated himself from this recent statement.</p>
<p>In reality, far from promoting a pro-development investment framework, the ICC has declared support for a WTO investment agreement that would include high levels of investor protection, including national treatment for foreign investors, the freedom to transfer all payments related to their investments, an investor-to-state dispute-settlement mechanism and the principle of progressive liberalisation.</p>

WTO rules on investment and development: a tenuous link

WTO investment rules will not lead to increased levels of investment

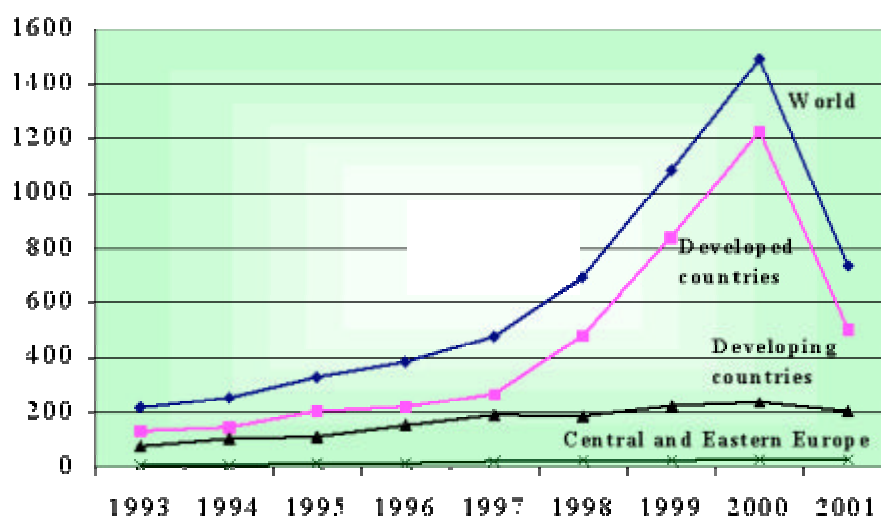
Proponents argue that a WTO investment agreement will enable developing countries to attract more FDI. However, there is no evidence to support this claim.

According to available studies, liberalisation through binding treaties, at a bilateral or regional level, has not led to any significant increase in investment flows. Proponents of a WTO agreement have failed to show why more of the same medicine would produce a different effect. Analysing a single year of investment, an UNCTAD study examined whether the amount of investment received by the host country correlated with the number of BITs signed.¹⁷ Its conclusion was that there was little evidence to prove that BITs led to increased FDI inflows. Another study, which applied the same test to 20 years of data, covering bilateral flows between OECD members and 31 developing countries, found that countries with BITs were no more likely to receive additional FDI than those without such agreements (Hallward-Driemeier, 2002).¹⁸

Moreover, proponents have not provided any evidence that a WTO investment agreement would lead to a more equitable sharing of FDI flows among developing countries. FDI remains highly concentrated. During 2001, the five largest developing host countries received 62 per cent of total inflows, and the 10 largest received three-quarters (see Figure 1).

What is worse, the 49 least-developed countries (LDCs) who have signed close to 300 BITs,¹⁹ so far remain marginal recipients of FDI, with only 2 per cent of all FDI flowing to developing countries.²⁰ FDI in the LDCs increased from a flow of \$573 million in 1990 to an average of \$3.9 billion between 1996 and 2001. However, these amounts are not sufficient to cover LDCs' most urgent financial needs. As of 2000, LDCs had a total debt burden of \$143 billion and annual debt-service payments of \$4.6 billion. Moreover, FDI flows in LDC are extremely concentrated, with the four oil-exporting countries receiving more than 50 per cent of total inflows in 1999 and 2000.²¹

Figure 1: Global inflows of FDI 1993-2001, US\$ billion, by groups of countries



Source: UNCTAD, DITE Statistics on FDI

One reason for the tenuous link between liberalised investment rules and increased flows of FDI is that the primary motives of companies investing abroad have little to do with investment regulations. In its *Global Economic Prospects 2003*, the World Bank indicated that other factors, such as political stability or market access into developed countries, were much more important determinants.²² These conclusions are confirmed by a survey by the Multilateral Investment Guarantee Agency (MIGA), analysing how firms make their investment decisions. According to this survey, the two main objectives of investing abroad are improved market access and the reduction of operating costs. The choice of a particular country is driven primarily by access to customers and by a stable social and political environment. The greatest perceived risks in FDI are physical insecurity of staff, war or civil disturbance, currency inconvertibility, and breach of contract.²³

WTO investment rules will undermine governments' ability to regulate FDI in a pro-development manner

The impact of FDI on development partly depends on governments' ability to regulate investors, domestic and foreign alike. As the World Bank suggests, international agreements should not hinder the freedom of governments to adopt appropriate reforms. 'Countries get most of the positive growth stimulus from domestic unilateral reforms tailored to local strategy and conditions, and these reforms should not be held hostage to international agreements,' the World Bank says.²⁴

First of all, governments need to be able to minimise the possible negative side-effects of the activities of both domestic and foreign investors on a

country's human and sustainable development. They also need to be able to achieve macro-economic balance through appropriate regulatory steps.

Furthermore, governments might need to discriminate between domestic and foreign investors. For instance, domestic firms might need specific support to develop and compete against foreign firms, through measures such as tax incentives, government procurement, or targeted subsidies. FDI cannot substitute for the development of domestic investors and savings, which still form the backbone of the economy in most countries.²⁵ As UNCTAD notes, 'there may be no substitute for the promotion by host countries of domestic industries to ensure economic development and, in a world marked by stark inequalities in economic power, technical capabilities and financial strength, a certain differentiation between national and non-national firms may be necessary precisely in order to bring about a degree of operative equality'.²⁶

WTO investment negotiations could undermine the ability of developing countries to put such regulations in place. The WTO's main mandate is liberalisation, which aims to reduce barriers imposed by governments on trade flows. In this context, any regulation that has an impact on trade flows (such as performance requirements) constitutes a target. Moreover, the core principles of the WTO's Most Favoured Nation status (which requires countries to treat equally all foreign investors) and 'national treatment' (which requires countries to treat foreign investors and their investments no less favourably than domestic investors) would directly circumscribe the ability of governments to discriminate among investors.

As shown below, the full liberalisation of investment flows and the application of national treatment to investment regulations could have negative consequences for development, including the risk of financial instability, failed industrialisation, and threatened human development.

The risk of increased financial instability

National governments' ability to regulate capital inflows and outflows can be a determining factor in maintaining financial stability in a country. However, a WTO investment agreement could endanger the ability of governments to regulate inflows and outflows of capital through screening, performance requirements, or balance-of-payment safeguards.

