# Multilateral Investment Agreement in the WTO

## Issues and Illusions

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## Contents

**List of Boxes**

## Introduction

The Fifth Ministerial Conference of the World Trade Organization (WTO) would be held at Cancun, Mexico in September 2003, in the midst of several controversial issues. Since Cancun Conference is expected to provide a further push to the trade negotiations, both the proponents and critics of trade liberalization are apprehensive about its outcome. Already there is growing discomfiture in the policy circles as the mandated deadlines (for agreement on the modalities on agriculture, special and differential treatment, implementation issues, and TRIPs and public health), agreed upon at the Fourth Ministerial Conference at Doha in 2001, have been missed.

Many developing countries have expressed their disenchantment with the ongoing negotiations at the WTO, as the promised benefits of trade liberalization have not materialized. The developing countries are concerned with the lack of meaningful progress on development issues including those relating to the removal of imbalances and inequities in the existing WTO agreements, popularly known as "implementation issues." In particular, the developing countries are disappointed with the lack of access to essential medicines under the TRIPs and ineffectiveness of "special and differential treatment" provisions of the WTO agreement that were meant to benefit them. With the developed countries not fulfilling their commitments, it is likely that the current impasse in the international trade negotiations would continue in the coming months. In the light of these developments, the Cancun Conference has acquired a special significance.

The Cancun Conference is also significant as decisions would be taken by "explicit consensus" on whether to widen the scope of trade negotiations to new issues — popularly known as "Singapore issues" — aimed at setting up multilateral rules on foreign investment, competition policy, government procurement and trade facilitation. At the Doha Ministerial Conference, the member-countries initiated a two-year work program on new issues leading to the Cancun Conference. Since a number of developing countries have expressed their opposition to bring new issues under the ambit of a new round of multilateral trade negotiations, the road to Cancun is expected to be a bumpy one.

Among the new issues, investment appears to be the most contentious one. Notwithstanding the proliferation of over 1800 binding treaties that contain provisions related to foreign investment at the bilateral, regional (e.g., NAFTA, EU, and MERCOSUR) and sectoral levels, there is no comprehensive multilateral agreement on foreign investment. In the past, several attempts to establish a multilateral investment regime through various fora have failed miserably. As discussed elsewhere in this paper, the negotiations on international agreements on investment have generated heated debates. Although developing countries have consistently resisted international agreements on investment liberalization, it is to be noted that there is no consensus on investment liberalization issues even among the developed countries given the failure of the Multilateral Agreement on Investment (MAI) at the OECD in the late 1990s.

In spite of serious doubt as to whether the WTO is an appropriate venue for hammering out an extensive international investment agreement, efforts are being made to launch negotiations at this organization. The Ministerial Declaration, also known as the "Doha Development Agenda," recognized "the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment." The Declaration further stated that "negotiations will take place after the fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations."

However, there is widespread confusion over the exact import of this part of the Ministerial Declaration because developed countries have conveniently interpreted it as a mandate to launch negotiations on investment at the Cancun Conference. Some developing countries including India have expressed strong reservations on this interpretation. Notwithstanding the prevailing ambiguity regarding the exact interpretation of Ministerial Declaration, developed countries are employing myriad strategies to force consensus on investment issues. Thus, it would be naïve to think that the prospects for a comprehensive multilateral regime on investment have receded.

Since diverse forms of legal and administrative rules governing foreign investment at the national level thwart the smooth operation of global capital, a multilateral investment agreement with stringent provisions on foreign investment liberalization and protection has become imperative in the emergent global economic order. As investment issues criss-cross several sectors of economy, the consequences of an investment agreement at the WTO could be more detrimental than the existing agreements. The one-size-fits-all multilateral framework on investment liberalization at the WTO could have manifold ramifications since its member-countries are at different levels of development. A multilateral agreement on investment would not only bind member-countries to pursue indiscriminate investment liberalization but it would also significantly reduce the space for countries to maneuver investment policies to suit their specific conditions. It is in this context that the rationale behind a multilateral investment agreement at the WTO needs to be thoroughly examined.

**Regulation of Foreign Investment**

Notwithstanding liberalization of investment rules in recent decades, every country has used a variety of regulations to control foreign investment depending on its stage of development. Both the developed and the developing countries have imposed a host of regulations on foreign investment to meet the wider objectives of economic policy, particularly those related to national development. Traditionally, control on foreign investment vested with national governments. The State has the right to regulate the activities of foreign investors operating within its sovereign territory. The right to regulate foreign investment is delineated in the Resolution on Permanent Sovereignty over Natural Resources approved by the UN General Assembly on December 14, 1962 which recognizes permanent sovereignty over natural wealth and resources as a basic constituent of the right to self-determination. While conferring the right to retain control over economies, the Resolution emphasizes that foreign investment should not be subject to conditions that are contrary to the interests of the recipient states.

Unlike trade, foreign investment is a much more politically sensitive issue since it essentially means exercising control over ownership of national assets and resources. In the post-war period, regulations were imposed on foreign investment due to past experiences where foreign firms not only indulged in restrictive and predatory business practices but also interfered in the domestic political affairs of the host countries. Consequently, several countries undertook measures like nationalization and appropriation of assets of foreign companies in the aftermath of their independence from colonial rule.

When a foreign investor enters a host country, it is supposed to follow the regulatory measures of that country. Several countries have devised special measures for foreign investors (both negative and positive) to distinguish between foreign and domestic investors. History shows that most investment agreement proposals are attempts at disciplining those regulatory measures which negatively discriminate foreign investors in the host countries. The discriminatory forms of regulatory measures on foreign investment vary from country to country. For instance, host countries often impose pre-admission regulations on foreign investment. Such restrictions could include screening all foreign investment on case-by-case basis, not allowing foreign investment in certain sectors of economy (for instance, telecommunications, aviation, media and atomic energy), and putting general and sectoral equity limits on foreign investment.

Concerned with sovereignty issues, the rationale behind pre-admission regulations is to ensure that foreign investors do not control productive and strategic sectors of the economy. It is important to stress here that the pre-admission regulations are not confined to the developing and the under-developed countries. Several developed countries (for instance, US and Japan) have extensively imposed pre-admission regulations on foreign investment and many of them still regulate the entry of foreign investment in strategic sectors such as media, atomic energy, telecommunications and aviation. In fact, a large number of bilateral investment treaties reserve the right of the host countries to regulate the entry of foreign investors. Contrary to popular misconception, rapid economic development has occurred amidst tight regulations on the entry of foreign investments in the two most successful cases of the post World War II period, namely, Japan and South Korea. China — the latest “success story”— too has imposed stringent pre-admission restrictions on foreign investment including screening, negative list and sectoral limits.

In addition, there are also post-admission restrictions which are imposed once the foreign investor enters the host country. Designed to maximize economic gains from foreign investment, these restrictions could include compulsory joint ventures with domestic counterparts, restrictions on remittance of profits, royalty and technical fees, additional taxes, and performance requirements (conditions imposed on investors such as local content requirements, export obligations, preference to local people in employment, location of an industry in a "backward" region and mandatory technology transfer).

Performance requirements deserve special mention here because developed countries have been advocating their elimination on the ground that these are inefficient and distortionary thereby hampering foreign investment and economic growth. On the contrary, evidence suggests that performance requirements such as local content requirements and technology transfer help in establishing industrial linkages upstream and downstream and contribute significantly towards economic development of the host country. In the absence of local content requirements, a foreign corporation is likely to source many inputs from outside which could impede the development of local clusters in the host countries. It is a well established fact that TNCs, particularly those which have very high levels of intra-firm trade, manipulate transfer pricing to avoid taxes. With the help of transfer pricing, TNCs can underprice imports of inputs thereby circumventing tariff restrictions in the host countries. Since many developing countries lack the capacity to check abuse of transfer pricing, local content requirements could serve as an alternative mechanism to curb such manipulations.

In India, the authorities have extensively imposed performance requirements in the form of export obligations on TNCs to ensure that the corporations earn enough foreign exchange to balance the foreign exchange outgo via repatriation of profits, royalty and other payments. For instance, Pepsico was allowed to operate in India in 1989 with the performance requirement that it will export products worth 50 per cent of its total turnover, each year for 10 years. In addition, at least 40 per cent of this export obligation has to be met by selling the company's own manufactured products.[1] Similar performance requirements have been imposed by other developing countries as well.

