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ISSUES RELATED TO INTERNATIONAL ARRANGEMENTS

Note by the UNCTAD secretariat*

Executive summary

The international policy dimension of countries' efforts to attract FDI and benefit more from it continues to intensify and proliferate at the bilateral, subregional, regional and inter-regional levels. The resulting network of investment rules is multi-layered and multi-faceted, with obligations differing in geographical scope and coverage and ranging from the voluntary to the binding. The question arises as to what extent this network has contributed to improving the investment environment in developing countries and helped them benefit from FDI, and how the development dimension in future investment instruments could be strengthened. This note sets out a number of policy issues that emerge from the discussion at various international fora, as well as research and policy analysis of the secretariat.

* Late submission caused by clearance delays due to the outcome of the Cancún conference.

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INTRODUCTION

1. In accordance with the decision by the Commission on Investment, Technology and Related Financial Issues at its seventh session (Geneva, 20–24 January 2003),[1] the secretariat prepared this note as an input to the discussions at the eighth session of the Commission. The purpose of the note is to review recent developments in international investment rulemaking (drawing mainly on the analysis and data contained in the *World Investment Report 2003*)[2] and to set out a number of policy questions related to international investment agreements (IIAs) for consideration by the Commission.

2. Events in Cancún have shown that the issues at stake are complex and complicated, and not easily prone to consensus. Nonetheless, the international policy dimension of countries' efforts to attract FDI and benefit from it will continue to intensify, especially at the bilateral, subregional, regional and interregional levels.

3. Indeed, the existing network of investment rules is laid out in a large number of bilateral investment treaties (BITs), free trade agreements (FTAs) with investment components, double taxation treaties (DTTs), **r**egional trade agreements (RTAs) and multilateral agreements. This network is multi-layered and multifaceted, with obligations differing in geographical scope and coverage and ranging from the voluntary to the binding – constituting an intricate web of commitments that partly overlap and partly supplement one another.

1. Bilateral agreements

4. The number of BITs increased steadily between 1959, the year that the first BIT was concluded, and the beginning of the 1990s. As of the second half of the 1990s, this pace accelerated, with their number almost doubling. At the end of 2002, there were 2,181 BITs in existence, and judging by past years' performance, this number can be expected to increase further by the end of this year (figure 1). BITs now encompass 176 countries and cover mostly investment relations between developing countries as well as between them and economies in transition.[3] Today, more than 45% of the BIT universe does not include developed countries. They are the most widely used international agreement for protecting FDI.[4] In parallel with BITs, countries have also concluded agreements for the avoidance of double taxation (DTTs). By the end of 2002, their number stood at 2,256. These address, among other things, the allocation of taxable income, reducing incidents of double taxation.

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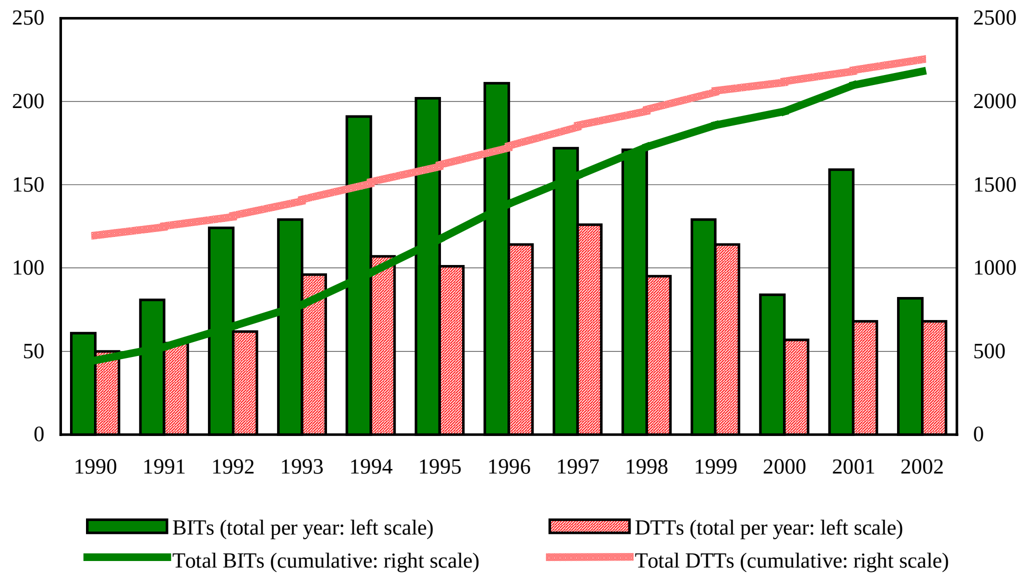
[1] "*The secretariat, in line with paragraph 21 of the Doha Declaration, should […] also continue its in-depth analysis of which policies and measures can help developing countries attract and benefit more from foreign direct investment (FDI) as a means for development […]*" (TD/B/COM.2/50, 5 February 2003, agreed recommendations, paragraph 3).