Even though the Doha mandate mentions only FDI, some WTO members would like to create disciplines applicable to all types of investment. In discussions at the WTO's Working Group on Trade and Investment (WGTI), the USA is proposing a broader definition and scope of investment that covers all assets, including portfolio and short-term capital flows.²⁷

Even if the USA fails to achieve the broad coverage that it is seeking, WTO disciplines might still unduly limit countries' capacity to control disruptive

capital inflows and outflows. Proponents of a WTO investment agreement, including the EU, insist that any agreement should provide for freer entry of foreign capital into an economy. For instance, they agree on the desirability of providing pre-establishment rights for investors.

In order to keep their balance of payments in check, governments must be able to use screening criteria – for instance, to ascertain if the investment involves the construction of new capacity or the purchase of existing capacity, or if backward linkages into the domestic economy are created, with the aim of limiting foreign-exchange costs for imported inputs.

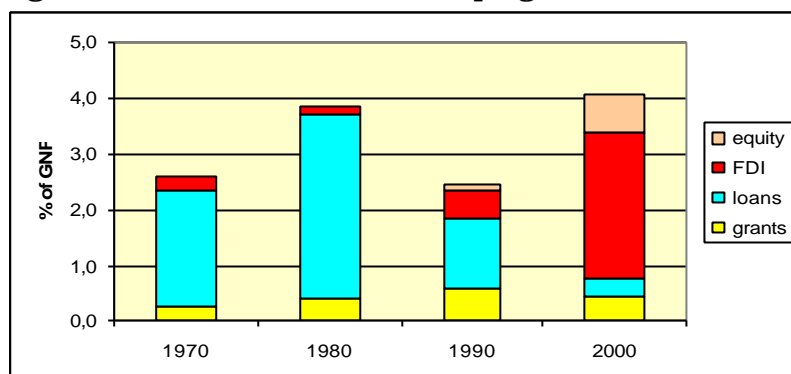
Moreover, for investors who are already established, governments might need to put in place various performance requirements regarding the use of local content (to limit input-related imports), the repatriation of profits, or the proportion of output dedicated to exports.

Finally, if faced with a balance-of-payments crisis, governments might need to apply special measures to re-establish macro-economic balance. The EU, Canada, Japan, the USA, and South Korea all insist on limiting the rights of governments to use balance of payments (BOP) safeguard provisions. According to the EU, the future WTO agreement on investment should allow the use of BOP safeguards only in exceptional circumstances. This demand is clearly incompatible with the so-called pro-development approach that the EU claims to be taking.

A WTO agreement limiting governments' ability to control all types of financial flows could be disastrous. In fact, the high level of FDI stock and the delicate balance between capital inflows and outflows in developing countries warrant extreme caution. Both short-term and FDI-related capital outflows have played a decisive role in recent financial crises affecting developing countries.

At the time of the debt crisis in the 1980s, direct investment, which grew dramatically in the 1990s, was seen as an alternative source of financing for developing countries. By 2000, combined with portfolio equity investment, FDI represented overall financial flows to developing countries of more than 4 per cent of GDP, above the level of indebtedness at the time of the debt crisis. FDI stocks in developing countries are now very high (on average 30 per cent of GDP in 2000) and are continuing to grow. This means that, in the case of investor panic, decreasing export revenues, or world economic downturn, countries could face severe balance-of-payment crises.

Figure 2: Financial Flows to Developing Countries, 1970-2000



Source: David Woodward, 2003

These FDI and portfolio investment inflows have not come free of cost. Far from it. For every \$1 transferred in the form of FDI in developing countries, around 0.3 leaves in the form of repatriated earnings (1991-1997 average). In sub-Saharan African countries, profit repatriation represents three quarters of FDI inflows.²⁸

High levels of profit repatriation reflect high rates of profit associated with FDI. In national accounting terms, the profit rate of return can be thought as equivalent to an interest charge. For developing countries, that interest charge averaged around 15 per cent in the second half of the 1990s (and twice that level for Africa). This is twice as high as the rate of interest on sovereign loans (UNCTAD, 2000). It follows that FDI can be a very expensive source of financing.²⁹

Short-term capital outflows or profit repatriation have played an important role in the financial crises that afflicted developing countries in the 1990s. One of the catalysts of the 1997 financial crisis in Asia was a huge outflow of short-term funds, as commercial banks and institutional investors called in loans. The resulting losses were equivalent to more than 10 per cent of GDP for some countries.³⁰ In response to such crises, even the supreme defender of free markets, the IMF, has changed its approach and recommended caution to developing-country governments in the matter of capital-account liberalisation.

Box 3: Argentina, BITs, and foreign investors' rights³¹

In the 1990s, Argentina opened its financial markets, privatised its public assets, and pegged its currency to the US dollar through a currency board. As part of a strategy to attract investment, Argentina signed at least 53 bilateral investment agreements, many of them with developed countries, including the UK, the USA, France, Spain, Italy, Belgium, Germany, Switzerland, and Canada.

For some time, the strategy paid off: non-inflationary economic growth returned, fuelled by enormous capital inflows in the form of FDI, loans, bond issues, and portfolio investment. But with the crises in South East Asia (July 1997), Russia (August 1998), and Brazil (January 1999), things changed radically.

<p>Argentina's net transfer of resources became negative, to the order of US\$13 billion in 2001, leading to the government's failure to service its debt and a severe economic crisis with devastating social impacts.</p>
<p>Argentina is now faced with investment disputes brought by investors under the provisions of several BITs. Foreign firms which signed contracts with the Argentine government to supply services such as gas, electricity, or water claim that they have suffered revenue shortfalls because of the elimination of peso/US dollar parity, the repeal of adjustment and indexation clauses in governments' contracts, and the 25 per cent tax imposed on oil and gas exports.</p>
<p>The cost to Argentina of defending these cases is already huge, as the world's leading lawyers are involved. If Argentina is found to have indirectly expropriated investors' assets, the costs could be enormous for a country that is still facing a crippling financial crisis.</p>

Less volatile than portfolio investment flows, FDI flows can still lead to serious financial problems. Declining equity prices, corporate debts, and uncertainty about profitability have a restrictive effect on foreign investment. As a result, FDI tends to dry up when developing countries need it the most in order to boost economic activity.³² FDI-related transactions may also contribute to current-account deficits. For instance, Malaysia had very large inward stock of FDI (48 per cent of GDP at the start of the crisis). Whereas FDI inflows in 1990-93 were sufficient to cover the deficit related to FDI-related transactions (imports, profits and royalties), in 1994-96 they fell dramatically behind. This suggests that the overall effect of FDI in these years was to increase the need for other capital inflows by between about 4 and 9 per cent of GDP.³³

Existing bilateral investment agreements, such as the US-Chile Free Trade Agreement, have already started to place undue limitations on countries' ability to regulate capital flows. The example of Argentina clearly illustrates the adverse impact that such restrictions have in practice (see Box 3).