However, recent investigations have revealed that foreign investors make all kinds of false promises to honor performance requirements in order to gain entry into the host country. Once they step in, they show scant regard for fulfilling performance requirements. Several instances have been reported where foreign investors have openly flouted their post-admission commitments in the host countries. For instance, Coca-Cola has openly violated its commitment to divest 49 per cent of its equity to Indian public after five years of its operation (see Box 1). Unfortunately, the regulatory authorities in the host countries often refuse to take any action as it may deter foreign investors from investing in the country. This is a serious issue and should not be neglected by policy makers of the host countries.

In the context of investment liberalization, countries have also started offering incentives to foreign investors in the form of tax holidays, exemption of duties, direct subsidies, loan guarantees and export credits. Many of these incentives are often tied to performance requirements. The capital exporting countries use financial incentives in the form of loan guarantees and export credit to support the ventures of their corporations while the capital importing countries offer tax holidays to attract foreign investments in their countries. However, at present, there are no effective rules at the international level to discipline the use of investment incentives.

**Box 1: Coca-Cola's Divestment in India: A Mockery of Performance Requirements**

The US soft-drink giant, Coca-Cola, re-entered India in the 1990s after abandoning its businesses in the late 1970s in the wake of Foreign Exchange Regulation Act of 1973. The Act, meant to "Indianize" foreign companies, made it mandatory for foreign companies to dilute their shareholdings to 40 per cent. Instead of diluting its shareholdings to the required limit prescribed by the Act, Coca-Cola decided to discontinue its operations in India. However, taking advantage of the liberalized and deregulated environment of the nineties, Coca-Cola re-entered India through its 100 per cent owned subsidiary, Hindustan Coca-Cola Holdings. Coca-Cola's re-entry was based upon several post-admission performance requirements which the company agreed to implement in due course. One of the major performance requirements pertained to Hindustan Coca-Cola Holdings divesting 49 per cent of its shareholding in favor of resident shareholders by June, 2002.

For several months prior to the deadline, Coca-Cola lobbied hard with the Indian political establishment to ensure that its Initial Public Offerings (IPOs) be deferred by another 5 years on account of accumulated losses and depressed market conditions. The real motive of Coca-Cola for not issuing IPOs had little to do with depressed market conditions or accumulated losses. Rather, Coca-Cola was apprehensive that by offering its shares to public, all its activities would come under the ambit of public scrutiny. Hence Coca-Cola's discomfiture.

To mould public opinion in its favor, Coca-Cola launched a propaganda blitz in the financial media. When it became evident that all its arguments have come a cropper in shaping public opinion, Coca-Cola approached two senior US officials, Robert D. Blackwill, the US Ambassador to India and William J. Lash, Assistant Secretary for Market Access and Compliance, Department of Commerce, to plead on its behalf. Media reports have confirmed that the Indian authorities succumbed to these pressures by waiving the mandatory IPO requirement and subsequently acceding to company's request for a private placement of shares. One wonders why the US administration decided to support Coca-Cola's unreasonable demand despite being fully conscious of the fact that the agreement is essentially between two entities — Coca-Cola and the Indian government.

Under the new arrangement, the Indian Government has allowed Coca-Cola to divest 39 per cent of its equity to private investors and business partners and the balance 10 per cent in favor of local resident Indian employees' welfare and stock option trusts. The off-loading of shares to "friendly" investors has made a mockery of the divestment process and is contrary to the spirit of divestment clause of Coca-Cola's agreement with the Indian authorities. To further dilute the divestment conditions, Coca-Cola denied voting rights to the Indian shareholders. The proposal of offering voting rights to Indian shareholders is "substantive and onerous," stated the company. Denial of voting rights militates against the very purpose of the mandatory condition ensuring Indian shareholding. By refusing to grant voting rights to Indian shareholders, the parent company wants to retain complete control over the subsidiary.

This sordid episode has exposed the hypocritical stand of foreign investors and their lobbies who preach sermons on corporate governance, social responsibility and corporate citizenship. By allowing Coca-Cola to go ahead with private placement and non-voting rights to the shareholders, the Indian authorities have sent out wrong signals to foreign investors that agreements with India can be breached with impunity. On March 21, 2003, the Finance Minister, Jaswant Singh, admitted in the Indian Parliament that 21 TNCs had violated the mandatory guidelines of granting equity to the Indian public. These murky episodes not only make mockery of regulations governing the operations of foreign investment but also weaken India's vehement opposition to investment issues at the WTO.

## History of Investment Agreements

The dominant perception that the exponential growth in foreign investment in recent years has given impetus to launch a multilateral investment agreement is not correct. The first attempt to forge a multilateral agreement on foreign investment was made in the immediate post World War II period. In 1948, the draft Charter to establish an International Trade Organization (ITO) was presented at a meeting in Havana. The ITO was meant to be the third institution for promoting post-war economic cooperation along with the International Monetary Fund and the World Bank. Besides trade issues, the draft Havana Charter had provisions under Articles 11 and 12 to address foreign direct investment issues. Had the Havana Charter been ratified, the ITO would have played a decisive role in the investment policies of the governments worldwide.

Earlier proposals on the Charter by the US contained extensive rights for investors including the obligation of host countries to extend national treatment and most-favored-nation treatment. But these measures were strongly opposed by other countries. For instance, the Czech government was not in favor of giving German investors the same status as investors of other countries. As a result, the US had to dilute several rights granted to foreign investors in its earlier proposals. The Charter also faced the wrath of the US corporations due to provisions under Chapter V regulating anti-competitive policies of private businesses. In comparison to the present situation, the scope of investment policies under the Havana Charter was rather limited. For instance, the Charter did not incorporate any rules related to performance requirements and dispute settlement mechanism between governments and foreign investors.

Notwithstanding the fact that the US government was one of the driving force behind the Havana Charter, the US Congress refused to ratify it. Consequently, the proposal for establishing ITO was given up and the General Agreement on Tariffs and Trade (GATT) was launched as a temporary measure. For nearly four decades since its inception, GATT never brought investment issues under its rubric and prudently maintained the dividing line between trade and investment issues. It was only at the Uruguay Round of the GATT negotiations from 1986 to 1994 that the issue of investment was brought within its framework.

The failure to establish ITO was one of the major reasons which facilitated a shift from multilateral to bilateral investment agreements. In the 1950s and 60s, bilateral investment agreements were the dominant instruments of investment agreements. In those decades, majority of bilateral investment agreements were geared towards protecting foreign investors against the threat of expropriation as many developing countries had undertaken nationalization measures in the aftermath of independence from colonial rule. In 1966, the International Centre for Settlement on Investment Disputes (ICSID) was set up in the World Bank to facilitate the settlement of disputes between governments or between investors and governments. ICSID provides a mechanism through which host countries, home countries and foreign investors can agree to submit investment disputes to third-Party arbitration.

In the sixties and seventies, international investment negotiations shifted to other fora. Big capital exporting countries led by the US started initiating discussions on investment issues at the OECD, whose membership at that time consisted of the developed world and most of its member-countries were in favor of a liberalized investment regime. As a result, two Codes — Code of Liberalization of Capital Movements and the Code of Liberalization of Current Invisible Operations — were enacted to encourage member-countries to liberalize restrictions on the cross-border movement of capital. Although the Codes were comprehensive and binding, yet the provisions related to the rights and obligations of foreign investors were not included. OECD also attempted to bring investor protection issues in the 1960s with a multilateral convention on the protection of foreign property but it was never adopted. An attempt to enact a non-binding code for transnational corporations at the OECD began in the seventies. In 1976, the Guidelines for Multinational Enterprises was adopted by OECD member-countries, largely in response to the Code of Conduct on TNCs then under negotiation at the UN.

