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Chapter 22. Home Country Measures*

Executive summary

Most international negotiations on foreign direct investment (FDI) focus on issues involving the paired relationship between transnational corporations (TNCs) and host countries. TNCs desire access to foreign resources and markets to further their strategic global business objectives. Host countries desire FDI that promotes national economic and social objectives. Many host countries, including developing countries, adopt measures to attract FDI by, for example, improving their regulatory framework for FDI, enhancing educational programmes, or offering incentives. In reality, however, this paired relationship between TNCs and host countries is triangular. Home countries also influence FDI flows, including the relative prospects that their TNCs will select developing country investment sites. The question thus arises: to what extent do international investment agreements (IIAs) address home country measures (HCMs) that influence FDI flows to host countries?

A variety of HCMs affect TNC decisions regarding the selection of host country investment sites. In addition to possible restrictions on capital outflows, HCMs can enompass general policy pronouncements, information and technical assistance, transfer of technology, financial and fiscal incentives, investment insurance and market access regulations. A stock-taking analysis of HCMs in IIAs shows that developed countries have removed most national restrictions on outward FDI and embrace declaratory statements in inter-governmental agreements that endorse the promotion of FDI, particularly to developing countries. These policy declarations, however, are often not linked to specific obligations for the adoption of HCMs. Many FDI promotional declarations remain hortatory, particularly in the context of bilateral investment treaties (BITs). Similarly vague language is found in other international accords, although some regional agreements between developed and developing countries create a basis for complementary follow-up assistance programmes that offer practical support to both capital-importing countries and potential investing enterprises.

Promotional efforts often aim at correcting market imperfections that can disadvantage developing countries as TNCs consider prospective FDI sites. Developed countries can help provide information and facilitate contacts that match potential investors with FDI opportunities in host developing countries. Some national and regional programmes provide financial or fiscal incentives as well as investment insurance guarantees to help offset some of the risk associated with FDI, particularly in smaller developing countries where investors (particularly smaller ones) have less experience. HCMs may also prioritize assistance to promote FDI with particular technology transfer benefits or support FDI flows to the least developed countries, for example, through preferential market access.

Most of this assistance, however, remains at the discretion of the developed country and is commonly shaped to serve its own business interests along with general development objectives. This national benefit factor is particularly evident in the design of many financial and fiscal assistance programmes as well as market access HCMs (such as product certification or rules-of-origin regulations)that can discourage FDI flows by diminishing market access prospects for FDI projects with export potential. The limited input of developing countries into the design and execution of HCMs, as well as the often uncertain commitment to the duration of FDI promotional assistance, may diminish the beneficial impact promotional programmes can have on development, including on technology transfer objectives. Increased stability, predictability and transparency among these promotional efforts could serve the interests of both host and home countries, as well as TNCs.

The range of HCMs affecting outward FDI leads to interactions with a number of other concepts related to discussions of IIAs. The most significant interactions occur with issues involving

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* The chapter is based on a 2001 manuscript prepared by John Kline. The final version reflects comments received from Susan Borkowski, Werner Corrales, William Dymond, Corinne Dreyfus, Felipe Jaramillo, Joachim Karl, Mark Koulen, Mansur Raza, Homai Saha, Chak Mun See and Marinus Sikkel. For a later discussion of home country measures, see UNCTAD, 2003a, chapter VI.

incentives, taxation, transfer pricing, transfer of technology, most-favoured-nation (MFN) treatment and investment-related trade measures (IRTMs).

Most policy options to increase the beneficial impact of HCMs on FDI flows also relate to these areas. The practical effectiveness of these options are likely to increase proportionately to the strength of the policy commitments contained in IIA provisions, running along a continuum from hortatory declarations to binding obligations accompanied by detailed implementation plans and monitoring mechanisms. Similarly, the significance of IIA outcomes is likely to vary with the range and scope of HCM issues addressed by these policy provisions. For example, while encouraging a more direct link between developed country statements regarding FDI promotion and follow-up programmatic actions, increased collaboration on promotional initiatives could improve delivery mechanisms for financial incentives, establish development preferences for the administration of fiscal regulations and enhance technology transfer options for developing countries. A cross-cutting implementation issue that also merits consideration is the potential extraterritorial impact that HCMs might have in host developing countries, including the influence on a potential investor's decision to engage in FDI as well as a TNC's performance, once invested.

