International Investment Carousel

BY SUSAN ARIEL AARONSON

When it comes to rules for international investment, it's time to stop riding the WTO.

Money makes the world go round. Today international investment is a much greater factor in global economic growth than trade. Yet foreign investment has grown without a formal international system of rules. This contrasts with trade. Growth in trade, which was so essential to Asia and Europe's recovery from the Second World War, was fueled by the development both of an international system of rules to govern trade and the establishment of a forum to promote trade liberalization (GATT/WTO).

Since 1946, policymakers have tried and failed four times to develop an internationally acceptable agreement on investment. The most recent failure occurred during the WTO's fifth ministerial in Cancun, Mexico, in September 2003. Many developing countries refused to discuss an international framework to govern investment until their negotiators had achieved common ground with the developed nations on agriculture.

Some economists, policymakers, and business leaders argue that creation of an international set of rules to govern international investment would facilitate global economic efficiency, just as the GATT/WTO system spurred trade. They believe such a system must be built on most-favored nation and national treatment principles, should delineate the rights and responsibilities of investors and states, and should include an internationally accepted dispute settlement mechanism. Finally, they argue that such a system would ensure that foreign investment would flow to the developing world.

Susan Ariel Aaronson is Senior Fellow and Director of Globalization Studies at Kenan Institute in Washington, Kenan Flagler Business School, University of North Carolina.

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888 16th Street, N.W.
Suite 740
Washington, D.C. 20006
Phone: 202-861-0791
Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

In an ideal world, it may make sense to develop an international investment system, but it does not make sense to embed such a system within the WTO. There is no evidence that a new international agreement on investment will in fact stimulate greater investment or channel such investment to the world's poorest nations—the supposed purpose of the new round of WTO trade talks, the Doha Round. Second, international investment is already governed by a system of rules at the bilateral and multilateral level that provides basic stability and clarifies the rights and responsibilities of investors and states. Third, while trade and investment are linked, policymakers have not made the case that international investment rules belong under the aegis of the World Trade Organization. Finally, policymakers in the United States and abroad have not explained why international rules to govern foreign investment are in the interest of their own citizens or businesses.

THE CURRENT FRAMEWORK FOR INTERNATIONAL INVESTMENT

The world actually has a system of rules, with bilateral and multilateral elements, governing investment. Most countries, whether developed or developing, rely on bilateral investment treaties (BITs). At the end of 2001, there were some 2,099 such BITs. There are many different types of BITs, but they generally define foreign investment broadly, ensure that nations treat private foreign investment fairly and equitably, and ensure that foreign investment is treated the same as domestic investment (national treatment). Many BITs also provide limits on expropriation of investment and guarantee fair compensation should expropriation occur. BITs give investors the right to transfer funds in and out of host countries using market exchange rates. Finally, they generally set up state-to-state and sometimes investor-state dispute settlement provisions.

Each country can tailor its BITs to provide the level of investment protection it wants. Moreover, these BITs are not tied to other countries' preferences as would happen in a multilateral agreement, or used as a negotiating tool to achieve other market access objectives. By relying on the BITs, policymakers can ensure that certain sectors can be protected from foreign investment or development objectives can be met. Thus, the United States can ensure that foreigners don't control its defense industry; France can ensure that its culture remains uniquely French rather than a mirror image of that of the United States, and smaller countries have leverage when negotiating against bigger richer nations.

The WTO also includes some rules that govern investment related to trade. Trade-related investment measures such as local content measures were banned under an agreement negotiated during the Uruguay Round, which ended in 1993. Moreover, the General Agreement on Trade in Services includes rules governing foreign investment in services. However, these rules are designed to stimulate trade-related investment but not investment *per se*. As a result, some policymakers, academics, and business leaders believe that the WTO is the right place to govern international investment. They stress that because trade and investment are linked in the real world, the system of rules that governs trade must also govern investment. But international investors have different needs from international traders. Experience has taught these investors that property rights are more likely to be protected by impartial judges than by state-to-state dispute settlements. In particular, they don't need or necessarily want the state-to-state system of dispute settlement. Nonetheless, proponents of including international investment within the WTO seem to have little understanding of why such efforts failed in the past