On the other hand, the developing countries started raising investment issues with an entirely different perspective at the United Nations in the 1970s. The UN became the obvious choice for the developing countries to raise international investment issues since it ensured equal voting rights for member-countries in the General Assembly. The drive to address investment issues at the UN originated from the bitter experiences of several developing countries that were the victims of unwarranted meddling by the foreign investors in their domestic political affairs. One of the notorious examples was the International Telephone and Telegraph's (ITT) efforts to overthrow the democratically-elected Salvador Allende government in Chile in the early 1970s. When similar instances of TNCs intransigence in other countries came to notice, the Group of Eminent Persons was constituted in 1972 to study the activities of the TNCs in the host countries. Later, the United Nations Commission on Transnational Corporations and the Center on Transnational Corporations (UNCTC) were set up by the Economic and Social Council of the UN (ECOSOC) to conduct extensive research on investment issues. These initiatives were geared towards drafting a UN Code of Conduct on Transnational Corporations to curb abuse of corporate power and establish guidelines for corporate behavior in the host countries. In fact, the Code was an integral part of a broader initiative to launch a New International Economic Order (NIEO) for addressing the concerns of the developing world.

When drafting of the Code began in 1977, it was supposed to cover only the activities of transnational corporations but it later incorporated the conduct of governments as well. The 1986 draft of the Code contained extensive provisions regulating the entry and operations of transnational corporations in the host country. Concerned with the fact that the Code was unlikely to serve the interests of capital exporting countries, the US persuaded other developed countries to block the draft Code of Conduct at the UN. The Code was not approved and the UNCTC was dissolved in 1992. Since then, the work on investment issues has been carried out by the Program on Transnational Corporations of the UNCTAD with an entirely different agenda of promoting foreign investment. At the Earth Summit in 1992, another attempt was made to introduce regulation of TNCs under the auspices of the UN. But the developed countries along with corporate lobbies scuttled the move to incorporate environmental regulation of corporations in the Agenda 21. With the ascendancy of neoliberal ideology, the tide had started to turn against the regulation of TNCs.

UN initiatives also lost momentum in the eighties when excessive build up of external loans triggered the debt crisis in the developing countries as many countries were unable to service their huge external debts. The debt crisis of the 1980s paved the way for liberalization of investment rules as part of structural adjustment programs supported by the IMF and the World Bank. The drying up of commercial bank lending forced developing countries to open their doors to foreign investment. As a result, the developing countries that once nationalized foreign companies started wooing foreign investors.

Initiatives at UN did not deter the US from aggressively pursuing the investment liberalization agenda. The US not only negotiated bilateral investment agreements to secure its investment interests, it also started pursuing the investment liberalization agenda in non-UN fora where it was confident of maneuvering the outcome. Under the aegis of the Joint Development Committee of the IMF and the World Bank, the US launched discussions on the distortionary effects of investment regulations (such as performance requirements) in the host countries. These discussions provided an impetus for the enunciation of TRIMs. In the World Bank, the discussions on investment disputes led to the establishment of Multilateral Investment Guarantee Agency (MIGA) in 1998. The Agency was set up to encourage flow of private investment to the developing countries by guaranteeing the investment of foreign corporations against risks like civil war, currency restrictions, nationalization, etc.

Since the GATT (unlike the OECD) had provisions to make the rules binding among member-countries, the US returned to the GATT negotiations to push the investment liberalization agenda. Despite its failure to include investment in the Tokyo Round negotiations during 1973-79, the US remained resolute in pushing a comprehensive agreement on investment at the GATT. In the early 1980s, the US proposed a work program at GATT to include both trade in services and trade-related performance requirements imposed on foreign investors with the sole aim of addressing investment issues. But it was vehemently opposed by the developing countries, particularly India and Brazil. However, the possibility of including trade in services and investment issues at GATT negotiations became quite apparent in the mid-1980s as the opposition from developing countries waned due to bilateral trade pressures from the US as well as domestic pressures to liberalize investment regimes. The ambiguities created by the GATT ruling on the Foreign Investment Review Agency of Canada also gave momentum to the negotiations on TRIMs. The GATT panel found that the Agency's decision to screen investment proposals and impose certain performance requirements (e.g., local content) on foreign investment were in violation of Article III: 4 of GATT (National Treatment). By incorporating TRIMs and General Agreement on Trade in Services (GATS) in the Final Act of the Uruguay Round, the developed countries were successful in bringing investment issues under the ambit of GATT.

The 1990s witnessed the emergence of regional initiatives on investment liberalization. In 1991, negotiations also took place among the US, Canada and Mexico to launch North American Free Trade Agreement (NAFTA). In many aspects, NAFTA was an extension to Mexico of the Canada-US Free Trade Agreement. Formally established in 1994, NAFTA contains comprehensive investment measures which are discussed in the succeeding pages. The maximum number of bilateral investment treaties were also negotiated during the 1990s.

To circumvent opposition from the developing countries, the developed countries started investment negotiations under the aegis of the OECD in the early 1990s when the neoliberal doctrine was at its zenith. In those times, a thorough liberalization of controls on foreign investment was not only considered desirable but also as a necessary precondition for economic development. Trade and investment issues were deemed complementary to advance the global system of production. It is in this context that the US had called upon the OECD to launch a comprehensive binding investment treaty known as Multilateral Agreement on Investment (MAI) which included heavy dose of investment liberalization, protection of investors and a dispute resolution mechanism. Since most OECD member-countries had already liberalized investment rules, opposition to MAI was not expected. Twenty nine member-countries of the OECD participated in the negotiations on the MAI from 1995 to 1998. In 1997, the OECD also identified certain countries (Argentina, Brazil, Chile, Hong Kong, China and the Slovak Republic) as likely candidates for accession and invited them to take part as observers at the MAI negotiations. The three Baltic countries — Estonia, Latvia and Lithuania — were later invited to join as observers.

The MAI definition of “investment” was even broader than that adopted in Chapter 11 of NAFTA. Despite high degree of consensus among member-countries on the principles of MAI, questions were raised about the timings and preferred venue for such negotiations. In particular, the European Union and Canada were in favor of WTO as the venue for MAI because it could offer an enforceable dispute resolution mechanism. Initially, the US was not in favor of shifting the venue to WTO but eventually it supported the proposal with the caveat that Canada, the European Union and Japan should reaffirm their support for negotiations of MAI at the OECD.

In the mid-1990s, efforts to launch a multilateral investment agreement at the WTO intensified. Simultaneously, a number of international corporate lobbies (for instance, International Chamber of Commerce) started supporting efforts at the WTO and the OECD to work out international investment rules. At the WTO Ministerial Conference held in Singapore in December 1996, a proposal for multilateral negotiations on investment along with competition policy, government procurement and trade facilitation was mooted. However, strong resistance by some developing countries (particularly India) led to a compromise whereby a Working Group on Trade and Investment was set up under the WTO to examine the relationship between trade and investment issues. Working groups on other new issues were also set up at the Singapore Conference.

While the Working Group on Trade and Investment made slow progress at the WTO, the differences among the OECD member-countries on MAI started unfolding in 1997. In spite of a consensus on the broad parameters of the agreement that included investor protection, national treatment and an extensive dispute settlement process encompassing disputes between investors and governments, disagreements cropped up on few issues which remained unresolved. Differences among member-countries on specific issues such as Helms-Burton Act and the demand for exemption from national treatment for culture raised by France made it well nigh impossible to meet the deadlines.

In the midst of MAI negotiations, the US Parliament enacted the Cuban Liberty and Democratic Solidarity Act – popularly known as Helms Burton Act – in 1996. The Act empowered US citizens and corporations whose property was expropriated by the Cuban government after January 1, 1959 to claim damages against anybody who transacts in their former property. The Act also prohibited entry into the US by persons who transact in confiscated property. This Act became a bone of contention between the US, EU and Canada in the middle of the MAI negotiations. The underlying problem was that the Act operated extra-territorially and discriminated against foreign investors from non-US countries operating in Cuba. After the EU filed a complaint against the US over the Helms Burton Act in the WTO, the scope of the Act was significantly constricted. By then, France had already withdrawn from the MAI negotiations. In addition, widespread popular opposition to the MAI by the NGOs, trade unions and others stalled the negotiations and the MAI was finally shelved at the OECD in November 1998.