Introduction

An FDI transaction establishes a triangular relationship involving three main actors: the TNC investing funds; the capital-importing host country; and the capital-exporting home country. Most discussions of international investment issues focus on the TNC/host country dimension, especially on issues of why TNCs invest and how they behave in host countries as well as what host country factors attract FDI and how those countries should treat foreign investors. This chapter examines a key aspect on the third point of the triangle: the laws, regulations and policies of home countries that relate to FDI and the extent to which such HCMs are, or can be, reflected in IIAs. A central concern is the impact HCMs exert on FDI flows and, in particular, how HCMs might increase such flows, including associated technology transfer, to developing countries.

When used in the context of international investment instruments, the term "home country measures" refers to how such instruments might address a range of national laws, regulations and policies that affect outward FDI. Historically, the term has drawn limited attention because HCMs fell under the unilateral authority of developed country Governments that acted principally to promote the interests of their own TNCs. Nevertheless, these measures, which may restrict, permit or promote FDI, can influence both the quantity and quality of investment flows to developing countries. The resulting impact on development may be director indirect, deliberate or unintentional.

Although HCMs may restrict FDI, the principal policy debate revolves around actions capital-exporting developed countries might take to promote FDI, especially to developing countries. Many developed countries espouse policy positions that support FDI promotion, but the reality of follow-on programmatic activities often does not match the rhetoric of their declaratory statements. Development assistance programmes may contain a component of FDI promotion, including information dissemination, financial or tax incentives and investment insurance. Most HCMs operate unilaterally while others support initiatives stemming from bilateral, regional or multilateral agreements.

When formulated unilaterally by home country Governments, the principal focus of HCMs is a TNC's parent-affiliate link and how that relationship affects home country interests. Nevertheless, HCMs also acquire a development dimension from the nature of their actual or potential impact on FDI flows to developing countries. A first step to enhancing development benefits would be to enlarge the magnitude of FDI flows, removing impediments HCMs may impose that discourage FDI and augmenting promotional programmes that assist investors to identify and undertake projects in developing countries. Further benefits might be realized through a coordinated approach to the design, development and implementation of HCMs. Developed and developing countries could cooperate on how measures might best enhance FDI quality as well as quantity, including their impact on technology transfer. IIA negotiations might provide an opportunity to explore this type of cooperative relationship on HCMs as they relate to development objectives.

Section I
Explanation of the Issue

The relative novelty of discussing HCMs in the context of IIAs requires some basic definition and identification of the types of measures that comprise this topic. Although national laws and policies are not covered, the increasing integration of national economies with global commerce expands the range of HCMs that influence FDI decisions, including potential investment flows to developing countries.

A. HCMs with impacts on FDI in developing host countries

This chapter focuses on the main groups of HCMs that directly promote FDI to developing host countries. Before examining these measures, however, two issues should be noted that will not be centrally addressed by this analysis. The first relates to HCMs that govern whether, and under what circumstances, FDI may occur. National Governments may restrict capital outflows in their national interest, for example, to encourage domestic investment or respond to balance-of-payments concerns that might threaten national interests during times of foreign exchange shortfalls or other financial instability. However, most traditional home countries have engaged in a progressive liberalization of capital outflow restrictions, stimulated principally by the Organisation for Economic Co-operation and Development (OECD) Code of Liberalisation of Capital Movements, a binding agreement that covers outward and inward FDI. By the mid-1990s, OECD countries had removed most capital outflow restrictions, including those on capital outflow to developing countries. However, some restrictive measures remain for use in emergency situations, to prohibit FDI in certain countries and in regulatory regimes in newer capital-exporting countries not covered by the OECD agreements (UNCTAD, 1995a).