WHAT POLICYMAKERS CAN LEARN FROM PAST INTERNATIONAL INVESTMENT AGREEMENTS

In any international investment negotiation, nations have different positions based on their perceived need for foreign capital or need to protect property rights. Capital-importing countries generally want a framework that could ensure that international investment rules promote that nation's economic culture, help that country meet its development objectives, and improve its economic efficiency. Capital-exporting countries generally want national treatment and most-favored nation privileges for their investors. They also want an adequate system of arbitrating disputes between investors and states. But because every country is different, policymakers have found it difficult to delineate consistent rules to govern entry and post-entry conditions.

Policymakers first tried to negotiate international investment rules as part of the International Trade Organization. The ITO was designed to govern employment, investment, commercial policies and business practices. Policymakers from the 54 participating nations who negotiated the ITO charter in 1947 recognized that trade and investment were related but they also knew that it would be difficult to develop a package of rules to link trade and investment without creating a multitude of exceptions. Most developing and European countries needed these exceptions because on one hand, they desperately wanted foreign investment, but on the other hand, they feared foreign control of important sectors of their economy. Although it was business leaders who had insisted on including investment in

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the ITO, the same business leaders feared that the ITO, in the end, did not provide adequate guarantees that foreign governments wouldn't at some point expropriate their investments. Because of business opposition and policymaker ambivalence, the U.S. Congress never voted on the ITO and it was abandoned in 1950.

Policymakers tried again to negotiate an international investment agreement at the United Nations. In 1972, the United Nations Economic and Social Council unanimously adopted Resolution 1721, which set up a study group and called for the negotiation of a code of conduct for international investors. But because most foreign investment came from the United States, U.S. business leaders and policymakers perceived this effort as tainted with anti-Americanism. UN diplomats spent some twenty years trying to negotiate a code, but could never resolve the scope, legal standing, and implementation strategy for such a code. After years of U.S. pressure, as well as changing global economic conditions, this effort was abandoned in 1992.

While diplomats struggled at the United Nations, members of the Organization for Economic Cooperation and Development also tried to negotiate an investment code that could stimulate international investment and also shape business behavior. In 1976, these nations developed a Declaration on Investment, as well as a code of conduct for investors called the OECD Guidelines for Multinational Enterprises. The Declaration was designed to set rules governing investment so as to stimulate investment, while the Guidelines gave policymakers recommendations regarding how their multinationals should behave overseas when they invested and produced abroad. Today, some 38 nations adhere to both instruments, but the Guidelines remain nonbinding.[1] Unfortunately, most governments that have agreed to adhere to these instruments, including the United States, have done little to inform their firms about the Guidelines. Not surprisingly, most corporate officials have not heard of them. Finally, these instruments were negotiated by and for industrialized nations.

The most recent and egregious failure occurred in 1995, when policymakers at the OECD authorized negotiation of an international investment treaty, the Multilateral Agreement on Investment (MAI). According to economist Edward Graham, industrialized country officials chose the OECD as the negotiating forum because its members were "like-minded on investment policies and already had put in place relatively liberal investment regimes." Several OECD members, including the United States, did not want to negotiate with developing countries because policymakers feared these countries could not find common ground on the terms of investor rights and responsibilities.

The MAI participating nations hoped to establish rules to remove existing barriers and controls on all types of foreign investment, from portfolio to direct investment. But the delegates were not in fact like-minded. The United States feared the European governments would not let it maintain unilateral sanctions against foreign-owned companies engaged in transactions with Cuba, Iran, and Libya. The French and Canadians wanted to exclude cultural sectors from the MAI. And the United States wanted the MAI to be like its bilateral investment treaties, where it demanded treatment that was "no less favorable" than that granted either to domestic investors or foreign investors from other countries in similar circumstances. (But this language might force a country to give preferential treatment to foreign investors.) Because delegates wanted a multitude of exceptions, the MAI became a document without universal rules.