After the collapse of the MAI negotiations, the Working Group on Trade and Investment at the WTO remains the only multilateral forum where investment issues are under discussion. Outside the WTO, the prospects for a new multilateral initiative on investment agreement remain bleak. It is unlikely that a multilateral agreement on investment could again be negotiated at the OECD. In the light of recent experiences, the ideological moorings on which investment liberalization agenda is rooted has been rigorously questioned in the following section.

**Popular Myths About the Benefits of Investment Liberalization**

Current approaches advocating international investment agreements take it for granted that free flow of investment across borders offers immense benefits to countries in terms of transfer of technology, creation of jobs, quality products and services along with managerial efficiency. In the light of recent experiences, such notions need to be refuted. The perceived benefits may hold true for some investments, but it would be a serious mistake to make broad generalizations based on such investments. Besides, these approaches do not give adequate attention to economic, social and environmental costs and as a result fail to establish linkages of foreign investment with poverty reduction and sustainable development. An attempt has been made here to debunk several myths associated with investment agreements in particular and foreign investment in general.

To begin with, there is no evidence to prove conclusively that investment agreements lead to increased foreign investment in all countries. Nor does it boost the prospects of obtaining investment in future. Evidence collated from several developing countries shows that there is no causal relationship between investment agreements and increased foreign investment. Studies undertaken by UNCTAD reveal that there is little correlation between receiving increased foreign investment and signing of a bilateral investment agreement. On the contrary, there are ample cases where substantial foreign investment have taken place in the absence of any investment agreement. Though the US happens to be the largest foreign investor in India, there is no bilateral investment treaty between the two countries.

Since the 1980s, a large number of developing countries have carried out wide-ranging investment liberalization measures and have signed numerous bilateral investment agreements, yet they receive less than one-third of total FDI flows. Further, FDI flows are highly concentrated in a few developing countries. In an era of declining official aid and growing 'donor fatigue,' bulk of FDI flows have gone to a select few developing countries like China, Brazil, Mexico and Argentina. In 2001, only five countries accounted for 62 per cent of the total FDI flows to the developing world.[2] While 49 least developed countries (LDCs) received only 2 per cent of total FDI flows to the developing world and 0.5 per cent of world FDI.[3] Similarly, bulk of portfolio investment flows are concentrated in a few "emerging markets."

A closer look at several African countries confirms that investment agreements do not guarantee increased investment. Since the early 1980s, many African countries have signed investment treaties and have carried out comprehensive investment and financial reforms but are receiving only a fraction of the global private capital flows. It is noteworthy that share of Africa in the FDI flows to the developing economies declined from 9 per cent in 1981-85 to just about 4 per cent in 1996-97. During 1990-96, Sub-Saharan Africa (excluding South Africa) received negligible net portfolio flows, while FDI flows (mostly related to exploitation of natural resources) were concentrated in a few countries such as Nigeria, Botswana, Ghana, Mozambique and Uganda. It is not lack of investment agreements and policy reforms that prevent the flow of foreign investment to Africa, rather small size of domestic markets, poor infrastructure, locational disadvantages, civil unrest and political instability in the continent which are responsible for meager inflows.

Another common notion that investment liberalization is vital for higher economic growth requires closer scrutiny in the light of recent experiences. There is little evidence linking investment liberalization to growth. Liberalization of investment by itself cannot enhance growth prospects because it is a complex process, subject to a wide range of factors. If one tries to match the periods of investment liberalization with the economic performance of countries, the results may appear contradictory. Growth started deteriorating around 1970s when many countries moved towards liberalized investment regimes. The 1980s and the 1990s witnessed sharp deterioration in economic performance of many countries, both developed and the developing ones. The worst decadal-growth performance occurred in the 1990s. Restrictions on investments have not necessarily led to poor economic performance. Many countries enjoyed high growth without liberalizing their investment regimes. Japan, China and South Korea are some of the examples.

To a large extent, the quality of investment determines the growth and productivity rates. The composition of private capital flows has undergone rapid transformation in the last two decades. Although FDI has remained constant, portfolio investment, which was negligible in the seventies and eighties, has become sizeable since the nineties. Portfolio investments now surpass loans as the most important source of cross-border finance. According to the latest Coordinated Portfolio Investment Survey (CPIS) compiled by the IMF, total cross-border investment in debt and equity securities equaled $12.5 trillion at the end of 2001. In comparison, the outstanding stock of cross-border loans and deposits totaled $8.8 trillion and foreign direct investment amounted to $6.8 trillion. Since most portfolio investments have tenuous linkages with the real economy and are speculative in nature, it would be naïve to theorize on their contribution to economic growth. Besides, bulk of portfolio investment and other speculative funds are prone to reversals. Sudden withdrawal of capital can negatively impact on the exchange and interest rates. Volatile capital inflows can substantially complicate economic management and threaten macroeconomic stability. Several episodes of financial crisis in Mexico, Southeast Asia and Turkey in the 1990s not only point to the severe economic and social costs but also to the preeminent role of unregulated short-term portfolio flows in precipitating a financial crisis.

In the last two decades, the attributes of FDI flows, known for their stability and spillover benefits, have also changed profoundly. FDI is no longer as stable as it used to be in the past. The stability of FDI has been questioned in the light of evidence which suggests that as a financial crisis becomes imminent, transnational corporations indulge in hedging activities to cover their exchange rate risk which, in turn, generates additional pressure on the currencies. Since bulk of FDI flows are associated with cross-border mergers and acquisitions, their positive impact on the domestic economy through technological transfers and other spillover effects has been significantly diluted.

Foreign direct investment is not a panacea for development. There is hardly any reliable cross-country empirical evidence to support the claim that FDI *per se* accelerates economic growth. In the present circumstances, it is quite difficult to establish direct linkages between FDI and economic growth if other factors such as competition policy, labor skills, policy interventions and comprehensive regulatory framework are not taken into account. Further, in the absence of performance requirements and other regulations, many of the stated benefits of FDI would not occur. The positive impact of FDI depends on several factors including the sector in which the investment is taking place. For instance, if the bulk of FDI flows are directed towards exploitation of natural resources in the host countries (as in the case of Africa and Latin America), then the benefits in terms of transfer of technology, knowledge and skills would be negligible. Likewise, the entry of foreign firms in capital intensive industries is not going to solve the problem of unemployment in the host countries.

**Box 2: Cross-Border M&A Mania**

Since the 1990s, TNCs are widely using the strategy of mergers and acquisitions (M&As) to consolidate and expand their global reach. Instead of launching 'greenfield' projects which create new opportunities for employment and competition, TNCs rather prefer the easy route of M&A to consolidate their economic power. In reality, M&A add little to productive capacity but are simply transfer of ownership and control with no change in the actual asset base. The major negative fallout of M&A activity is the promotion of monopolistic tendencies, which in turn, curb competition and widen the scope for price manipulations. In situations where M&A deals are not possible because of anti-competition regulations, TNCs often form commercial alliances.

After acquisition, corporations often break up the newly acquired firms, reduce workforce and indulge in various malpractices to curb competition. Therefore, M&As have become one of the quickest means to acquire new markets. These deals generally lead to strategic firms and sectors of economy (e.g., infrastructure and banking) coming under the total control of TNCs. As top managements carry out M&A deals with the primary objective of raising shareholder value (rather than making strategic gains), it is not surprising that M&A deals have markedly flourished in the bullish global financial markets.

At the global level, cross-border M&As account for the bulk of FDI flows. Due to M&A, the landscape of global corporate world is not only rapidly changing but also becoming more and more complex. A look at the top global 500 TNCs list over the past few years reveals that several well-known corporations have either disappeared or merged into a new entity. As a result, the list of top global 500 TNCs keeps changing every year. In the year 2000, Exxon Mobil, Citigroup, DaimlerChrysler, JP Morgan Chase & Co. secured top positions in the top 500 list of TNCs only due to M&A.

The year 2000 was an important milestone in the history of M&A deals. It witnessed record M&A deals both in terms of numbers and value. There were as many as 38292 M&A deals, totaling nearly $3500 billion in the year 2000. Interestingly, more than half of M&A deals took place in US confirming that M&A mania had gripped corporate America. The bulk of M&A activity at the global level is taking place in the financial and banking sectors.