[2] *World Investment Report 2003. FDI Policies for Development: National and International Perspectives* (WIR03), United Nations publication, Sales No E.03.II.D.8.

[3] BITs are not concluded between developed countries, as their legal systems reflect investor protection standards evolved over many years of experience with such issues.

[4] They are, however, a far cry from a full geographical coverage: 18,145 BITs would be needed to ensure full coverage of the world's 191 economies.

Figure 1: The universe of BITs and DTTs



Source: UNCTAD, BITs and DTTs databases.

5. The scope and content of BITs have become more standard over the years. Today, the main provisions deal with the scope and definition of foreign investment; admission and establishment; national treatment in the post-establishment phase; most-favoured-nation (MFN) treatment; fair and equitable treatment; guarantees and compensation in the event of expropriation; guarantees of free transfers of funds and repatriations of capital and profits; and dispute settlement provisions, both State-State and investor-State. But given the sheer number of BITs, the formulations of individual provisions remain varied, with differences in the language of the BITs signed some decades ago and those signed more recently. More importantly, a few countries have recently extended their coverage, with provisions for the right to establishment, performance requirements and employment of key foreign personnel. These changes – mainly in recent BITs, including those currently being renegotiated – are giving rise to a new generation of BITs with greater obligations and with more far-reaching implications.

6. The number of bilateral FTAs covering investment issues is rising as well, with most early ones involving neighbouring countries and newer ones tending to be concluded between distant countries in different regions and having investment commitments in a separate chapter. Out of 197 FTAs currently in force, 55% contain specific chapters on investment and another 22% have general provisions on investment. Among the main issues addressed are: pre-establishment and post-establishment national treatment; MFN treatment; prohibitions of performance requirements (often going beyond the Trade-related Investment Measures (TRIMs) Agreement of the WTO); promotion and protection, including for expropriation and compensation; dispute settlement, both State-State and investor-State; and transfer clauses guaranteeing the free transfer of payments, including capital, income, profits and royalties. An example of a recent agreement of this type is the Japan-Singapore Agreement for a New-Age Economic Partnership.

7. By signing BITs – which provide protection for investment under international law and thus help reduce the non-commercial risks facing foreign investors in host countries – signatory countries send a signal of their commitment to providing a favourable investment climate, although it is difficult to ascertain whether or not BITs play a role in specific circumstances and for specific countries. However, BITs signal that a host country's attitude towards FDI has changed and that its investment climate is improving. In addition, investors appear to regard BITs as part of a "good" investment framework. The conclusion of BITs can therefore provide an important ingredient in the overall attractiveness of a host country, especially when complemented by economic determinants that attract FDI (such as market size and growth, skills, abundant competitive resources and good infrastructure). In other words, BITs (like all IIAs) tend to make the regulatory framework more transparent, stable, predictable and secure – that is, they set the stage for the economic determinants to come into play. And when IIAs reduce obstacles to FDI and the economic determinants are right, they can lead to more FDI.

2. Regional and interregional agreements

8. The universe of regional and interregional agreements dealing directly with investment matters is growing as well.[5] But only a few are devoted exclusively to investment, with the OECD liberalization codes covering capital movements and current invisible operations (1961) and the OECD Declaration on International Investment and Multinational Enterprises (1976) being particularly noteworthy. Recent examples involving developing countries include the Framework Agreement on the ASEAN Investment Area and the Andean Community's Decision 291. Unlike BITs and bilateral free trade agreements, not all regional instruments are binding. Norms of a non-binding nature relating to foreign investment in the Asia–Pacific Economic Cooperation forum (APEC) were adopted in the 1994 APEC Non-Binding Investment Principles.