A second, somewhat related issue not extensively addressed in this chapter concerns how provisions in IIAs might deal with HCMs in a manner that recognizes the increasing number of TNCs now based in developing countries. Although HCMs are primarily associated with developed countries, the concept would also apply, at least in principle, to how IIAs address measures affecting capital exports from developing countries.[1] General principles in IIAs that might seek to proscribe HCM restrictions on FDI may require qualifications to reflect the particular needs of developing countries, for example, by permitting a gradual liberalization schedule comparable to the experience with the OECD' s Liberalisation Code (*ibid.*). Similar issues may arise in drafting IIA provisions on other HCMs, where broad principles derived from historical experience in developed countries may entail differential application to developing country capital exporters.

B. Identification of major types of HCMs

Although no standardized classification of HCMs exists, six broad categories encompass the major types of HCMs that are used to promote or otherwise influence FDI flows:

- **Policy positions** that encourage FDI to developing countries are typically positive in tone but vague in specific commitments. Many home countries face competing policy objectives where support for national TNCs may conflict for example with domestic labour interests, and the concept of official neutrality on FDI flows contrasts with proclaimed support for increased FDI flows to assist developing countries. These competing or conflicting interests can lead home countries towards generalized statements on intentions or goals that maintain maximum flexibility on follow-up implementation, if any. In general, such policy pronouncements are hortatory and set forth positions that would benefit the home country as well as host developing countries. Nevertheless, these statements could be linked to more substantive policy or programmatic commitments to development assistance, including actions involving other types of HCMs.
- **Information provision and technical assistance** can help overcome market imperfections that sometimes disadvantage developing countries. Promoting FDI to many developing countries must begin with fundamental steps to gather, publish and disseminate basic information regarding the countries' legal frameworks, macroeconomic circumstances, sectoral conditions and other factors that form the broad political and socio-economic context within which foreign enterprises will look to invest. Developed

countries can help collect and disseminate information on the investment climate and potential opportunities in developing countries, facilitating business contacts or even sponsoring "matching" programmes, particularly for small and medium-sized enterprises (SMEs). Although sometimes especially appropriate for a developing country's situation, these firms generally lack the global breadth, background and resources to conduct a wide search of unconventional FDI sites. Promotional HCMs may also offer technical assistance to developing countries that seek to enhance their investment climate, including support for regulatory reforms to improve transparency and administrative efficiency in areas of major concern to investors.

- **Technology transfer** can be facilitated by HCMs that encourage particular types of FDI or enhance host country conditions conducive to technology-related FDI. Some programmes tailor their support for FDI projects to encourage increased technology transfer or prioritize grants of assistance to promote specific technology-transfer objectives (for example, relating to environmental protection goals). Technology transfer can also be fostered by technical assistance that strengthens the receptive capacity of developing countries for FDI, in particular for technology-intensive sectors.
- **Financial and fiscal incentives** comprise a diverse array of HCMs that seek to promote FDI to developing countries. Development assistance institutions in some countries offer national enterprises direct financial support in the form of grants, loans or even equity participation for investment projects in eligible developing countries. Special support might be offered for FDI in designated industries, such as infrastructure projects, or for ventures undertaken by SMEs or with local business partners. Fiscal incentives (or disincentives) arise from HCMs relating to taxation, especially in the granting of tax exemptions, deferrals or credits for taxation of foreign source income, as well as general tax sparing provisions. Transfer pricing standards, monitoring, enforcement and information-sharing arrangements can also affect FDI prospects.
- **Investment insurance** represents a narrower but extensive, traditional category of HCMs aimed at promoting FDI. Most national and some regional or multilateral programmes offer coverage of political and other non-commercial risk not normally included under conventional, private insurance policies. These financial guarantee programmes promote FDI because the protected risk is generally higher in developing countries. Although the principal purpose of such HCMs is to protect their own national investors, the resulting off-set of risk helps encourage FDI. Some investment insurance agencies provide associated promotional support specifically designed to encourage investment in development-oriented projects.
- **Market access regulations** encompass trade-related measures dealing with matters such as product certification, country-of-origin definitions or preferential import regimes. These regulations can influence the comparative profitability of FDI in various developing countries, thereby affecting prospective investment decisions, particularly for export-related facilities. HCMs that inhibit domestic market access for exports from overseas facilities, or conversely grant favoured treatment to imports from selected countries, help shape the distribution pattern of global FDI flows. These regulations comprise one cluster of IRTMs that affect TNC production strategies.