Since the first half of 2001, however, M&A deals have gone down dramatically. There are several reasons behind this decline. Firstly, there has been an exceptional fall in the share prices globally, especially with the bursting of high-tech bubble. Secondly, the specter of global economic slowdown, particularly in the US, is fast becoming a reality. Lastly, the adverse results and experiences of several previous M&A deals have come to light. On paper, mergers and acquisitions sound attractive but in the real world, synergies often do not materialize. Since each corporation has a distinct work culture, it becomes an uphill task for the board, management and workers to function cohesively in the aftermath of a M&A deal.

Most of M&A deals have not yielded desired results. Despite the massive layoff of workers and organizational restructuring, two-thirds of M&As have failed to achieve the intended objectives. Several instances (e.g., DaimlerChrysler) have come to light where corporations suffered huge losses after M&A. The *Businessweek*'s report, "The Merger Hangover," found that 61 per cent of mergers between 1995 and 2001 destroyed shareholder wealth. This puts a big question mark on the real objective of M&A deals.

Another guiding principle that determines the impact of FDI on national economic growth is whether foreign capital complements or substitutes domestic capital. In several developing countries, it has been observed that foreign investment often displaces domestic investment. In Latin America, the increase in real investment has been only to the tune of one third of the net capital inflow.[4] In fact, if one takes the Latin American region as a whole, external savings have crowded out the national savings. In New Zealand, both household and corporate savings have witnessed a steep decline since liberalization.[5] There is ample evidence of lower private saving rates following liberalization in Argentina, Chile, Colombia and the Philippines.[6]

There are several instances where liberalization and globalization policies have contributed to a consumption boom. In Mexico, the inflows sustained a boom in private consumption after its capital account was liberalized in the late 1980s. In 1992-93, capital inflows were estimated at 8 per cent of the GDP. With higher interest rates in Mexico, the international investment banks and fund managers invested billions of dollars in the financial markets and real estate, and consequently, a sharp real estate and stock market boom ensued. Higher but unrealistic valuation of stocks and real estate coupled with the appreciation of the exchange rate fuelled the consumption boom. There was a substantial hike in consumer lending after liberalization in Mexico as banks rapidly expanded credit card businesses and loans for consumer items. As a result, investment stagnated and foreign savings crowded out domestic savings. The national savings as a ratio of the GDP plummeted by more than 4 percentage points between 1989 and 1994. Mexico had to pay a high price for liberalization as its GDP contracted by 7 per cent in 1995.[7]

It is an established fact that transnational corporations indulge in manipulative transfer pricing to avoid tax liabilities. The predatory business practices of TNCs and their adverse consequences on the domestic businesses, particularly infant industries, need no elaboration here. Of late, instances have been reported suggesting that investors are relocating their polluting industries from the developed countries to countries with lower environmental standards. Although lower environmental standards in the developing countries may not be the primary reason for relocation, a study conducted by the author found that several German investors were influenced by it while relocating their dye industry in India.[8]

The entry of foreign investment in the banking sector deserves detailed analysis since this sector has definite linkages with economic growth and development. As more and more developing countries are easing restrictions on the entry of foreign banks, the costs in terms of allocation of credit and financial efficiency have not been critically assessed. The impact of allowing foreign banks to acquire stakes in the domestic banking sector has been more dramatic in Central and Eastern Europe (CEE) region where most domestic banks have already become or are likely to become subsidiaries of large foreign banks. In the wake of massive privatization programs in these countries, foreign banks have rapidly taken control over the domestic banking sector. In the nine CEE states, foreign bank holdings have risen from 20 per cent in 1997 to over 60 per cent by the end of 2001. In the Baltic states of Estonia, Latvia and Lithuania, foreign banks (particularly from the Scandinavian countries) have captured the domestic banking market within a short span of time. In Estonia, for instance, foreign-owned banks increased their market share from 2.3 per cent in 1997 to over 97 per cent in 2000. The top three banks of Estonia — Hansapank, Uhipank and Optiva — are all foreign-owned. In Latvia, Poland and Slovak Republic, foreign-owned banks accounted for more than 65 per cent of the total market shares in 2000. In terms of assets, over 90 per cent of Czech banking sector has come under the control of foreign banks.[9]

In Latin America, similar trends are also visible. For instance, all the three top banks of Mexico (Bancomer, Serfin and Banamex) have come under the control of foreign banks through M&A deals. With the recent takeover of Bital by a transnational bank, HSBC, the total foreign ownership in Mexican banking industry has touched 90 per cent of the total banking assets.

The rapid market driven consolidation in the global banking industry has important implications for allocation of credit, which in turn affects economic growth. Rampant competition in the domestic financial sector due to entry of foreign banks could enhance the risks. Fearing erosion of the franchise value due to increased competition, banks and financial institutions have a natural tendency to lend more money to risky projects. Fierce competition in the banking sector has given rise to a situation where banks are increasingly resorting to speculative and risky activities (e.g., foreign exchange speculation) to reap higher profits. A study by Andrew Sheng of the World Bank found that increased competition was responsible for bank failures in Chile, Argentina, Spain and Kenya.[10]

Moreover, the entry of foreign banks in the domestic market does not necessarily lead to better access to credit. Analysts have reported that in several countries the amount of real credit has actually declined in the wake of increased presence of foreign banks. Based on the study of two of the earliest transition economies, Hungry and Poland, Christian Weller established that there is a link between greater international financial competition and less real credit.[11] Weller found that while the number of financial intermediaries, particularly foreign-owned ones, grew in both economies, the amounts of real loans declined.[12] The decrease in total credit was more pronounced in Hungry. While real loans decreased by 5.2 per cent in Poland from 1990 to 1995, and by 47.5 per cent in Hungary between 1989 and 1994, the number of multinational banks increased from 0 to 14 in Poland and from 9 to 20 in Hungary.[13] These economies experienced considerable deterioration in their growth rates during the same period.

While the entry of foreign banks is generally considered beneficial as they offer better quality services and sophisticated products and have "deep pockets" to support losses, they can put domestic banks — whose long-term interests are aligned with the local economy — at a competitive disadvantage. It has been observed in some instances that rapid entry of foreign banks could stall the development of the local banking sector, as witnessed in Australia in the 1980s. By neglecting small and medium-sized enterprises (SMEs), foreign banks can even jeopardize the prospects of economic growth. If recent experiences are any guide, foreign banks have a tendency to serve the needs of less risky segments such as transnational corporations and "cherry-picked" host country corporations. Thus, the consequences for the real economy could be disastrous for most economies where small and medium-sized enterprises constitute the backbone of manufacturing and services.

**Investment Liberalization Under NAFTA: Some Lessons**

Some developed countries are hell bent on pushing negotiations for an international investment agreement at the WTO, without learning anything from past experiences, viz., NAFTA and MAI. It is important to highlight here that a substantive part of investment commitments pertaining to NAFTA was simply lifted and extended to the MAI. Formulation of MAI at OECD was doomed because of its blanket approach towards investment liberalization and the secretive manner in which negotiations took place. However, the MAI experience has many lessons to offer, the most important one is that an international investment agenda which is exclusively aimed at serving the interests of foreign investors is destined to be a failure. Though MAI was finally shelved, yet several cases filed by private corporations under the NAFTA regime are a pointer to how the agreement severely restricts the ability of governments to pursue public policies. Private corporations from NAFTA member-countries have exploited the provisions of the agreement to challenge those regulatory measures that infringe on their investment rights. The growing conflicts between private corporations and regulators are the outcome of the investment provisions under Chapter 11 of the NAFTA which entails non-discriminatory treatment to the foreign investors. Analysts have surmised that negotiators are likely to look into the NAFTA framework while formulating an agreement on investment at the WTO.[14] Hence, it becomes imperative to examine Chapter 11 of NAFTA which contains the most comprehensive rules on foreign investment.

The Chapter 11 of NAFTA has four main components:

**(i) Scope of Application:** Article 1101 deals with the coverage of provisions of NAFTA encompassing the geographical spread of the agreement (i.e., Canada, US and Mexico). NAFTA adopts a very broad, asset-based definition of "investment" extending beyond FDI. It includes portfolio investments, debt finance and real estate.