9. The trend is towards comprehensive regional agreements that include both trade-related and investment-related provisions, even extending to services, intellectual property rights and competition. Indeed, most regional free trade agreements today are also free investment agreements, at least in principle: out of 58 RTAs in force, 66% contain specific chapters on investment and another 17% have general provisions on investment. Examples are NAFTA and the MERCOSUR Protocols. The general aim is to create a more favourable trade and investment framework through the liberalization not only of regional trade but also of restrictions on FDI and through a reduction of operational restrictions, all to increase the flow of trade and investment within regions. Generally addressing a broader spectrum of issues than bilateral agreements, regional agreements allow trade-offs across issue areas. And those between developed and developing countries typically use the panoply of traditional international law tools – such as exceptions, reservations and transition periods – to ensure flexibility in catering to the different needs, capacities and policy objectives of countries.

10. As with BITs it is difficult to identify the impact on FDI of regional or interregional agreements dealing only with the harmonization of investment frameworks of member countries. They improve the enabling framework, and where they reduce obstacles to FDI (as most regional agreements do), they can increase investment flows – again, if the economic

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[5] Most of these instruments (or relevant excerpts) have been published in UNCTAD, *International Investment Instruments: A Compendium* (Geneva: UNCTAD, various years).

determinants are favourable. The main economic determinant that influences FDI flows in regional agreements is market size. But that is the result of reducing barriers to trade, not of FDI.

3. Multilateral agreements

11. Efforts to create comprehensive multilateral rules for FDI, even the non-binding ones undertaken occasionally in the post-war period, have failed. Most prominent among them were the United Nations Code of Conduct on Transnational Corporations (in the late 1970s and 1980s) and a Multilateral Agreement on Investment developed by the OECD (in the late 1990s). But the World Bank Guidelines on the Treatment of Foreign Direct Investment, a non-binding instrument, set down (in 1992) certain standards of treatment for investors on which a level of international consensus could be said to exist. Some efforts dealing with specific investment aspects bore fruit as well. The Convention on the Settlement of Investment Disputes between States and the Nationals of other States provides a framework for the settlement of investment disputes. The ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy deals with a range of labour-related issues. The Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) enhances the legal security of FDI by supplementing national and regional investment guarantee schemes with a multilateral one. The WTO Agreement on TRIMs prohibits certain trade-related investment measures (adopted as part of the Uruguay Round). And the General Agreement on Trade in Services (GATS), also concluded as part of the Uruguay Round, offers a comprehensive set of rules covering all types of international services delivery, including “commercial presence”, akin to FDI. The GATS leaves member countries considerable flexibility on the scope and speed of liberalizing services activities. It allows them to inscribe, within their schedules of commitments, activities that they wish to open and the conditions and limitations for doing this – the positive list approach.

12. The relationship between trade and investment was introduced into the WTO work programme during the First Ministerial Conference of the World Trade Organization (WTO), held in Singapore in 1996, as one of the four so-called Singapore issues. In their Declaration at the Fourth Session of the WTO Ministerial Conference in Doha in November 2001, members of the WTO agreed on a work programme on the relationship between trade and investment (paragraphs 20–22).[6] In doing so, they recognized (in paragraph 21) the need for strengthened technical assistance in the pursuance of that mandate, explicitly referring to UNCTAD. In response, the WTO Working Group on the Relationship between Trade and Investment (set up at the WTO’s 1996 Ministerial Conference in Singapore) has deliberated on the seven issues listed in paragraph 22 of the Declaration, as well as technology transfer.[7] The discussions of the Working Group are reported to the WTO General Council. The Doha Conference recognized “the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade” (paragraph 20). It was also

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[6] “Ministerial Declaration”, Ministerial Conference, Fourth Session, Doha, 9-14 November, WT/MIN(01)/17.

[7] The Doha Declaration provides, in paragraph 22: “In the period until the Fifth Session, further work in the Working Group on the Relationship Between Trade and Investment will focus on the clarification of: scope and definition; transparency; non-discrimination; modalities for pre-establishment commitments based on a GATS-type, positive list approach; development provisions; exceptions and balance-of-payments safeguards; consultation and the settlement of disputes between Members." In its meeting on 1 December 2002, the Working Group discussed its annual report and an intervention by a group of developing countries dealing with home country measures and investor obligations.

indicated "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" (paragraph 20).