Although not a separate category of HCMs, **extraterritorial controls** constitute a related issue that cuts across the preceding categories. This particular method of implementing HCMs merits separate consideration because of its unusual and often controversial use. Applying national laws or regulations outside a home country's borders to TNC operations occurring within another sovereign political jurisdiction constitutes an extraterritorial extension of HCMs. Extraterritorial controls can include HCMs already discussed, such as taxation of foreign source income, as well as HCMs not previously identified, such as competition policy or trade controls. More broadly, the concept might also be used to extend HCMs in other areas, such as labour relations, the environment or corporate social responsibility standards. From the perspective of private foreign investors, potential conflicts over national jurisdictions can act as disincentives to investment because TNCs do not want to be caught in the middle between home and host country laws, where they are subject to the authority and

potential sanctions of two (or more) sovereign Governments whose interests may conflict.

Section II
Stocktaking and Analysis

A. Policy positions to encourage FDI to developing countries

Policy positions to encourage FDI in developing countries are generally found as part of a development assistance programme. Although potential FDI recipients may offer suggestions regarding how such policies might aid their development, home countries generally control the formulation of programme goals and implementation procedures. Many initiatives are, therefore, weighted towards the type of FDI policy that promotes the home country's TNCs and, more specifically, the realization of export growth and employment benefits within the home country's own borders (boxes 1 and 2). (In parallel fashion, such initiatives may restrict FDI promotion to developing countries for projects that threaten adverse impacts on home country employment or other interests.)[2] Most policy position statements contained in IIAs are general, hortatory calls for FDI promotion that neither substantively obligate nor constrain home country actions. Nevertheless, some IIAs, particularly regional instruments involving multiple developing country participants, incorporate specific policy positions regarding FDI promotion activities, providing a possible basis for assessing follow-up implementation activities.

When IIAs lack specific development assistance commitments, their policy position statements usually address the promotion of FDI, if at all, in only the most broad and general terms. The Pacific Basin Charter on International Investments,[3] under the heading "Basic Principles", suggests only that "Governments – especially those of economies in a creditor or favorable foreign exchange position – should stimulate and encourage the flow of private investments abroad". The Asia-Pacific Economic Cooperation (APEC) Non-Binding Investment Principles address HCMs indirectly in terms of removing restrictions rather than actively promoting FDI. Under the heading "Removal of Barriers to Capital Exports", "Member economies accept that regulatory and institutional barriers to the outflow of investment will be minimised". Similar general policy positions regarding FDI promotion to developing countries are found in most BITs whose provisions usually contain only hortatory calls for home countries to promote outward FDI flows. These policy positions stand in stark contrast to BIT provisions that contain more specific, binding obligations regarding the treatment of inward FDI by host countries (UNCTAD,1998a, pp. 7, 50-51).

Box 1. Examples of promotional HCMs in the United Kingdom

"The Commonwealth Development Corporation (CDC) is the UK Government's main instrument for directly mobilising private investment in developing countries. It is a public/private partnership with the UK government holding a substantial minority shareholding and a "golden share". It has existed since 1948 and now has an investment portfolio in excess of $1.5 billion with around 80% in countries with a GNP per capita of less than $1,600. The CDC invests ethically in projects in developing countries with the objective of "maximising the creation and long term growth of viable businesses in developing countries". As well as the developmental impact of its investments, the CDC also has a strong demonstrative effect by showing that private investors can achieve returns from investing in poorer countries. The CDC investment strategy includes conditions to promote development, such as 70 % of all investment must be for the immediate or prospective benefit of poorer countries".

The country's "new Infrastructure Financing Facility for Africa was launched in September 2000. To date there has been very little long-term private investment in infrastructure in sub-Saharan Africa with foreign investors regarding it as too risky and local markets lacking the ability to provide long term investment. The Facility will offer to reduce the risk to investors and therefore aims to attract private investment in sectors such as electricity, gas pipelines, telecommunications, transport and water and sanitation"….

