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MULTILATERAL FRAMEWORK FOR INVESTMENT: AN APPROACH TO DEVELOPMENT PROVISIONS

I. INTRODUCTION

1. The Doha Ministerial Declaration recognizes the case for a multilateral framework on investment to secure transparent, stable and predictable conditions for long term cross-border investment particularly foreign direct investment (paragraph 20 of the Doha Ministerial Declaration). In the period until the fifth Ministerial Meeting, the Working Group on the relationship between trade and investment has been mandated to clarify several components of a multilateral framework on investment. This communication aims at contributing to the discussion of the Working Group referring to development provisions (paragraph 22 of the Doha Ministerial Declaration).

II. THE RELATIONSHIP BETWEEN INVESTMENT, TRADE AND DEVELOPMENT

2. The relationship between investment, trade and development has been extensively documented in the literature and also in the communications presented in the Working Group since 1997[1], as well as by UNCTAD and the OECD in particular.

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[1]The following communications were i.a. presented: Submission by Hong Kong, China (WT/WGTI/W/10); Communication from Japan (WT/WGTI/W/11); Submission by the European Community and its Member States (WT/WGTI/W/12); Communication from Colombia (WT/WGTI/W/15); Submission from Korea (WT/WGTI/W/16); Communication from Bolivia (WT/WGTI/W/20); The relationship between trade and foreign direct investment: FDI originating in developing countries, Note by the Secretariat, (WT/WGTI/W/25); FDI and economic development, Communication from the OECD (WT/WGTI/W/26); Communication from Costa Rica (WT/WGTI/W731); Synthesis of the information made available to the working group on the links between FDI and development, Note by the Secretariat, (WT/WGTI/W/38); The effects of FDI on development: technology and other know-how transfers and spillovers, Note by the Secretariat (WT/WGTI/W/65); Communications from India (WT/WGTI/W/72); (WT/WGTI/W/73); (WT/WGTI/W/74); International investment agreements: concepts allowing for a certain flexibility in the interest of promoting growth and development, Communications from UNCTAD (WT/WGTI/W/77); (WT/WGTI/W/78); Communication from the European Community and its Member States (WT/WGTI/W/84); International investment and development: A report of UNCTAD's Work Programme in the area of investment after UNCTAD X, Communications from UNCTAD (WT/WGTI/W/85), (WT/WGTI/W/94).

3. Over the past years, there has been a growing interest to analyse the relationship between trade and investment as about one third of world trade is being undertaken within and another third between multinational corporations. This clearly implies that policies affecting trade have an impact on investment and conversely policies affecting investment have an impact on trade. It follows that trade has become so closely intertwined with investment that further progress in the trade area cannot ignore investment regimes.

4. Economic growth theory and empirical evidence demonstrate unambiguously that investment is a key factor enabling societies to increase their living standards. Infrastructure, education and professional training represent the cornerstones an economy on which production of goods and services takes place. Investment is required to increase production and total factor productivity which in many instances accounts for most of the growth. The main and most efficient form of technology transfer takes place through FDI. Higher productivity leads to higher income, higher demand, higher consumption and higher productive investment.

5. Investment plays a critical role in societies' future for developed as well as developing countries. The basic dynamics are identical. A major difference, however, is that in particular since the 1980s debt crisis, developed countries have a far better access to international capital markets to finance public as well as private investments. Developed countries have hard currencies and/or savings rates enabling them to finance investment expenditures with international or national borrowing.

6. FDI does not play the same macro-economic role depending on the development level. Developed countries have various sources of capital, are home- and host-countries of FDI, transfer and receive technology and know-how in the same types of industries. Based on historical industrial development, some developed countries are very large net foreign investors while others are very large net FDI recipients. In countries at various development stages, however, the role of FDI has somehow been different; at a macro-economic level, FDI enables them to ease foreign exchange and savings constraints at the time when FDI is made. It represents a direct contribution to domestic investment which is at the heart of economic and total factor productivity growth thereby contributing significantly to local management, know how, technology, backward and forward linkages and other externalities.[2]

7. It has also been recognized that in the 1990s, large capital inflows in some developing countries did not contribute to raise total investment as domestic savings were decreasing. This was in particular linked with a growing interest of firms for mergers and acquisitions as compared to greenfield investments. In mergers and acquisitions, additional investments are nevertheless generally made to upgrade the technological level and, in privatisations, to make privatised firms profitable. As FDI earns profits, repatriation of earnings or amortisation of capital may lead to capital outflows larger than inflows on a project basis. A complete assessment of a FDI project must however take into consideration all the effects on the host country including employment, backward and forward linkages, fiscal revenues, technology and management transfer.

8. Limitations to international debt and borrowing of sovereign states and private companies imply that FDI will keep playing in the future an important role in economic development.[3] During and after the Asian financial crisis, the global amounts of FDI to developing countries remained at a level of US$170 to 200 billion while long-term borrowings became negative. FDI has proven to be the most stable factor in external financing, being very valuable in a volatile world.

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[2] Such externalities may include stronger competition, regulation, institution-building and education.