The risk of failed industrialisation

Many governments and development banks see FDI as an effective tool for industrialisation in developing countries. FDI can contribute to providing access to technological and R&D expertise.

But none of these benefits is guaranteed, if the right policies are not in place. For instance, in the absence of government intervention, FDI does not necessarily guarantee technology spill-over, due to the unwillingness of foreign firms to share knowledge or grant licences to local firms.³⁴ Likewise, the benefits of FDI can remain limited to the specific sector, region, or town where they occur, with limited backward linkages to the local economy. Many foreign firms use only local labour inputs, importing all other inputs, including low-technology items that could be produced by

local firms. This is why open-door investment policies devoid of performance requirements, like those incorporated in NAFTA, have had disappointing development results (see Box 4).

Box 4: The disappointing results of Mexico's open-door investment policy³⁵

The Mexican government created the Maquiladora Program in 1966 to generate employment, to boost the Mexican trade balance, and to promote technology transfer. Despite an apparent success—maquilas' output increased by more than 200 per cent between 1968 and 1998 --, the maquiladora sector has failed to fulfil expectations in several critical areas:

- *Foreign-exchange revenues:* While maquilas are often portrayed as representing 40 per cent of the Mexico's exports, the net contribution to foreign-exchange revenues is actually much lower, as imports represented between 75 and 85 per cent of total maquila production between 1988 and 1998. Net exports are actually only 20 per cent of total maquila exports. Net maquila exports – worth \$8.8 billion -- represented only around 8 per cent of the country's total exports in 1997.
- *Employment:* By 1998, the maquila sector employed more than one million workers. However, wages remain low and working conditions unsatisfactory. In fact, real wages declined by 70 per cent between 1966 and 1998. The minimum wage, which many maquila employees receive, is insufficient to cover households' basic needs. In 1997, it amounted to less than one third of the minimum wage in Taiwan or Korea. The low level of wages cannot be explained by low levels of productivity. According to estimates, the wage gap between Mexico and the United States is much greater than actual differences in productivity levels. Instead, low wages are the result of the weakening of labour rights and deep rural poverty, which provides a steady supply of labour, even at poverty-wage rates.
- *Industrial development:* Due to the fact that most maquila operations are assembly plants, local value-added remains low, only \$900 million in 1998, compared with overall output. Forty-nine per cent of the value-added comes from labour, 30 per cent from machinery and real estate, and 7 per cent from raw materials. Backward linkages with the rest of the economy are limited. Only 3 per cent of inputs for the maquila sector are produced locally, most of them, such as office-cleaning services, not even linked with the production process. Moreover, the maquila sector's contribution to building human capital in Mexico remains limited. While many firms have now introduced training programmes for their workforce, the proportion of skilled labour in the maquilas is still extremely low: 7.2 per cent in 1998, compared with 26.6 per cent in the rest of the economy.

These disappointing results are the effect of corporate strategies reliant on cheap labour and assembly plants and the lack of pro-development regulatory framework. For instance, the Mexican government has failed to develop a credible national strategy to support technological upgrading, promote linkages between TNCs and local firms, and to train the workforce and protect their rights.

On the contrary, interventionist policies have allowed many developing countries to climb the development ladder, industrialise, and increase exports of high-added value as part of a coherent development strategy.

Such policies, for instance screening of investors or limits on foreign ownership, would be severely limited by WTO rules on investment. The case of Mauritius shows how these policies can be beneficial for development (Box 5).

<p>Box 5: The Mauritian Miracle, or how not to use Washington consensus policies³⁶</p>
<p><i>“It is going to be a great achievement if Mauritius can find productive employment for its population without a serious reduction in the existing standard of living ... The outlook for peaceful development is poor.”</i> James Meade, Nobel Prize Winner, 1961</p>
<p>Contrary to the sombre predictions of James Meade, Mauritius is one of the few African countries that have moved decisively to the next stage of development. Real GDP growth averaged 6 per cent per annum between 1985 and 1999. Poverty and inequality have dramatically declined. In three decades, the annual income of the average Mauritian increased tenfold, as the economy successfully diversified away from sugar and into manufacturing and services.</p>
<p>Among other factors, growth was spearheaded by export-processing zones (EPZs), high levels of domestic savings and investment rates -- exceeding 20 per cent of GDP -- and pro-development policies. The EPZ sector now provides 26 per cent of GDP, 38 per cent of employment, and 66 per cent of exports. Foreign</p>
<p>Direct Investment played a significant role in the development of the EPZs as well as the tourism sector. Annual FDI inflows averaged between \$10 million during 1980-1989 and \$38 million in 1990-1999.</p>
<p>Mauritius did not apply policies recommended by the Washington consensus. In fact, Mauritius was classified in the 1990s as one of the least open countries in the IMF trade-restrictiveness Index. While the government provided tax incentives for foreign investors, it carefully screened their entry by limiting openness to priority sectors such as the EPZs, tourism, and banking, and by putting constraints on foreign ownership. For instance, the government, concerned with over-capacity in hotel rooms in the 1990s, restricted the entry of foreign investors, especially in the sector of small hotels. Unlike other countries, domestic investment in EPZs was strongly encouraged. In fact, most investors in Mauritian EPZs are national companies. Moreover, the government fostered the establishment of strong links between the export-processing zones and the rest of the economy.</p>
<p>While guaranteeing fair and equitable treatment to foreign investors through various BITs, Mauritius does not necessarily provide national treatment or contractual stability for specific measures of investor protection (such as funds repatriation). Labour regulations have been made more flexible, but minimum-wage provisions are still applied in export-processing zones, as in the rest of the economy³⁷. As a result, the rising levels of productivity associated with export production were reflected in raising real wages. However, these achievements are currently threatened by the growing use of foreign workers in EPZs, who have little choice but to accept lower pay and longer working hours.</p>

The claims of developed countries about the virtues of open-door policies are a stark example of hypocrisy, given their recent past. When they were still net recipients of foreign investment, today's developed countries imposed strict regulations on foreign investment. Industrialised countries changed these policies only when their economic structure and external

conditions changed.³⁸ Apparently suffering from memory loss, these very same countries would like now to prevent rising industrial powers such as Brazil, India, China, and Malaysia from using the means that they themselves used to climb the development ladder (see Box 6).

Box 6: How the use of industrial policies has allowed rich countries to become today's free traders³⁹

South Korea used the carrot-and-stick method through providing extensive financial incentives to TNCs, while at the same time imposing extensive performance requirements.

The most important policy measure was a restriction on entry and ownership, with the result that in the 1980s around 50 per cent of all industries and around 20 per cent of manufacturing industries were still 'off-limits' to FDI. Other policy measures were also used, such as screening the technology of the TNC, and prescribing local-content requirements. Investors who were more willing to transfer technologies were selected in preference to other potential investors. The investment regime of Korea was drastically liberalised after 1996, in part due to the pressure of International Financial Institutions.