The Overseas Investment Insurance Scheme "provides insurance for UK investors against the main political risks of expropriation, war, restrictions on remittances and breach of government undertakings. The scheme covers equity investments in, and loans advanced to, overseas enterprises. Loans need not be tied to the export of goods/services from the UK or a third country, and they are not dependent on the country in question having a bilateral investment treaty with the UK. A recent example of support was for an $80 million investment in Mozambique. The support, in the form of a loan from a syndicate of banks, will help to finance the purchase of South African goods for a giant aluminum smelter plant under construction near the capital, Maputo."

Source: United Kingdom, 2000, pp. 3 and 4.

Box 2. Examples of Swiss HCMs promoting FDI and technology transfer

Services of the Swiss Organisation for Facilitating Investments

- Information
- General investment related advisory services
- Partner search (matchmaking)
- Business planning assistance
- Financial structuring of investment projects
- Search for funds

Funding facility for pre-investment studies

Purpose: facilitate investment of Swiss SMEs in developing countries by sharing the financial risk during the preparation/test phase through partial funding of the pre-investment studies/pilot projects.

Offer:(1) Credit up to 1 million Swiss francs;
(2) Interest rate: 3 year-SEBR plus 3 per cent;
(3) No collateral required;
(4) Credit can not be converted into a grant if study/pilot phase shows that the project is attractive to invest further

Swiss Development Finance Corporation

Purpose: Swiss Development Finance Corporation is an equity investment company initiated by the State Secretariat for Economic Affairs and operated by Swiss Emerging Market Partners in Zurich. Its purpose is to provide financial support to investment projects in countries with economies under development or in transition. It is owned 49 per cent by the Swiss Confederation and 51 per cent by private Swiss companies.

Offer:(1) Subordinated (mezzanine) debt with warrants;
(2) Direct equity investments;
(3) Short term senior bridge financing up to 6 months to strengthen the capacity of clients to borrow senior debt.

Source: SOFI, 2000.

One of the more specific BIT policy position statements of a home country commitment to promoting FDI to a developing country is reflected in the BIT signed in 1980 between the Belgium-Luxembourg Economic Union and Cameroon. Article 2 (3) states: "Aware of the importance of investments in the promotion of its policy of cooperation for development, the Belgium-Luxembourg Economic Union shall strive to adopt measures capable of spurring its commercial operations to join in the development effort of the United Republic of Cameroon in accordance with its priorities" (UNCTAD, 1998a, p. 52). An even more substantive approach to structuring BIT policy provisions on FDI is outlined in the Caribbean Community (CARICOM) Guidelines for Use in the Negotiation of Bilateral Treaties which calls for more assured home country promotion of FDI. Under the heading "Type of Agreement Desired", the Guidelines suggest that:

"The preamble of the BIT should include:

(i) a provision which reflects the objective of increasing capital flows from the USA to the CARICOM States to build up their productive base and hence enhance their economic and social development;

(ii) a provision which reflects the undertaking of the USA to establish incentives and institutional arrangements to encourage the flow of investments from the USA to CARICOM States."

Although no negotiated BITs between the United States and CARICOM States incorporate these Guidelines provisions, the United States did unilaterally endorse a policy position linking FDI encouragement to development objectives in the "African Growth and Opportunity Act " passed in 2000. That legislation approved provisions offering enhanced trade preferences to countries in sub-Saharan Africa in the belief that such steps "will encourage both higher levels of trade and direct investment in support of the positive economic and political developments under way throughout the region" (United States, Congress, 2000, Section 102(9)). Some policy positions adopted in regional development agreements also provide a basis for more concrete follow-up actions on FDI promotion. The Fourth Convention between the African, Caribbean and Pacific countries (ACP) and the European Economic Community (EEC) (Lomé IV) sets forth "Principles governing the instruments of cooperation", including article 23 which promotes "helping the ACP States to gain access to the capital markets and encouraging direct private European investment to contribute towards the development of the ACP States ". Some specific promotional activities to implement this policy position are examined in subsequent parts of this section.