The MAI permitted investors to sue states for alleged violation or national treatment or most favored nation treatment of investment. When a copy of the draft MAI was leaked, it aroused the opposition of a broad international constituency of development, consumer, environmental, and civil society groups. Graham notes that these individuals and groups saw the MAI "as creating a new doctrine towards regulatory takings…more friendly to owners of assets whose value might be diminished by regulation." Moreover, they perceived the MAI as giving international investors greater rights than domestic investors because they could seek compensation for regulatory takings through the international agreement. These MAI critics also noted that NAFTA, also negotiated in secret, also included these new rights for foreign investors. Not surprisingly, such activists concluded that although all developing nations needed foreign investment, they would be ill served by secretive international investment negotiations that could undermine democratically erected national rules. These activists remain determined to thwart any international investment negotiations.

This legacy of public concern about international investment rules' impact upon democracy coupled with the history of failures should teach policymakers that it would be exceedingly difficult to agree on a scope and objective for international investment negotiations. Yet it didn't stop policymakers from trying again, under the purview of the WTO.

INVESTMENT STUMBLES AT THE WTO

In 1996, under pressure from Japan and several European nations, members of the WTO agreed to undertake exploratory and analytical work on investment. But the early discussions stumbled over the scope of the negotiations. The European Union wanted investment negotiations to cover both portfolio and direct investment. However, India, China, and several other developing countries demanded that any investment agreement delineate not just the rights of investors and the rights of states, but also the responsibility of investors. WTO members also disagreed regarding how and when to negotiate investment. Many developing countries insisted that the members of the WTO must first decide by "explicit consensus" whether or not to include investment even though "explicit consensus" has no meaning for WTO members. Because of these differences, when WTO members met in 2001 in Doha, Qatar, they provided no guidance on what investment negotiators should do.

Two years later, progress remained stalled. When negotiators arrived at Cancun on September 10, 2003, they found many developing countries objected to discussing the Singapore issues until other priority issues (subsidies, agriculture, and market access) were addressed. The European Union and its allies, Japan and South Korea, however, insisted that WTO members had already agreed that the Singapore issues were ripe for negotiation and held firm. Meanwhile other nations such as Korea used the Singapore issues as a bargaining chip to thwart agreement in agriculture. By September 14, although the European Union agreed to drop its demand for negotiations on the Singapore issues, the concession came too late. The talks collapsed. Many pundits blamed the failure of these talks on this insistence on including investment.

Since that failure, the European Union continues to insist investment must be part of the Doha round, while the U.S. government has not clarified its current view on investment negotiations since the failure of the Doha round. One can argue that the Bush Administration has become more enamored of bilateral agreements in trade—and thus the same may hold true for investment (including linking investment and trade within individual free trade agreements). But the views of American business are quite clear. U.S. business was never enthusiastic about the WTO investment negotiations. Business representatives have concluded that international negotiations, in contrast with bilateral negotiations, generally yield weak agreements that tend to stay weak. Such a gradualist strategy is fine for trade, where each round can achieve progressively stronger trade obligations, but rarely do further negotiations result in stronger investment protections. Moreover, many European and American business leaders are happy with the BITs as a tool to set rules governing investment. Investors prefer arbitration to state-to-state dispute settlement because they believe it is faster and fairer. Finally, and most importantly, proponents of international investment negotiations have not explained why such agreements are needed at the multinational level. In rich and emerging nations alike, citizens worry about a loss of political and economic control when foreign investors own substantial shares of businesses producing goods and services. They are not likely to be amenable to an international agreement, which they might perceive as leading to weaker protections.

Unfortunately, most governments that have agreed to adhere to the Declaration on Investment and Guidelines for Multinational Enterprises, including the United States, have done little to inform their firms.

Thus, policymakers should be leery of embedding such rules within the purview of the WTO, an agreement that already arouses great suspicions for its impact upon sovereignty. They shouldn't invest any more of their limited time and resources in international investment negotiations, which are not likely to provide much of a return. ◆

NOTE

1. The following countries are not OECD members, but they adhere to both the Declaration and the Guidelines: Argentina: Brazil, Chile, Czech Republic, Estonia, Israel, Hungary, Mexico, Slovakia, Slovenia, Poland. and Turkey. The OECD reports 38 members adhere to the Guidelines.