The risk to human development

'Not all FDI is in the best interests of host countries. Some can have an adverse effect on development' – UNCTAD, *World Investment Report 1999*

Granting full market access for foreign investors, especially in sensitive sectors, could have a devastating impact on sustainable development and on poor people.

Investment in the extractive sector in poor countries, for example, can generate important export earnings, but is also associated with abuses of the environment and human rights, such as the pollution of water supplies, displacement of local communities, and abuses of the rights of indigenous peoples. Economic growth and unregulated investment in the extractive sector can exacerbate existing unsustainable patterns of development, unless effective domestic regulations are in place.⁴⁰

Because land and mining have a strategic role to play in ensuring food and energy security, governments may need to screen or restrict foreign investment in certain sectors, to ensure that the resources are properly managed to benefit local people, or they may need to impose environmental regulations. If investment negotiations were launched, developing countries would come under pressure to grant market access to investors in protected areas, or to limit the freedom of local and national governments to introduce regulations that would have an impact on already-established investors. With such rules in place, the Shuar people of

Ecuador might not have been able to prevent a potentially destructive investment project on their land (Box 7).

The use of national treatment or the prohibition of performance requirements in the mining sector could also cause many economic problems. Mining by large TNCs tends to crowd out local companies. Through performance requirements, such as the participation of local firms, countries are trying to retain more of the processing industries and other spin-offs from extraction within their own economies.

Box 7: FDI and the rights of indigenous communities⁴¹
In the lowlands of northern Ecuador, the discovery of oil has brought about devastating environmental damage. The Shuar and Achuar people of this region denounced the tactics of the US oil company Arco Oriente, Inc., which used offers of employment, water supplies, health care, and air travel to pressure the Shuar into granting permission to explore and extract oil from their traditional lands. At the request of the Federacion Independiente del Pueblo Shuar de Ecuador (FIPSE), an Oxfam partner, lawyers from the Center for Economic and Social Rights brought a suit to prohibit Arco from directly approaching FIPSE individuals, rather than consulting with the organisation's legitimate leadership about the potential investment project.
On 8 September 1999, a judge ruled that Arco had violated the rights of the Shuar people to organisational integrity, and ordered the company to refrain from approaching or negotiating with individual members of the FIPSE community without court authorisation. The court decided that Arco had forced the Shuar to decide between the alleged benefits of the investment project and the harm that would be done to their ancestral lands by oil-industry development. It was acknowledged that this was a clear violation of the collective rights of the Shuar people to determine how to manage their own natural resources independently, as they had done for centuries.
Because the constitution of Ecuador permits indigenous people to decide how to manage their own natural environment, the Shuar people were able to challenge the Arco Corporation successfully. But multilateral rules on investment might supersede such rights and limit the powers of the courts.

WTO investment rules and the risk to working conditions

Many developing countries have attracted FDI on the basis of cheap labour and weak protection of workers' rights. A WTO investment agreement could make the improvement of labour standards more difficult, by pressuring countries to compete in a regulated 'race to the bottom'.

While most jobs created through FDI, in particular by large TNCs, are generally better paid than other available employment, rates of pay are still dismally low in most countries, and working conditions tend to be harsh. In many cases, the wages paid to workers in export industries are close to poverty-line levels – for instance, in Mexico (see box 4).⁴²

A WTO investment agreement could make the improvement of labour standards more difficult. Discriminatory practices – such as screening investors on the basis of their worker-compensation packages, obliging foreign investors to train workers, or obliging them to hire a given percentage of nationals in leadership structures – could be prohibited.

Moreover, if there were WTO negotiations on investment, there would be a push for the inclusion of regulatory or indirect expropriation, and minimum standards of treatment for foreign investors, as well as for an effective enforcement system, such as an investor-to-state dispute-settlement mechanism. This would have a disastrous impact on the many countries that have provided labour and environmental exemptions on a case-by-case basis to foreign investors, freezing domestic regulation at a damagingly low level (see box 8). And even though existing agreements like the NAFTA and the US-Chile Free Trade Agreement contain very weak provisions on labour laws, asking countries ‘to strive not to relax their existing labour laws in order to attract investment’, this does nothing to ensure that countries will harmonise their labour laws upwards in (for instance) the direction of ILO standards.

<p>Box 8: The Metalclad case, or how pro-development policies have been outlawed in Mexico</p>
<p>Since the entry into force of NAFTA, private investors have used its investment provisions to challenge public health and environmental rules and policies at the national, state, and local levels on the basis of ‘regulatory expropriation’. The example of Metalclad is instructive.</p>
<p>A Mexican company called Coterin wanted to expand a transfer station for hazardous waste to a hazardous-waste landfill site, but it was denied a municipal construction permit in both 1991 and 1992 by the local municipality of Guadalupe. Under Coterin’s management, the site was contaminated with 20,000 tons of toxic, and potentially explosive, waste.⁴³ In 1993, Metalclad, a California-based corporation, bought Coterin and the transfer station.⁴⁴ The municipality declared the area an ecological reserve.</p>
<p>On 2 January 1997, Metalclad sued the government of Mexico for \$90 million under NAFTA’s investment provisions. Metalclad claimed that the actions of the municipal government amounted to expropriation without compensation. In addition, the company claimed that the government of Mexico had failed to provide fair and equitable treatment in accordance with international law.</p>
<p>On 30 August 2000, a special NAFTA tribunal awarded Metalclad \$16,685,000. The tribunal held that the denial of the construction permit, as well as the creation of an ecological reserve, constituted ‘indirect’ expropriations in violation of NAFTA Chapter 11.⁴⁵ The tribunal decided that the actions at all levels of government failed to allow Metalclad to continue operations, thus failing to provide ‘a transparent, clear, and predictable framework for foreign investors’.⁴⁶</p>

The EU's investment-for-development framework: a slippery slope

So far the European Union, actively supported by Japan, Canada, and South Korea, has played the role of front-runner in trying to convince the WTO's membership to launch negotiations on investment and other 'Singapore issues' at, or even before, the ministerial meeting in Cancun in September 2003. The EU has presented its new push to create a WTO agreement on investment as a very limited exercise (in contrast with the OECD MAI), focusing on non-discrimination, transparency, and the predictability of domestic investment laws.

It is true that the EU proposal – in its current form – is less ambitious than the MAI. Unlike the MAI, the EU proposal aims to cover FDI only (not portfolio investment as well). It proposes a bottom-up approach and does not include an investor-to-state dispute mechanism. According to speeches and WTO proposals made by the European Commission, the right of governments to regulate would be fully protected, and developing countries would be given ample policy flexibility to pursue their development policies.⁴⁷ In fact, the EU recently went so far as to call the future WTO investment agreement 'an investment for development framework'.