**(ii) Investment Liberalization:** Under Articles 1102, 1103, 1104 and 1106, specific measures related to investment liberalization have been stipulated. Designed to ensure non-discriminatory treatment, foreign investors have been given National Treatment and Most-Favored Nation Treatment, which extend to both pre-admission and post-admission stages. Unlike GATS, NAFTA adopts a "top-down" approach which means that commitments cover all economic sectors unless specifically exempted by the submission of a negative list by a NAFTA member-country. The commitments under NAFTA include an outright prohibition on the use of certain performance requirements (for instance, technology transfer requirements) by member-countries. Article 1106 restricts the capacity of member-countries to link the use of incentives to certain performance requirements.

**(iii) Investment Protection:** Like bilateral investment agreements, NAFTA also contains rules related to investment protection under Articles 1110 and 1105. NAFTA incorporates strong guarantees of investment protection though the threat of expropriation of foreign investment has receded. Article 1110 does not allow nationalization or expropriation of foreign investment except for a public purpose. To offset the possibility of expropriation, NAFTA has in-built obligation to compensate the foreign investor of a NAFTA member-country. Article 1110 also provides an obligation to compensate when state regulatory measures "tantamount to nationalization." But there is no clear definition in NAFTA as to what constitutes this type of indirect expropriation. Article 1105 also stipulates a minimum standard of treatment "in accordance with international law, including fair and equitable treatment and full protection and security" for investors. However, there is no clear definition in the NAFTA text as to what constitute "fair and equitable treatment" and "full protection and security."

**(iv) Dispute Settlement:** This section deals with the procedures relating to the settlement of investment disputes in the eventuality of violation of rules. In addition to the normal state-to-state dispute resolution mechanism, Chapter 11 also incorporates investor-to-state dispute resolution process. An investor of a NAFTA member-country can take legal action against violation of any of the provisions in Section A of Chapter 11. This is a major departure from other existing investment agreements. The investor-to-state dispute resolution mechanism under NAFTA has become controversial since foreign investors take recourse to it frequently.

Since its inception in 1994, NAFTA has been mired by a host of controversies. Although a majority of controversies relate to investor-to-state dispute settlement mechanism, but some pertain to conflicting interpretations and undefined areas of investment liberalization and protection measures thereby providing a leeway for its abuse. Most galling is the interpretation of the concept of "expropriation" which, in reality, could restrict the ability of governments to carry out social and developmental measures that adversely affect the businesses of foreign investors. Since a listing of all litigations under Chapter 11 is beyond the scope of this paper, four representative cases are cited here to highlight the conflicting interpretations of its several investment related Articles.

**1. Metalclad Corporation vs. United Mexican States:** The US company, Metalclad Corporation, acquired land in order to establish a waste landfill in the Mexican Municipality of Guadalcazar. In 1993, Metalclad was granted permission to construct a waste landfill and construction work began at the site. However, the state government and local bodies opposed the project on mandatory environmental safety requirements. As a result, the company was asked to apply for a municipal construction permit. The company applied for a permit and completed the landfill in 1995. But the Municipality of Guadalcazar refused to entertain Metalclad's application for a permit and consequently the Governor of the State issued an ecological decree prohibiting the use of waste landfill. At the NAFTA Tribunal, the company argued that Mexico breached Articles 1105 (Minimum Standard of Treatment) and 1110 (Expropriation) of NAFTA. The Tribunal decided that Mexico had breached the stipulated obligations and awarded $16.7 million in damages to Metalclad in August 2000.

**2. Ethyl Corporation vs. Government of Canada:** In April 1997, the Canadian Government banned the import and transport of MMT, a potentially toxic gasoline additive, on environmental grounds. The ban did not, however, prohibit the production and sale of MMT in Canada. Ethyl Corporation, a US company, was an importer and distributor of MMT in Canada. The company sued Canada under Chapter 11 of NAFTA for $251 million for the "expropriation" of its "property" and the "damage" to its "good reputation" caused by the public debates. The corporation filed the suit on the ground that the ban breached Articles 1102 (National Treatment), 1106 (Performance Requirements) and 1110 (Expropriation). However, anticipating an adverse decision, Canada agreed to settle the dispute in July 1998. Under the settlement, the Canadian government lifted the ban on MMT and agreed to pay $13 million in compensation to Ethyl Corporation and publicly announced that "MMT poses no health risk." The settlement took place in the midst of the NGO campaign against the MAI.

**3. S.D. Myers Inc. vs. Government of Canada:** Another US company, S.D. Myers Inc., engaged a Canadian entity to transport hazardous waste (PCB) from Canada to its treatment plants in Ohio. The company claimed that Canada's blanket banning of PCB exports from November 1995 to February 1997 breached Articles 1102 (National Treatment), 1105 (Minimum Standard of Treatment), 1106 (Performance Requirements) and 1110 (Expropriation). In November 2000, the NAFTA Tribunal pronounced the verdict that Canada had breached the first two claims but found no violation of Article 1110 on expropriation. The Tribunal ordered Canada to pay $50 million to the company in 2000.

**4. Methanex vs. United States:** In 1999, a Canadian corporation, Methanex, filed a Chapter 11 suit against the US because the State of California had decided to phase out a cancer-causing gasoline additive known as MBTE. The decision to ban MBTE was based on a study undertaken by the University of California which found that there were significant risks related to water contamination due to the use of MBTE. Methanex filed the suit under Chapter 11 on the ground that the measure violated Articles 1105 (Minimum Standard of Treatment) and 1110 (Expropriation) and claimed damages of $970 million. The United States vehemently opposed the claim by pointing to the detrimental impact on the regulatory autonomy of the NAFTA member-countries. It is noteworthy that till the Methanex case, the US was generally opposed to clarifications on Chapter 11.

The above-mentioned cases not only reveal the inherent shortcomings of Chapter 11 but also raise the issue of regulatory autonomy to deal with environmental and developmental issues. In the background of such shortcomings, the NAFTA member-countries under the aegis of the NAFTA Free Trade

Commission (FTC) agreed to limit the application of some of the Articles under Chapter 11. To conclude, the experience of NAFTA highlights the inherent difficulties in pursuing an investment liberalization agenda within a binding treaty that is limited to only three member-countries. One can well-imagine the intricacies to be encountered once an international agreement on investment incorporating similar provisions is formulated at a heterogenous conclave like WTO whose membership extends beyond 140 member-countries.

**Investment Under the WTO Regime**

Though there is no comprehensive multilateral agreement on foreign investment under the present WTO regime, investment-related provisions are contained in a number of existing agreements. These provisions were introduced during the Uruguay Round of GATT negotiations.

**1. Trade Related Investment Measures (TRIMs) Agreement:** This agreement came into effect on January 1, 1995 as part of the Uruguay Round of negotiations. It was enacted to address trade related investment measures. The Agreement did not define TRIMs, but provided an illustrative list to abolish investment measures that adversely affect trade such as requirements on domestic content and the balancing of trade between imports and exports. As mentioned earlier, TRIMs were included in the Uruguay Round negotiations largely at the insistence of the developed countries, while many developing countries, including India, opposed it on the ground that domestic content is useful and a necessary tool of economic development.

Under the TRIMs agreement, existing GATT disciplines relating to national treatment (Article III) and the prohibition of quantitative restrictions (Article XI) were reaffirmed. The TRIMs introduced standstill and rollback mechanisms applicable only to local content rules, trade balancing and foreign exchange balancing. Export performance requirements were not dealt with since several developed and developing countries have been using investment incentives and performance requirements.

A committee was set up as per the agreement to monitor the implementation of TRIMs commitments. The member-countries were given 90 days to notify the WTO of any existing TRIMs. Further, member-countries were granted a transition period during which their notified TRIMs were to be eliminated. The duration of transition period was based on the level of development — developed countries were given two years; developing countries five years; and the least-developed countries were granted seven years. Article 5.3 of the Agreement allows the developing and the least-developed countries to apply for an extension of the transition period. Several member-countries (for instance, Argentina, Chile, Malaysia and Pakistan) have submitted requests for the extension of transition period. However, under accession protocols, countries are required to comply with the TRIMs on accession without any transition period. For instance, China gave specific commitments to foreign investors without any transition period.