Even more specific policy statements regarding home country commitments to promote FDI are found in regional agreements among developing countries. These IIAs offer a greater symmetry between home country responsibilities to promote outward FDI as well as host country obligations regarding FDI treatment. (This

symmetry between promotion and treatment seldom occurs when regional agreements are negotiated between developed countries at substantially similar levels of economic development.) For example, the revised draft Model Agreements for Promotion and Protection of Investments developed by the Asian-African Legal Consultative Committee sought to encourage FDI among developing countries in the region. Article 2(i) states that: "Each Contracting Party shall take steps to promote investments in the territory of the other Contracting Party and encourage its nationals, companies and State entities to make such investments through offer of appropriate incentives, wherever possible, which may include such modalities as tax concessions and investment guarantees".

The policy positions adopted in some regional agreements among developing countries explicitly call for preferential promotion of FDI. The Treaty Establishing the Caribbean Community differentiates between the more and less developed countries among its membership, establishing in chapter VII, article 59(1), a special regime for financial assistance "with a view to promoting the flow of investment capital to the Less Developed Countries". The Agreement on Investment and Free Movement of Arab Capital Among Arab Countries endorses a policy in article 1(a) that: "Every Arab state exporting capital shall exert efforts to promote preferential investments in the other Arab states and provide whatever services and facilities required in this respect". A follow-up mechanism to this commitment was the Convention Establishing the Inter-Arab Investment Guarantee Corporation to provide investment insurance as well as other promotional activities designed to stimulate FDI.

The Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) contains policy position statements that provide a basis for follow-up programmatic actions. The preamble of this instrument states clearly that it is adopted "to enhance the flow to developing countries of capital and technology for productive purposes under conditions consistent with their development needs, policies and objectives, on the basis of fair and stable standards for the treatment of foreign investment". To promote these objectives, in addition to establishing an investment insurance programme, the MIGA Convention also provides in article 23 for "Investment Promotion" activities involving research, information dissemination and technical assistance. These activities shall under article 23(a)(ii) "seek to remove impediments, *in both developed and developing member countries* , to the flow of investment to developing member countries "(emphasis added).

Policy references to HCMs may also occur in IIAs in relation to specific sets of policy issues. For example, relevant policies in the area of restrictive business practices are addressed in the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices. Among the principles advanced to meet the Set ' s objectives is the "preferential or differential treatment for developing countries ", which under paragraph 7 states that "particularly developed countries, should take into account in their control of restrictive business practices the development, financial and trade needs of developing countries, in particular of the least developed countries". This provision should encourage developed countries to consider possible investment or technology transfer impacts on developing countries, rather than only the effects on their own domestic economies, when contemplating whether, or how, to take action against anti-competitive TNC behaviour.

The General Agreement on Trade in Services (GATS) incorporates a more general policy position which, if implemented, could both promote service-related FDI to developing countries while reducing HCMs that may restrict the access of developing country service providers to developed country markets. Article IV specifically states:

"The increasing participation of developing country Members in world trade shall be facilitated through negotiated specific commitments, by different Members pursuant to Parts III and IV of this Agreement, relating to:

(a) the strengthening of their domestic services capacity and its efficiency and competitiveness, *inter alia* through access to technology on a commercial basis;
(b) the improvement of their access to distribution channels and information networks; and
(c) the liberalization of market access in sectors and modes of supply of export interest to them."

This policy provision could lead to home country activities to promote service-related FDI into developing countries to strengthen their capacity as well as alter HCMs that may restrict the access of developing country service providers to developed country markets. On the other hand, a

narrower interpretation could view such a response as going beyond actions envisaged by the GATS provisions, because its specific commitments do not directly address FDI-related aspects of trade in services. Although the "shall" wording of the provision indicates a level of commitment beyond hortatory formulations, practical implementation has fallen short of developing country expectations (Shahin,1999).

One example of possible follow-up to the GATS policy language emerged in the Cotonou Agreement signed by the ACP countries and the European Union, on 23 June 2000, following the expiration of Lomé IV. In a chapter on "Trade in Services", the provisions of Article 41 acknowledge both the requirement for addressing developing country interests in liberalization agreements and "the need for special and differential treatment for ACP suppliers of services". While noting the application of most favoured nation treatment under the GATS, the article stated the European Union's intention to "give sympathetic consideration to the ACP States' priorities for improvement in the EC schedule, with a view to meeting their specific interests". In this context, the article specified particular areas in which:

> "The Community shall support the ACP States efforts to strengthen their capacity in the supply of services. Particular attention shall be paid to services related to labour, business, distribution finance tourism, culture and construction and related engineering services with a view to enhancing their competitiveness and thereby increasing the value and the volume of their trade in goods and services " (Cotonou Agreement, 2000, p. 31).