However, the clever use of semantics by the EU falls far short of making its proposal pro-development.

The assurances given by the EU about the capacity of developing countries to retain 'policy space' are not only unconvincing but also irrelevant. **The fundamental debate in the WTO Working Group on Trade and Investment should not be about the benefits and costs of FDI. Instead, it should consider whether WTO disciplines would contribute to increased FDI flows and ensure that they promote the sort of investment that leads to sustainable development.**

Apart from making blanket statements, none of the EU's submissions has included any serious evidence on this crucial point. In fact, the EU recognises that 'it has never been suggested that the establishment of such rules was key to enhancing the attractiveness of host countries to FDI. Rather they would make a limited but valuable contribution by enhancing legal certainty for investors.'⁴⁸ Instead, the EU has made a tactical move to shift the burden of proof on to opponents of such an agreement, requiring them to prove why a WTO investment agreement would not be pro-development.

It is far from evident that the EU's current proposals would indeed protect the ability of developing countries to regulate foreign investors. First, the EU keeps questioning the need for policy space in developing countries.

For instance, the EU stated that ‘If flexibility is understood as the right of governments to discriminate among investors, it will not be effective as a means to enhance development’.⁴⁹ The recent paper presented by the European Union on policy space criticised the use of joint ventures and performance requirements as development tools:

‘We believe that the intended objectives of these instruments are better achieved through means other than performance requirements (paragraph 7).’

‘Most countries are removing joint venture requirements because they have realised that these policies do not work’ (paragraph 12).⁵⁰

Moreover, the EU presents the GATS-type approach as a ‘silver bullet’ that would ensure policy space for developing countries. Unfortunately, this is far from the reality.

Under the GATS-type approach,⁵¹ there would still be enormous pressure on developing countries to make ambitious commitments and to get rid of a whole new raft of so-called ‘discriminatory’ regulations. As mentioned above, the EU continues to label measures that form part of the policy space as trade-restrictive. Moreover, the progressive liberalisation built into the current GATS negotiation clearly demonstrates that the regulatory conditions listed by developing countries in the most recent round of negotiations are now being targeted for removal (see Box 9)

Box 9: Six examples of developing-country investment regulations currently targeted in the GATS negotiations⁵²

- *Botswana*: Giving nationals priority in purchasing assets owned by foreigners.
- *Cameroon*: Specifying that for every CFA 5 million (equivalent to US\$10,000) of foreign investment, at least one job must be created.
- *El Salvador*: Placing a 50 per cent ceiling on the remittance of profits abroad.
- *Honduras*: Ensuring that foreign investment is authorised on the basis of an economic-needs test.
- *Pakistan*: Requiring maximum foreign equity participation of 51 per cent and authorising the acquisition of real estate to foreigners on a case-by-case basis.
- *Philippines*: Requiring foreign investors buying real estate to have 60 per cent local capital.

The EU also advocates a GATS-type ‘positive list’ approach of national treatment for the entry of investors (pre-establishment). At present only BITs signed with Canada and the USA, along with NAFTA, go as far as including pre-establishment clauses. A WTO investment framework would therefore go further than the common practice in most BITs.⁵³ The EU’s proposal on post-establishment rights would include a general standard of non-discrimination. The EU claims that this would not hinder domestic policies⁵⁴ – a statement that again is based on the presumption that ‘discrimination is not an effective development tool’.

With regard to possible exceptions to national treatment, the EU refers only to the possibility of retaining *existing* measures in a country, not introducing measures in the future.⁵⁵ This would in effect freeze a country's regulatory framework at its current level, constituting a serious limitation to its policy space, because future governments would be bound by choices made before their arrival. This argument is often dismissed by proponents of a WTO investment agreement because the GATS has a procedure allowing for the withdrawal of commitments. A closer look, however, reveals that this procedure is so cumbersome that in practice it would be extremely difficult for future governments to withdraw from such commitments.⁵⁶

Finally, the EU presents a multilateral framework as an alternative to the multiplication of BITs and Regional Trade Agreements (RTAs). But neither the EU nor the USA has made a commitment to refrain from negotiations of BITs or RTAs in the future. Instead, they intend to keep negotiations open on two tracks. Moreover, it is quite clear that the USA, which so far has been sitting on the fence, would not accept a WTO investment agreement that lacked the very high levels of investor protection that the US government has obtained in the Chile and Singapore Free Trade Agreements.

There is no guarantee that the EU would not tilt towards the US position in the hope of securing an agreement. In fact, the precedent of TRIPS and public health clearly shows that the EU is willing to stray far from its initial positions in order to accommodate US concerns.⁵⁷ Worse, the need for the EU to 'save face' by obtaining the launch of investment negotiations in return for concessions on agriculture means that it might be willing to accommodate concerns from the USA and other players, who want to promote a WTO framework based on high levels of investor protection similar to the model of NAFTA.

The danger of current WTO politics

In the run-up to the Doha ministerial meeting, developing-country governments expressed many times their opposition to the inclusion of the Singapore issues. However, during the Doha negotiations pressure mounted on developing-country negotiators to withdraw their opposition, to the point that many countries yielded entirely to pressure from the industrialised countries. An exception was India, which opposed the inclusion of new issues until the end.

Ambassador Chidyausiku of Zimbabwe said afterwards: *‘They [developed countries] said that if you don’t agree to the inclusion of new issues, you don’t get the TRIPS and Health Declaration and the ACP waiver. The other source of pressure was that no minister was prepared to be blamed for the failure of Doha, or standing in the way of fighting terrorism. There was so much pressure during the negotiations that [developing country ministers] did not have the guts to say, as far as my national position is concerned, this is not in our interest.’*⁵⁸

It seems we are faced today with a second episode of the same saga.

In Doha, ministers instructed the Working Group on Trade and Investment to work on clarifying issues in the period up until the fifth ministerial in Cancun.⁵⁹ As of today, there is still no consensus among members of the group on any of these issues. In these discussions the special development, trade, and financial needs of developing and least-developed countries should also be taken into account as an integral part of any framework. To date, the Working Group’s discussions have not shed any light on the reasons why a WTO agreement on investment would be beneficial to developing countries.

Finally, ministers are committed to developing an agreement that balances the rights of host and home countries. However, a paper on home-country and corporate obligations, put forward in the WTO Working Group discussions by a group of developing countries, including China, India, Cuba, Kenya, and Zimbabwe, has still not been properly addressed. For instance, the EU opposes in principle the inclusion in a WTO investment agreement of binding obligations on investors and home countries.