In the TRIMs agreement, there are some exemptions for the developing countries, which can deviate temporarily on account of balance-of-payments problems. The disputes under TRIMs are subject to the same settlement mechanism as other disputes governed by the Dispute Settlement Understanding of the WTO.

**2. General Agreement on Trade in Services (GATS):** This is the first multilateral, legally enforceable agreement that covers trade and investment in services. The GATS covers over 160 service activities including banking, telecommunication, energy, and education. The GATS outlines the obligations for trade in services in a similar manner that the GATT earmarked for trade in goods. The GATS is aimed at eliminating governmental measures that prevent services from being freely traded across national borders or that discriminate against locally established service firms with foreign ownership. It incorporates the "right of establishment," under which service providers have the right to enter another market by establishing commercial presence in sectors where countries have made specific commitments. Critics have rightly pointed out that GATS is an indirect way of introducing an agreement on investment, since one of the modes of trade in services is commercial presence. Commitments under commercial presence imply not only opening up commercial services (such as banking and insurance) to foreign investment but, more significantly, vital social services like health and education.

Under the GATS, the three important principles are Most-favored-nation (MFN) treatment, market access and national treatment. MFN treatment means a country has to treat the service supplier of another member-country no less favorably than it does the service supplier of any other member-country of the WTO. Market access obligations imply that a country is bound to allow foreign service suppliers to enter its market for providing services. National treatment refers to treating foreign suppliers under the same terms and conditions laid out for domestic suppliers.

The GATS employs a unique approach under which some obligations (such as MFN) are applied to all service sectors unless specifically exempted, while some others (national treatment and market access) are not applicable to service sectors unless specifically included in the "schedules of commitments" notified by the member-country. The countries are bound to liberalize only those sectors for which they have provided schedules and to the extent of the commitments undertaken in those schedules. This process is called "positive listing" or "bottom-up" approach. In contrast, "negative listing" or "top-down" approach implies that the obligations apply to all sectors unless a country specifically lists an exception. The oft-repeated claims that GATS-type approach is flexible and development-friendly require fresh thinking in the light of ongoing negotiations. Given the unequal power relations, developing countries have been compelled to undertake greater commitments over time by narrowing down the flexibility available to them. For instance, the EU request list seeks removal of wide range of regulatory measures in several sectors (e.g., telecommunications, environmental and financial services) which developing countries had listed in the last round.

Since service sector is subject to tight regulatory measures, the GATS became a part of WTO only after a protracted negotiating process. Though many countries were initially keen to keep the GATS outside the purview of the WTO, the negotiators were able to bring it under the WTO. All members of the WTO are signatories to the GATS framework and have made different commitments for different service sectors. A new round of service sector negotiations was mandated for the year 2000 and every five years thereafter. It commenced in 2000 and is still under negotiation. Since the biggest exporters of services are the US and EU, they are expanding the scope of GATS through progressive rounds of negotiations. The developing countries, on the other hand, are advocating inclusion of safeguard provisions in the GATS to ensure that global service providers do not pose a threat to domestic entities.

At the end of the Uruguay Round, the GATS called for extended negotiations in four service sectors: basic telecommunications, financial services, movement of natural persons, and maritime transport services. Negotiations for the first two sectors were concluded in 1997. Negotiations on movement of natural persons were finalized in 1995, though negotiations on maritime transport were suspended. The Financial Services Agreement (FSA) came into force in March 1999. By covering financial services including banking, securities and insurance, the FSA marked a major departure from the past as member-countries had agreed to a legal framework for cross-border trade, market access and dispute settlement mechanism. It has been estimated that the FSA covers nearly 95 per cent of global trade in banking, insurance, securities and other financial services. Although several countries have not undertaken comprehensive reforms as envisaged under the FSA, yet the developed countries, particularly the US, have used the agreement to open up the financial sector in the developing countries and emerging markets.

The dispute settlement mechanism of the WTO deals with any violation of commitments by the member-countries. Under the dispute settlement mechanism, a country may be required to give compensation if the tribunal finds that the member-country has not adhered to its commitments and is not making the necessary changes in policies.

In addition to TRIMS and GATS, the Trade-Related Aspects of Intellectual Property Rights (TRIPs) agreement also has provisions for liberalizing investment policies as it incorporates protection of intellectual property (patents and copyright) — a form of intangible asset. Besides, there are other less known WTO agreements (such as antidumping agreement, agreement on subsidies and countervailing measures, and agreement on government procurement) which also cover investment issues.

As mentioned earlier, the WTO had set up a Working Group on Trade and Investment in 1996 to examine the issues related to trade and investment. At the Doha Ministerial Conference, the Working Group was given a mandate to examine the elements of an investment framework in terms of scope and definition, transparency, non-discrimination, modalities for pre-establishment commitments based on a GATS-style positive list, development provisions, exceptions and balance of payments safeguards, consultation and the settlement of disputes between members. However, the task of Working Group is purely analytical and exploratory, with no mandate to negotiate new rules.

**Whither Multilateral Agreement on Investment in the WTO?**

The penchant of WTO towards liberalization in general and trade liberalization in particular, strengthens the notion that a prospective multilateral agreement on investment at this forum may give a fillip to investment liberalization agenda. This raises an important question whether the WTO is an appropriate venue for negotiating a multilateral agreement on investment. Elizabeth Smythe has examined this issue in the context of addressing the basic question of why some countries choose particular international organizations as their preferred venue for negotiations on international investment rules.[15] She concludes that countries' preferences for a particular venue are driven by their own investment interests. According to Smythe, countries view international economic organizations strategically and their influence within these organizations shapes their decisions about where negotiations should take place.[16] For instance, EU prefers the WTO for investment negotiations due to the fact that it could bargain as a united front at the WTO against countries like the US.[17]

At present, the EU, along with Japan, Chile, Costa Rica and South Korea are putting pressure to commence negotiations on a multilateral agreement on investment at the WTO. Although the EU and US are harping on "modalities" of negotiations on investment agreement at the WTO, the contents of negotiations remain highly problematic. To a large extent, the US insistence to put investment issue at Doha was a trade off for EU making meaningful moves in the agriculture sector. However, it is noteworthy that the US is pursuing investment agenda at other fronts as well. The US administration has perhaps taken note of the inherent difficulties to be encountered in actualizing a comprehensive investment liberalization agreement in a multilateral forum. Several factors, particularly the protracted negotiations and the resultant failure of the MAI as well as the ongoing problems related to the interpretation of Chapter 11 of NAFTA, have prompted the US to shift its agenda to other fronts.

Not surprisingly, the US has initiated bilateral and regional trade agreements which are easier to negotiate, without risking close scrutiny and opposition by critics. What is astonishing is the fact that the US has initiated bilateral negotiations with an investment liberalization agenda that goes beyond benchmarks set by existing bilateral and multilateral trade agreements. The just-concluded bilateral trade negotiations with Chile and Singapore include strict financial conditions curbing the use of capital controls along with aggressive safeguards for intellectual property rights. Under the provisions of these agreements, in case Chile and Singapore impose capital controls to defend their economies, they have to compensate American investors. Unfortunately, both these agreements have not come under public scrutiny.

Historically, a number of developing countries have resisted attempts to commence multilateral negotiations on investment issues. However, in the present day world, it is unlikely that the developing countries would continue their resistance. As witnessed during recent international economic negotiations, the much-touted unity of the developing world has come under strain. Apart from external pressures, many developing countries have also undertaken unilateral steps to liberalize their investment regimes. A powerful domestic lobby comprising big business houses, middle classes, big farmers and media in many developing countries is ardently seeking foreign investment. Simply put, there is "South" within "North," and "North" within "South." In fact, it is the unholy nexus between the "North" in the developing world and the "Global North" that prevails over the new global economic order. Since there is a discernible trend towards attracting foreign investment, the developing countries may not be able to prolong their resistance to investment issues at the WTO. As a compromise, the developing countries may bargain for some concessions at the WTO (for instance, specific exceptions and balance-of-payments safeguards) to ensure that the proposed framework on investment agreement takes care of their interests. In this context, critics must develop multiple strategies to address negotiations on investment agreement which are primarily political, not technical.