This more specific list of sectoral objectives provides more specific goals than the GATS provisions against which to evaluate actual implementation steps.

Thus, statements of policy positions related to HCMs are found in documents that range across the spectrum from unilateral declarations to international agreements. The vast majority of these statements, however, are confined to hortatory declarations that impose few specific obligations on home countries, or leave implementation steps to be negotiated or developed later. Approaches involving collaborative discussions among countries in a region, or in an international institution, may bolster the ability of developing countries to attain commitments regarding HCMs that reflect more appropriate developmental benefits than unilaterally-designed actions, or even BIT provisions in which the influence of single developing host countries may be more constricted. Nevertheless, practical outcomes will be magnified if a document's general statement of policy principles is followed by provisions containing a more detailed list of items or specific implementation process that will translate policy into practice.

B. Information provision and technical assistance

Programmes to gather and disseminate information on FDI opportunities in developing countries and to provide technical assistance to facilitate such investments comprise an important category of HCMs that can promote FDI. These initiatives help overcome market imperfections or structural deficiencies that often work to the disadvantage of developing countries, especially when an economy's relatively small size, geographic distance or limited prior experience withforeign investors serve to exclude it from customary listsof prospective FDI sites.

Investment climate information constitutes an essential element of an FDI decision-making process. Although prospective host countries can and do compile many of the necessary data, their efforts could be aided, particularly in the information-dissemination stage, by home country Governments and relevant international institutions. For example, the Convention establishing MIGA specifies in article 23 on Investment Promotion that the Agency undertake research, information dissemination and technical assistance activities to promote FDI in developing countries as an appropriate complement to the institution's investment insurance function. MIGA seeks to coordinate these activities with agencies that perform a similar promotional role, including the International Finance Corporation.

When developing countries negotiate agreements among themselves, their mutual interest in an exchange of investment climate information is sometimes reflected in provisions calling for the "Promotion of Investment and Exchange of Information". For example, article 17-14 of the Treaty on Free Trade between the Republic of Colombia, the Republic of Venezuela and the United Mexican States provides: "With a view to increasing reciprocal investments, the Parties shall design and implement mechanisms for the dissemination, promotion, and exchange of

information relating to investment opportunities". The Asia Investment Facility, a part of the Asia-Invest Programme of the European Union, was "designed to identify, evaluate and promote focused investment opportunities ". Among its various activities, this facility will conduct:

> "*Research, by country and by industrial* sector, into investment opportunities for European Union companies in Asia (principally in the less developed countries), and the subsequent dissemination of information through workshops and publications. In particular, individual Asian countries will be targeted and an assessment will be made of investment opportunities in specific industries, the legislative framework, financing opportunities and specific major projects" (UNCTAD and EC, 1996, p. 68).

Although the facility will also disseminate information in Asia on investment opportunities in European Union countries, this function would not require the same research and information preparation for developed countries on which data is already easily available.

Since 1996, the Asia Europe Meeting (ASEM) brings together the 15 member States of the EU, the European Commission and 10 Asian partners. ASEM economic ministers endorsed in 1999 a list of "Most Effective Measures to Attract Direct Foreign Investment" as a non-binding benchmark – they relate to investment policy measures that impact directly on the investment climate. Partners report annually on the implementation of these measures. In order to foster transparency of investment regimes, ASEM also set up the "Virtual Information Exchange" website giving access to ASEM partners' national investment websites that contain regulatory and promotional information. The listed national contact points allow direct communication with national authorities (Asia-Invest Secretariat, 2001).

The Cotonou Agreement includes a commitment in article 75 on "Investment promotion" to "disseminate information on investment opportunities and business operating conditions in the ACP States" (Cotonou Agreement, 2000, p. 49). In an annex on "Institutional Support", assistance is also pledged to strengthen efforts by the Centre for the Development of Enterprise to promote private sector development activities, including its initiatives to "provide information to European companies and private sector organisations on business opportunities and modalities in ACP countries" (*ibid*., Annex, III, p. 25). The Agreement also calls for periodically analysing and providing the business community with information on broad issues affecting ACP-European Union economic relationships as well as specific sectoral problems relating to the production or products at the regional or sub-regional level.