Unfortunately, past experience shows that negotiations could still be launched in Cancun if the EU, the USA, and other rich countries join forces to put pressure on developing-country ministers. Because of the lack of consensus on the content of modalities, the fear is that countries would agree only on procedural modalities similar to those proposed by the EU, and establish a target date for the completion of negotiations without a clear mandate. This would amount to signing a blank cheque. As shown by the TRIPS precedent, agreeing to procedural modalities would be a dangerous and slippery slope.⁶⁰

Conclusion

Given the lack of benefit to developing countries of an investment agreement at the WTO and the potentially devastating effects that such an agreement could have on their power to regulate investors, **developing countries cannot, and should not, risk moving towards investment negotiations at the WTO. This is why they should categorically oppose the launch of investment negotiations at the Cancun ministerial meeting.**

Developing countries need to strengthen their domestic regulatory framework to ensure FDI contributes to sustainable development – for instance, by screening foreign investors on the basis of their likely contribution to sustainable development, by encouraging technology transfer, or fostering backward linkages with the rest of the economy. Developing-country governments should resist the temptation to give tax exemptions or weaken their labour or environmental regulations for the sake of winning more poor-quality investment. They should instead work on strategies that genuinely improve the attractiveness of their country to high-quality investors (domestic and foreign alike), through sound macro-economic policies, good governance, education and training of their workforce, and better productive infrastructure.

At the multilateral level, the debate must now take a new direction. Its starting point should be the drawing up of multilateral rules on investment that could facilitate both the quantity and quality of investment to developing countries.

The current drive by developed countries to sign bilateral and regional free-trade agreements with the developing world should be re-examined in the light of the same principles. Rich countries should not impose on developing countries provisions, such as the prohibition of capital controls or indirect expropriation, that have been clearly proved to be anti-developmental.

At the global level, the idea of a pro-poor investment treaty at the UN or a free-standing agreement should be further explored. Such an agreement would aim to provide a better business environment for domestic and foreign investors and address crucial development issues, such as more secure and decently paid jobs, technology transfer, and taxation with proper enforcement mechanisms.

Moreover, rich countries need to take much more responsibility for ensuring that their companies operating in developing countries behave according to international standards and contribute to poverty reduction. As a first step, the existing OECD Guidelines for Multinational Enterprises could be strengthened – for instance, by home-country governments making export credits, investment guarantees, and eligibility for tendering conditional upon a company's respect for the guidelines. OECD

governments and inter-government organisations could also agree a policy of withdrawing benefits (such as export credits and investment guarantees) from companies found to be paying bribes, and a policy of making conflict-impact assessment a precondition for receiving these benefits. To make TNCs more accountable, much tougher international standards are needed for reporting or disclosure of information. A first step could be a multilateral agreement obliging TNCs to make public disclosures of all payments made to governments.

Existing investment-related provisions and intellectual property rules at the WTO should be amended to ensure that rules do not impede progress towards sustainable development. Under the WTO TRIMs agreement, among other reforms, 'trade-balancing' measures such as imposing export-performance and local-content requirements on foreign investors should be allowed.

The TRIPS agreement should give developing countries greater flexibility in deciding how and when to introduce higher levels of intellectual property protection, and should clarify that countries can insist on local manufacturing of patented products. Rich countries should also make binding commitments to provide incentives for technology transfer to developing countries.

Finally, there should be a moratorium on GATS negotiations until the impact of the liberalisation of services on developing countries is fully assessed. Public services must be fully protected in the essential sectors of water, health, education, social services, culture, the audio-visual sector, environment, communications, transport, energy, and social housing. Rich countries should not insist on liberalisation in these essential development areas.

In the run-up to Cancun, the WTO is facing a crisis of legitimacy. It has shown itself incapable of representing the interests of the majority of its membership and has so far failed to resolve issues important for sustainable development. Until it is radically reformed and becomes a truly development friendly organization, it cannot and should not house any multilateral agreement on investment. Instead of pushing for unfair investment rules rich countries should fulfil their promises of a development round in key issues of interest to developing countries, such as TRIPs, agriculture and Special and Differential treatment. It is time to Make Trade Fair in Cancun.

Notes

- ¹ UNCTAD, World Investment Report, 2002, p.1 of overview.
- ² It has to be stressed that over half of the FDI in China is a hybrid form of domestic investment as it comes from Hong Kong. “GNP quadrupled between 1978 – 95”, *International Herald Tribune*, 1 October 1999, p. 10;
- ³ Nicholas Lardy, *Integrating China into the Global Economy*, 2002.
- ⁴ Maria Carkovic and Ross Levine, ‘Does foreign investment accelerate economic growth?’, 2002.
- ⁵ World Bank, *Global Economic Prospects 2003*, 2002.
- ⁶ Please note that a significant portion of these BITs have not yet been ratified. UNCTAD, Experiences with bilateral and regional approaches to multilateral co-operation in the area of long-term cross-border investment, particularly foreign direct investment, Note by the UNCTAD secretariat, Expert Meeting on Experiences with Bilateral and Regional Approaches to Multilateral Co-operation in the Area of Long-Term Cross-Border Investment, particularly Foreign Direct Investment, Geneva, 12 - 14 June 2002, p. 6.
- ⁷ Van derStichelle, Myriam, *The difference between BITs and a possible WTO investment agreement*, April 2003.
- ⁸ The US-Chile FTA includes full national treatment, minimum standards of treatment, protection against indirect expropriation, the prohibition of performance requirements, and an investor-state dispute settlement (see released text, <http://www.ustr.gov>).
- ⁹ Susan K. Sell, ‘Multinational Corporations as Agents of Change: The Globalization of Intellectual Property Rights’, in Cutler, A. Claire/Haufler, Virginia/Porter, Tony (Ed.): *Private Authority and International Affairs*, New York, 1999.
- ¹⁰ OECD, ‘Main features of the MAI’, Symposium on the Multilateral Agreement on Investment, Seoul, Korea, 3-4 April 1997
- ¹¹ The MAI included a broad definition of investment; rights of entry and establishment on the basis of MFN and national treatment; prohibition of a number of performance requirements; protection against expropriation, including indirect takings (i.e. against regulations having an impact on a company’s ability to generate profits); and state-to-state and investor-state dispute settlement provisions. UNCTAD, *Lessons from the MAI*, 1999.
- ¹² *Export Processing Zones*, World Bank Policy & Research Series 20, 1992.
- ¹³ Jens Martens, ‘The need for a coherent approach to enhance the development impact of Foreign Direct Investment (FDI)’, Statement at the Financing for Development Roundtable on Coherence in Development (B4), UN International Conference on Financing for Development, (UN Mexico, March 20, 2002).
- ¹⁴ Oxfam, *Tax Havens, Releasing the Hidden Billions for Poverty Eradication*, 2000.
- ¹⁵ Sources for these box include submissions from the United States and the EU to the WTO Working Group on Trade and Investment as well as informal reports about the working group discussions.