[3] Between 1995 and 1999, FDI inflows remained at US$20 billion for five Asian countries mostly affected by the financial crisis – Indonesia, Malaysia, Philippines, Korea, Thailand – while bank loans and debt securities became negative. Source: World Investment Report, UNCTAD, 2000, p. 23.

9. FDI in general seeks natural resources, markets or efficiency**.** Natural-resource-seeking FDI is the oldest form of FDI. Trade creation results from the export of the natural resources and from the import of equipment and specialised intermediate inputs. Additional gains can be achieved from processing in the exporting country. Market-seeking FDI, generally follows a position established through trade. Domestic presence, however, is the preferred option in order to be closer to the market (consumer and intermediate goods). For the home country, market-seeking FDI generally replaces the existing exports in some production lines (trade-reduction effect) but adds to trade with export of equipment, intermediate goods, technology and know-how (trade-creation effect). Efficiency-seeking FDI focuses on standardized products. These FDI are trade-creating as they stimulate exports from the host country back to the home and other countries; imports of machinery and intermediate products are also necessary.

III. THE POLICY DIMENSION

10. FDI looks for countries fulfilling first basic conditions such as stable macro-economic policy framework including price and exchange rate stability, distortions-free labour and product markets as well as a given level of human capital and infrastructure. Second, flanking policies and governance conditions referring to rules and standards such as non-discrimination, national treatment, sector regulatory framework, judiciary system, property rights, competition policy, anti-corruption policies and environmental standards belong to the overall policy framework. In these areas, developing countries might take measures to maximise the development effects of FDI.[4] According to Balasubramanyam and Sapsfor[5], FDI is much more effective in promoting growth and technological change in open economies. FDI can be an important catalyst but is generally not among the prime movers of development.

11. A firm may begin the internationalisation process with exports, then with distributorship and then either with licensing or franchising agreements or FDI. FDI requires the strongest involvement and bears the highest risk. The trade regime of the host country has a significant importance for a foreign investor with for instance access to intermediate materials locally or abroad for export-oriented facilities. In that respect, export-processing zones may offer very favourable conditions. Large free-trade zones and customs unions may also be conducive to attract FDI in order to benefit from economies of scales.

12. For home countries the most fundamental interest lies in transparency and legal security for their companies abroad, including treatment according to the principle of non-discrimination particularly in the post-establishment phase. These basic conditions are generally granted among industrialised countries. As a matter of fact, countries and regions within countries compete fiercely for FDI while their firms may also invest heavily abroad in the same or other sectors. Skilled labour, upstream and downstream industries, research centres, universities, tax regimes, infrastructure, trade regimes and fiscal incentives belong to the policy framework decisive for the choice of a FDI location.

13. The policy dimension of FDI as such is mainly expressed through applied regimes on entry and establishment, ownership and control, operational restrictions, authorizations and reporting. Since the mid-1980s, the liberalization of FDI regimes has become the dominant feature of FDI policy world-wide. This trend accelerated in the 1990s with generally more than 60 countries introducing on

[4] For example, a government may invest massively in education, create science and technology institutions, industrial incubators, promote internet connectivity and enforce intellectual property rules to attract advanced/high tech investments; or, create linkages with the SME and micro-enterprise sector to contribute to poverty reduction.

[5] N. Balasubramanyam, D. Sapsford, "FDI and the WTO", Discussion Paper, Department of Economics, The Management School, Lancaster University, August 2001.

a yearly basis more than 100 regulatory changes more favourable to FDI, changes less favourable to FDI averaging less than 10.[6]

14. FDI is subject to various other policies. In some areas, government may protect local markets from foreign investment for legitimate national interests such as cultural heritage or protection of minorities. In other areas, governments may distinguish between FDI and national investment. Investment in some strategic fields might be kept for nationals or foreigners' participation and may be limited to minority holding; some sectors benefiting from high rents – high barriers to entry or high protection at the border – might also be sheltered against FDI competition. In cross-border mergers and acquisitions, competition authorities may also have to assess the impact of a new firm on competition. Environmental standards leading to sustainable production and minimal costs for the national resource base may be devised. Privatisation of important public enterprises may be undertaken after a thorough analysis of the market and potential buyers. Governments may also exclude some sectors for some time from FDI and privatisation if conditions maximising development effects cannot be met.[7]

15. Being a critical factor for economic and welfare growth, investment is at the crossroads of numerous policies addressing issues such as industrialisation, job creation, technical training, economic diversification, backward and forward linkages, research and development, technological capability, rationalisation, competition, total factor productivity, fiscal revenues, trade regime and balance of payments.

16. Investment has widely been recognized as a very complex phenomenon because it interrelates with many policy fields. The role of FDI for developing countries is significant with a contribution of 36.7% of gross capital formation in manufacturing and 11.1% in all industries in 1998.[8] Appropriate treatment for development is therefore of paramount importance in a multilateral framework on investment.