4. The status of investment discussions in the WTO [8]

13. Proponents of the investment issue in the WTO have highlighted the need to begin negotiations in order to promote greater investment flows, among others. Opponents of a binding multilateral agreement on investment lodged in the WTO perceive that this would extend the frontiers of the multilateral trading system further into national policy space and to issues not directly affecting trade. In addition, they point to financial and institutional constraints that already limit the ability of many member countries to negotiate and implement any WTO Agreements, and to the need for further clarification of the substance of the issues involved in order to fully understand the implications, including costs and benefits.

14. Given the lack of consensus on whether and, if so, how to take the investment issue forward, the proposal on investment in the Cancún Ministerial Text (CMT) Rev.1 provided the option of either beginning negotiations on modalities or continuing the process of studying and clarifying the issues. Regarding the latter, some elements for clarification were proposed by a group of developing countries.[9] These include the scope and content of provisions related to scope and definition, transparency, non-discrimination, exceptions and balance-of-payments safeguards, special and differential treatment, performance requirements, investor obligations and home country measures, incentives, protection from expropriation and compensation, and dispute settlement. There were no suggestions on any intermediate solutions.

15. At Cancún, the CMT Rev.2 provided a differentiated approach to the four Singapore issues. On investment, it proposed that the clarification process be intensified on the basis of the Doha Ministerial Declaration as well as other elements cited by members, including the elements identified by a group of developing countries (WT/MIN(03)/W/4); that the Working Group in Special Session be convened to elaborate procedural and substantive modalities, taking into account special and differential treatment for developing countries as an integral part of any framework, which should enable members to undertake obligations and commitments commensurate with their individual needs and circumstances; that consideration be given to the relationship of the negotiations to the single undertaking; and that modalities allowing negotiations on a multilateral investment framework to start be adopted by the WTO General Council by a specific date that would coincide with the date for agreeing on modalities on agriculture and non-agricultural market access.

16. No explicit consensus on commencing negotiations on the Singapore issues emerged in Cancún. Pending the outcome of the post-Cancún consultations, the future of the investment issue in the Doha work programme and the WTO agenda is unclear.

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[8] This section draws on "Review of developments and issues in the post-Doha work programme of particular concern to developing countries: The outcome of the fifth WTO Ministerial Conference" (TD/B/50/8), 29 September 2003.

[9] See WTO documents WT/GC/W/513 and WT/GC/W/514 and Corr.1.

5. Challenges ahead

17. Issues relating to IIAs will continue to be at the fore in international economic diplomacy, regardless of what will or will not happen at the WTO, simply because of what is happening now (as discussed earlier) at the bilateral, subregional, regional and interregional levels. Indeed, a number of new IIAs are under negotiation and/or discussion.[10] The most important challenge for developing countries in future IIAs is to strike a balance between the potential for IIAs to facilitate FDI flows and the ability of countries to pursue development-oriented FDI policies – as an expression of their right to regulate in the public interest. This requires maintaining sufficient policy space to give Governments the flexibility to use such policies within the framework of the obligations established by the IIAs they are parties to. The tension is obvious. Too much policy space reduces the value of international obligations. Too stringent obligations overly constrain the national policy space. Finding a development-oriented balance is the challenge. The development dimension has to be an integral part of international investment agreements in support of national policies to attract more FDI and to benefit more from it.

18. Against this background, the Commission may wish to consider the following issues with regard to recent trends in IIAs and their development dimension as part of its recommended actions:

- What are the main challenges as regards the existing multifaceted and multi-layered network of international investment rules?

- What major problems do developing countries face in negotiating new IIAs and in coping with existing ones?

- How can the development dimension in IIAs be further enhanced?

- Which are the major development concerns that need further clarification in UNCTAD's work?

- Which are the key issues that require further research and policy analysis?

- How can capacity-building in this area be further strengthened?

- How should non-state actors' views and concerns be reflected in the discussion of IIAs?

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[10] See WIR03, pp. 88-93.