While the debate on the appropriate multilateral venue for investment agreement remains inconclusive, concerted efforts must be made to ensure that the neoliberal framework of investment liberalization, protection and dispute settlement mechanism should not dominate the investment agenda if negotiations begin at WTO. Although some powerful corporate lobbies such as ICC have strongly recommended the replication of NAFTA/MAI framework, the WTO negotiators should firmly reject such frameworks as these are highly bias in terms of investment liberalization and ambiguities involved in the interpretation of rules. Instead, the negotiators should examine other frameworks for enacting investment rules. In this context, the draft UN Code of Conduct on Transnational Corporations could serve as a starting point since it attempted to address concerns of the developing countries. Although the draft Code, admittedly, remains deficient in terms of addressing the concerns of present day global economic order yet some of its basic principles hold true.

The basic framework of the negotiations should focus on the linkages of foreign investment with poverty reduction and sustainable development besides granting policy autonomy to member-countries to pursue investment policies to suit their specific conditions. Although some supporting countries (particularly the EU) appear to be in favor of adopting a GATS-type "bottom up" approach on investment, there is no guarantee that this approach would provide adequate policy space to member-countries to maneuver investment policies in accordance with their developmental priorities. As mentioned earlier, the GATS approach generates additional pressure on countries to undertake wider commitments over the years.

One of the key issues, *inter alia*, would be the definition of "investment." A consensus on the definition of investment appears to be elusive as there are sharp differences even among supporting countries. For instance, South Korea has proposed a narrow definition of investment, limited only to FDI while

**Box 3: Are Corporate Codes of Conduct the Alternative?**

Of late, sections of NGOs, trade unions and anti-corporate movements have evinced keen interest on corporate code of conduct and self-regulation. In fact, several environmental and human rights NGOs have played a key role in drafting codes of conduct for TNCs. Over the years, a variety of such codes have been formulated in response to growing awareness among consumers in the developed countries. The list includes the International Labor Organization's Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy; the OECD Guidelines on Multinational Enterprises; the UNCTAD Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices; the Food and Agriculture Organization's Code on the Distribution and Use of Pesticides; the World Health Organization/ UNICEF Code of Marketing Breast Milk Substitutes, etc. Corporations have also adopted similar codes such as the US Chemical Manufacturers Association's Responsible Care Program and the International Chamber of Commerce's Business Charter for Sustainable Development.

In operation for several years, corporate codes of conduct remain weak and ineffective because they are voluntary, non-binding agreements. These codes are not mandatory, i.e., they do not involve any penalties on TNCs who violate them. Moreover, corporate codes are limited to a few sectors, particularly those where brand names play a decisive role such as garments, footwear, toys, sport goods, consumer goods and retailing businesses. But the major sectors of economy remain outside the purview of corporate codes. Usually, codes are not universally binding on all operations of the company including contractors, subsidiaries, suppliers and agents. Further, many codes do not entail the right to organize, form unions and collective bargaining. Without such basic rights, codes remain ineffective.

Another problematic issue pertains to the actual implementation and monitoring of voluntary codes. Compliance with codes of conduct is voluntary. No government can enforce them. Numerous cases could be cited where the corporations are signatories to the voluntary standards but refuse to comply with them. Since big consultancy firms usually carry out monitoring of codes with little transparency and public participation, the actual implementation of codes by TNCs remain a closely guarded secret. This strengthens the suspicion that voluntary codes are meant to deflect public criticism rather than tackling the ground conditions. The mushrooming of voluntary codes in an era of increasingly deregulated business and trade raises doubts about their efficacy. Unlike the 1970s when codes of conduct for TNCs were largely pushed by the developing countries, it is mainly the developed countries who have been vigorously promoting the voluntary codes since the 1990s. Therefore, it is not surprising that there is a propensity among the advocates of neoliberalism to consider voluntary codes of conduct as a substitute to state regulations. The voluntary codes of conduct cannot be a substitute for state regulations. Nor can they substitute labor and community rights. At best, voluntary codes can complement state regulations and provide space for raising environmental, health, labor and other issues.

If the recent experience is any guide, the struggle for implementation of voluntary codes could be a frustrating, time-consuming exercise. It dissipates the enthusiasm for launching struggle for regulatory controls on TNCs. This was evident in the case of the decade-long campaign on the national code and law for promoting breast-feeding and restricting the marketing of baby food by the TNCs in India. Therefore, voluntary codes require serious rethinking on the part of those who consider these as a cure-all to problems posed by the TNCs.

US favors a broader definition including portfolio investment. As the characteristics of foreign investment including FDI have undergone substantial changes over the years, the negotiators should stick to a narrow definition of investment limited to greenfield FDI. In this regard, the opinion that the host countries should be left to define what constitutes FDI also merits consideration.

Any prospective WTO investment agreement must grant the right to regulate the entry and operations of foreign investment in accordance with developmental needs and priorities of member-countries. No existing international investment agreement gives absolute rights to foreign investor to enter and establish their businesses in host countries. Hence, pre-admission commitments should not be made a part of a multilateral investment agreement at the WTO. The host countries should retain policy autonomy in terms of screening foreign investment, restrictions on mergers and acquisitions, limits on foreign ownership, quantitative restrictions, compulsory joint ventures, minimum capital requirements, etc. Similarly, at the post-admission stage, countries should be permitted to impose performance requirements and other regulatory measures in order to maximize economic gains from foreign investment. Exceptions (such as systemic, general, balance-of-payments and country-specific exceptions) should form an integral part of a prospective investment agreement. National treatment at all stages of investment, particularly entry and establishment, should not be included in the proposed investment agreement at the WTO since it can have disastrous ramifications for the domestic businesses and investors.

The negotiators should refrain from deliberating on investor-state dispute settlement mechanisms because the WTO is not a competent authority to entertain such disputes. WTO trade arbitrators have no expertise to assess the quantum of compensation to be awarded to a foreign investor in the eventuality of violation of the terms of proposed agreement by a member-country. Further, inclusion of investor-state dispute settlement provisions in a prospective investment framework would entail fundamental changes in the WTO's structure since it is essentially an inter-state agency.

Furthermore, it is difficult to fathom the relationship between a prospective investment agreement at the WTO and the existing over 1800 bilateral and regional investment treaties. What would be the fate of these agreements if a multilateral agreement at the WTO comes into force? Would existing investment agreements become null and void? Till now, the Working Group on Trade and Investment has not contemplated on this important aspect.

Another problematic issue pertains to the liberalization of capital account. At present, balance-of-payment issues in the WTO are restricted to current account transactions. But an investment agreement at the WTO would necessitate liberalization of capital account by member-countries. In the aftermath of Southeast Asian financial crisis, there has been a rethinking on liberalization of capital account as it emasculates the ability of developing countries to protect themselves from the whims of volatile capital flows. The contention that developing countries would become more vulnerable to volatile capital flows under a prospective investment agreement at the WTO cannot be overruled.

The negotiators, while negotiating investment rules at the WTO, must deliberate on restrictions to be imposed on predatory business practices, manipulative transfer pricing, anti-labor policies, bribery and other corrupt practices employed by foreign investors.

In the light of recent corporate scandals (from Enron to Worldcom), the negotiators must give proper attention to investor responsibilities. Despite much-touted claims of corporate transparency and disclosures, the basic norms of governance were completely flouted by these corporations. Regulations related to accounting and reporting were either circumvented or followed in letter rather than in spirit. What is even more disturbing is the fact that most of these corporations used to have their own codes of conduct. Although it is a different matter that they violated their own codes. These scandals have exposed the systemic flaws of highly acclaimed American corporate governance model based on self-regulation. Thus, voluntary codes of conduct are insufficient to ensure that TNCs would conduct their business operations responsibly and therefore should not be considered as a substitute for state regulations. A prospective investment agreement should include measures to strengthen the regulatory regimes of the home countries.

Finally, the negotiating process should incorporate a higher degree of transparency to ensure wider debate and discussion.

## Notes and References


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