IV. FLEXIBILITY FOR DEVELOPMENT

17. Current international investment and investment-related agreements, both bilateral and multilateral, include flexibility for development in provisions referring to their objectives, their overall structure and modes of participation, their substantive provisions and application.

18. The objectives of international investment and investment-related agreements are commonly included in the preambles which, while not granting any right or obligation, are relevant for their interpretation. Development is being affirmed as a central objective of numerous investment or investment-related agreements. Among multilateral agreements, the preamble of GATS states: "*Recognizing the right of members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right; ...*", whereas the preamble of TRIPS contains the following: "*Recognizing also the special needs of the least-developed country Members in respect of maximum flexibility in the domestic implementation of laws and regulations in order to enable them to create a sound and viable technological base;...*". The Treaty establishing the Latin-American Integration Association includes for instance in article 3: "*Differential treatments, as determined in each case, both in regional and partial scope mechanisms, on the basis of three categories of countries, which will be set up taking into account their economic-structural*

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[6] Source: World Investment Report 2001, UNCTAD, p. 6.

[7] One important such condition might be that there are no guarantees for a competitive environment. A private monopolist might absorb many of the welfare gains produced by the investment.

[8] For manufacturing, this contribution was only 11.7% in 1980 and 22.3% in 1990; for all industries, it was respectively 1.2%, 4%. Source: World Investment Report, UNCTAD, 2000, p. 5.

characteristics. Such treatments shall be applied in a determined scale to intermediate developed countries, and in more favourable manner to countries at a relatively less advanced stage of economic development".

19. Special and differential treatment is a principle anchored in the overall structure and modes of participation of GATT and WTO. According to special and differential treatment, some countries benefit from particular rules (either permanently or temporarily) on a non-reciprocal basis.[9]

20. In GATS, Article XII:2 foresees that the liberalisation process will duly respect national policy objectives and development levels of various members. Appropriate flexibility should be provided to less developed countries to open fewer sectors , liberalize less types of transactions and enlarge access to their markets progressively based on their development level (Article XIX:2 GATS). Developing countries commitments in GATS are closely linked with the strengthening of their domestic services capacity, efficiency and competitiveness, improvement of their access to distribution channels and information networks and liberalisation of market access in the sectors and in modes of supplies of interest to their exporters (GATS, Article IV). GATS is all the more relevant in this respect as mode 3 ("commercial presence") is directly linked with FDI.

21. Transitional arrangements aim at providing flexibility by allowing more time before implementing an agreement. For instance, Article 5 of the TRIMS, Article 65 of the TRIPS, Part VIII of the Agreement on Subsidies and Countervailing Measures, all provide for longer time frames for compliance.

22. The use of positive lists is another important instrument allowing for flexibility for market access. Under the GATS positive list approach, a Party lists in its schedule the services industries subject to the rules of the Agreement. Furthermore, according to Article XX of GATS, a Party may introduce in its positive list terms, limitations and conditions on market access; conditions and qualifications on national treatment; undertakings relating to additional commitments and where appropriate the time frame for implementation of such commitments.[10]

23. The limitations foreseen in Article XVI of GATS illustrate the flexibility that a developing country may exercise in that agreement. The measures foreseen may restrict or require specific types of legal entities or joint ventures through which a service supplier may supply a service; limitations may also refer to the participation of foreign capital in terms of maximum percentage limit on foreign share holding of the total value of industrial or aggregate foreign investment.

IV. CONCLUSION

24. A transparent and predictable FDI regime is one of the key conditions to attract international investment. A multilateral Agreement on such investment will provide a common basic framework in this important policy area. Both host and home countries should benefit with the establishment of a clear framework including all the main elements mentioned in paragraph 22 of the Doha Declaration. However, as the liberalisation of FDI regimes during the past 20 years shows, other policies providing for an enabling environment continue to play a key role in investors' decisions.

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[9] For example: Article XVIII of GATT, Part. IV of GATT (adopted in 1964), the GSP – introduced at the UNCTAD II Conference in New Delhi and covered by a waiver -, the "enabling clause" (Tokyo Round Decision on Differential and More Favourable Treatment, Reciprocity and fuller Participation of Developing Countries) and the Uruguay Round Agreements with time-limited derogations, greater flexibility regarding certain obligations and "best endeavours" clauses.

[10] The issue of flexibility was also discussed in detail at the OECD Global Forum on Trade: Workshop on the Development Dimensions of the Singapore Issues organized in co-operation with APEC and the government of Hong Kong Special Administrative Region of China, Hong Kong, China 19 – 20 June 2002. Several important questions referring to flexibility were raised. See, Concluding Remarks on a personal basis by Luzius Wasescha, Chairman of the OECD Trade Committee, p. 5, OECD, Paris, 26 June 2002.

25. GATT, GATS, TRIPS and other WTO Agreements include provisions referring to the flexibility warranted by various stages of development. A multilateral Agreement on investment will also have to include development provisions allowing developing countries to take commitments according to their overall policy objectives and their level of development. It should strike a balance between the adoption of common basic principles, recognition of today's FDI regimes and the ability of Members to pursue essential regulatory policies.

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