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- ¹⁶ International Chamber of Commerce, press release, 18 March 2003; Policy statement: ICC's expectations regarding a WTO investment agreement March 7, 2003.
- ¹⁷ UNCTAD. 1998. World Investment Report.
- ¹⁸ World Bank, *Global Economic Prospect: Investing to unlock global opportunities*, Washington, 2003, p. 129.
- ¹⁹ UNCTAD, World Investment Report 2002
- ²⁰ OECD, *New Horizons and Policy Challenges for Foreign Direct Investment in the 21st Century*, Global Forum on International Investment (OECD, November 2001, Mexico).
- ²¹ UNCTAD. DITE database; UNCTAD. 2002. LDC report, *Escaping the poverty trap*.
- ²² World Bank, *Global Economic Prospects 2003*, Washington, 2002 (<http://www.worldbank.org/prospects/gep2003/index.htm>).
- ²³ MIGA, *Foreign Direct Investment Survey, 2002*.
- ²⁴ World Bank, *Global Economic Prospects 2003*, Washington, 2002 (<http://www.worldbank.org/prospects/gep2003/index.htm>)
- ²⁵ *ibid*.
- ²⁶ UNCTAD, 'National Treatment', 1999, p.4.
- ²⁷ Communication by the United States to the Working Group on Trade and Investment, covering FDI and portfolio investment in a WTO investment agreement (WT/WGTI/W/142), 16 September 2002.
- ²⁸ Oxfam, 2001. *Rigged Rules and Double standards: Rigged Rules and Double Standards*, p.178
- ²⁹ *Ibid*.
- ³⁰ International Monetary Fund, *International Financial Statistics CD-ROM*, (IMF, Washington, 1999).
- ³¹ Van derStichelle, 2003; Chakravarthi Raghavan (SUNS – issue no. 5037). Luke Eric Peterson. 2003. Research Note: *Emerging Bilateral Investment Treaty Arbitration and Sustainable Development*; Freshfields Bruckhaus Deringer, "The Argentine Crisis: Foreign Investor's Rights", January 2002, available at: www.freshfields.com/places/latinamerica/publications/pdfs/2431.pdf
- ³² UNCTAD, "World Investment Report 2002", (2002).
- ³³ David Woodward. March 2003. *Financial Effects of Foreign Direct Investment in the Context of a Possible WTO Agreement on Investment*. Presentation to NGO Workshop on WTO Negotiations on Investment and New Issues, Geneva, 18-19 March 2003, organised by Third World Network and others
- ³⁴ Teece D., 'Technology transfer by multinational firms: the resource cost of transferring technological know-how', *The Economic Journal*, Vol. 87, 1977, pp. 242-261.
- ³⁵ Twin Plant News 2002; and R Buitelaar, R. Padilha and R. Urrutia, 1999; Oxfam, 2001, *Rigged rules and double standards: trade, globalisation and the fight against poverty*; Mustapha Sadni-Jallab, Enrique Blanco de Armas. 2002. *A Review of the*

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³⁶ A. Subramanian. Mauritius Trade and Development Strategy: What Lessons does it Offer ?. Paper presented on the Seminar on Globalisation and Africa, (Washington IMF, Tunis April 5, 2001); World Bank. 2002. Country Assistance Strategy-Mauritius; Christian Aid. 2003. Trade and development: aspects of the Doha Agenda; Arvin Subramanina and Devesh Roy. 2001. Who can explain the Mauritian miracle: Meade, Romer, Sachs or Rodrik?. IMF Working Paper.

³⁸ Ha-Joon Chang, Foreign Investment Regulation in Historical Perspective – Lessons for the Proposed WTO Agreement on Investment, 2003.

³⁹ Ha-Joon Chang, 2003

⁴⁰ Nick Mabey and Richard McNally, 'Foreign Direct Investment and the Environment: from pollution havens to sustainable development', World Wide Foundation (WWF) research paper, (UK, November 1999), presented at the WTO ministerial conference in Seattle, US, 30 November-3 December 2000.

⁴¹ Oxfam International. 2003. Making Trade fair in the Americas: Three reasons to say no to the FTAA paper.

⁴² MaqGuide, source: <http://www.maqguide.com> (last checked on 4 February 2002).

⁴³ 'Toxic Shock in a Mexican Village', *Multinational Monitor*, vol.16 no.10, October 1995.

⁴⁴ Petitioner's Outline of Argument, In the Supreme Court of British Columbia, in the Matter of Arbitration Pursuant to Chapter 11 of NAFTA between Metalclad Corporation and the United Mexican States, ICSID Additional Facility, case number ARB(AF)/97/1, 22 January 2001.

⁴⁵ See NAFTA, Chapter 11: Investment, Section A – Investment, Article 1110: Expropriation and Compensation (source: <http://www.nafta-sec-alena.org/english/nafta/chap-111.htm#A1110>) and FTAA – Free Trade Area of the Americas Draft Agreement, Chapter on Investment, Article 10: Expropriation and Compensation (source: http://www.ftaa-alca.org/ftaadraft/eng/ngine_2.asp#art10).

⁴⁶ Final Award in the Matter of Arbitration Under Chapter 11 of the North American Free Trade Agreement, Metalclad Corporation v. the United Mexican States, International Center for Settlement of Investment Disputes, 23-24 August 2000.

⁴⁷ Hearing in European Parliament with Commissioner Lamy, Organized by the Heinrich Boll Foundation and the Green group in the European Parliament, 6 March 2003.

⁴⁸ Note by the WTO Secretariat, Report on the Meeting of 7 and 8 March 2001, WGTI/M/14, p.6.

⁴⁹ European Commission and member states, communication on development provision submitted to the Working Group on Trade and Investment (WT/WGTI/W/140), 12 September 2002.

⁵⁰ Communication from the European Community and its member states on policy space for development to the WTO Working Group on Trade and Investment, WT/WGTI/ W/ 154, 7 April 2003.

⁵¹ This section uses elements of a paper by Peter Hardstaff, The 'Flexibility' Myth: Why GATS is a bad model for a new WTO investment agreement.

⁵² Source: World Development Movement, 2003

⁵³ Van derStichelle, Myriam, Bilateral investment treaties and a WTO investment framework, 2003.

⁵⁴ Communication from the European Community and its member states to the WTO Working Group on Trade and Investment on Non-Discrimination, (WT/WGTI/ W/ 122), 27 June 2002.

⁵⁵ Communication from the European Community and its member states on policy space for development to the WTO Working Group on Trade and Investment, WT/WGTI/ W/ 154, 7 April 2003.

⁵⁶ Withdrawal can only be initiated three years after the commitment, with the consent of other WTO members and if compensation, normally in the form of some other kind of liberalisation, is given.

⁵⁷ After the failure of 16 December, the EU suggested that the US list of diseases served as a minimum list and thereby went in contradiction with the repeated assurances it had given in previous months.

⁵⁸ Aileen Kwa, 2003, pp31.

⁵⁹ The seven issues for clarification are scope and definition; transparency; non-discrimination; modalities for pre-establishment commitments based on a GATS-type, positive list approach; development provisions; exceptions and balance of payments safeguards; and consultation and the settlement of disputes between members.

⁶⁰ Revisiting the words of the Ministerial Declaration of the Uruguay Round of 20 September 1996, one is struck by how weak the mandate for negotiations on IPRs was. The first paragraph speaks of negotiations clarifying GATT provisions and elaborating 'as appropriate new rules and disciplines'; the second mentions developing a multilateral framework for trade in counterfeit goods; and the third paragraph states that the negotiations should not prejudice complementary initiatives in WIPO and elsewhere. As Daniel Gervais observes, the entire edifice of TRIPS rests on the words 'and elaborate as appropriate new rules and disciplines'.

Glossary

Balance of Payment provisions (BOP): Or balance of payment safeguards. This refers to the use of temporary and exceptional emergency measures to protect a country's balance of payments, restricting the outflow of money from the country.

Dispute Settlement Understanding (DSU): The DSU is part of the WTO Agreements. It sets out the procedures for resolving trade disputes among WTO members. One of its most important characteristics is that only governments have access to the dispute procedure. Additionally, there is no monetary compensation; rather, the DSU requires the losing member to bring its domestic law into compliance with the obligations of the WTO. According to the rules, the dispute-settlement processes should aim both to solve the dispute in question and to clarify the existing provisions of the WTO Agreements.

Foreign Direct Investment (FDI): An investment is considered direct when the investor's share of ownership is sufficient to allow control of the company. It is a type of investment generally made with the purpose of establishing lasting economic relations.

GATS: The General Agreement on Trade and Services was originally agreed at the conclusion of the Uruguay Round of trade negotiations in 1993. GATS aims to remove any restrictions or internal government regulations that are considered to be 'barriers to trade in services'. The services sector covers many different areas of economic activity, including libraries, schools, hospitals, banks, waste collection, and the provision of water.

GATS-type approach: Also known as the 'bottom-up' or 'positive list' approach to scheduling a country's commitments. To date, the 'positive list' approach has applied to GATS-specific obligations, i.e. market access and national treatment. However, a GATS-type 'positive list' approach has also been suggested as an element of future WTO investment rules, specifically for pre-establishment commitments. While at first glance this approach appears to grant countries considerable flexibility to decide in which sectors and sub-sectors, and in which modes of supply, they want to be bound by specific obligations, there has been increasing criticism that the politics of trade negotiations effectively nullify such flexibility.

Investment: There are several approaches to the definition of this term. Various bilateral investment treaties, as well as regional and multilateral agreements on investment, adopt different approaches. The two main approaches may be generally characterised as either 'enterprise-based' or 'transaction-based':

Enterprise-based approach: Investment is defined as the establishment or acquisition of a business enterprise, or a share in a business enterprise that gives the investor control over it. This definition is also used to describe Foreign

Direct Investment. However, distinguishing it from the 'asset-based' definition is not without difficulties.

Asset-based approach: This definition of investment is a wide-ranging one that includes both portfolio and real estate investment. There is room for variation in this category, such as the treatment of short-term capital regulations or exclusion of the movement of capital based on speculative financial transactions.

Market access: Refers to the conditions and the extent to which a country's products or services can enter another country's markets. The most common barriers to market access are tariffs and quotas, the latter being a clear case of quantitative import restrictions. WTO rules aim to eliminate such quantitative limitations on trade both in goods and services. The main GATT provision is Article XI and, in the case of the GATS, Article XVII.

Non-discrimination: Non-discrimination is the core principle of the WTO agreements. It includes the Most Favoured Nation (MFN) and the National Treatment (NT) principles. It was originally applied only to the trade of goods under GATT, but it has been extended to cover trade in services, intellectual property rights (IPR), government procurement, and trade-related investment measures (TRIMs), as the scope of the WTO agreements has expanded. In the context of investment, a provision on non-discrimination obliges members not to discriminate between foreign investors/investment and domestic investors/investment, or between foreign investors/investment from different countries.

Most Favoured Nation treatment (MFN): an international trade principle which states that the most favourable trade policy that a country offers to the products, services, or producers (depending on the coverage of the agreement) of one country must be offered to all other countries that are members of the respective agreement.

National Treatment (NT): a principle included in GATT, requiring that foreign goods and services, once they have entered a country and satisfied any formalities that are required, are treated no less favourably than goods, services or persons of the host country. With regard to investment, national treatment can be defined as a principle whereby a host country extends to foreign investors treatment that is at least as favourable as the treatment that it accords to national investors in comparable circumstances, both in the pre-establishment and the post-establishment phases of investment.

Negative list: In contrast with the positive list, in an international agreement this is a list of those items, entities, or products to which the agreement, or a specific provision thereof, will not apply.

Portfolio investment: Type of investment that provides the investor with a return, but not control over the company. (See 'Investment' above.)

Positive list: In an international agreement, a list of those items, entities, or products to which the agreement will apply, with no commitments to apply unless otherwise specified.

Post-establishment phase: The period following pre-establishment, when the investment has been made. WTO rules preserve the host country's right to treat domestic and foreign investors differently at the point of entry, e.g. through screening laws and operational conditions on admission.

Pre-establishment treatment: Refers to the laws and regulations of a host country governing the entry of foreign investment. Such rules determine whether admission (access) of foreign investment is possible at all and, if so, on what terms and conditions. A series of policy decisions by the host-country government is involved, concerning in particular which categories of foreign investment it is prepared to admit (FDI, portfolio investment, etc.); how it selects specific foreign investments to admit (on an ad hoc basis, through systematic screening policies, or through an 'open-door' policy); whether it permits foreign investment only in certain sectors and industries, or economy-wide; whether and how it applies Most Favoured Nation (MFN) and national treatment; and what conditions it attaches to the entry of foreign investment and its subsequent activities, for example through investment incentives, foreign-ownership limitations, performance requirements, and so on.

Transparency: Clarity, openness, and comprehensibility (used with regard to individual trade-related regulations and operation of institutions).

TRIMs: Agreement on Trade-Related Investment Measures, negotiated during the Uruguay Round. The TRIMs applies only to investment measures that affect trade in goods. Recognising that certain investment measures can have trade-restrictive and distorting effects, the Agreement states that no member shall apply a measure that is prohibited by, or inconsistent with, the provisions of GATT Article III (national treatment) or Article XI (quantitative restrictions). Examples of inconsistent measures include requirements on local content or trade balancing.

TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights. Negotiated as part of the Uruguay Round, this is to date the most comprehensive multilateral agreement on intellectual property. It prescribes minimum standards and periods for which protection should be granted to different intellectual property rights.

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