The Framework Agreement on the Association of Southeast Asian Nations (ASEAN) Investment Area includes a commitment in article 6 that member countries undertake a joint Promotion and Awareness Programme to encourage FDI flows. This approach emphasizes the shared nature of the endeavour, with home and host country agencies cooperating in joint FDI promotion activities, including seminars, workshops and training programmes. Investment promotion agencies in member countries are called upon to hold regular consultations on FDI promotion and exchange lists of industries in which good investment opportunities exist (see chapter 2).

Business contacts and facilitation functions are closely related to the dissemination of investment climate information. Seminars, workshops and investment missions all provide valuable occasions for personal exchanges when prospective investors can meet and speak with Government officials and potential local business partners in developing countries. The active participation of home countries plays an especially valuable role in linking prospective investors with opportunities in developing host countries. The European Union's Asia-Invest Programme embraces an unusually broad array of mechanisms for this purpose, including:

- The Asia-Invest Antennae: promotion points hosted by private sector groups in European Union countries that disseminate information to business organizations and enterprises;
- The Asia-Invest Membership Scheme: a distribution channel for newsletter and bulletins;
- The Asia-Invest Info route: information exchange and databases access service;
- The Annual Asia-Invest Conference: sessions to discuss recent country developments, obtain feedback and suggestions and provide opportunities for business people to meet (UNCTAD and EC, 1996, pp. 68-69).

The European Union engaged in similar promotional activities with the ACP countries

within the framework of the Lomé IV Convention. Among the actions specified in article 259 were:

“a) support efforts aimed at promoting European private investment in the ACP States by organizing discussions between any interested ACP State and potential investors on the legal and financial framework that ACP States might offer to investors;

b) encourage the flow of information in investment opportunities by organizing investment promotion meetings, providing periodic information on existing financial or other specialized institutions, their facilities and conditions and encouraging the establishment of focal points for such meetings.”

The new Cotonou Agreement reaffirms the usefulness of business facilitation measures. The document pledges under article 75 to “encourage the EU private sector to invest and to provide specific assistance to its counterparts in the ACP countries under mutual business cooperation and partnerships”. Included among the Agreement’s list of investment promotion measures are plans to “sponsor sectoral investment fora to promote partnerships and external investment” and to “promote national, regional and ACP-EU private sector business dialogue, cooperation and partnerships, in particular through an ACP-EU private sector business forum... to facilitate dialogue within the ACP/EU private sector and between the ACP/EU private sector and the bodies established under the Agreement” (Cotonou Agreement, 2000, p. 49). The Agreement’s support for the Centre for the Development of Enterprise calls for the Centre to “provide assistance for investment promotion activities, such as investment promotion organisations, organisation of investment conferences, training programmes, strategy workshops and follow-up investment promotion missions” (*ibid*., Annex III, p. 24).

The Tokyo International Conferences on African Development, held in 1993 and 1998, also spurred new efforts aimed at information dissemination and business contact facilitation. The Africa-Asia Business Forum and the Africa-Asia Investment Information Center, organized in 1999, promotes the matching of Asian FDI with African investment opportunities. For example, working in conjunction with UNCTAD to promote business networking, a meeting in March 1999 facilitated over 120 one-on-one discussions that resulted in 16 business agreements between Asian and African firms (UNCTAD, 1999a, p. 33).

Technical assistance to promote FDI in developing countries covers a wide range of applications, including assistance to host Governments to improve regulatory regimes and enhance institutional capabilities to attract, receive and utilize FDI. Technical assistance may also be provided to investing enterprises, particularly SMEs, as well as to local joint venture partners. To develop and strengthen SMEs, the Agreement Establishing an Association between the European Communities and their Member States, of the One Part, and the Republic of Estonia, of the Other Part, under article 74 (2), commits the Governments to “encourage the exchange of information and know-how” by improving legal, administrative, technical, tax and financial conditions for SMEs and cross-border cooperation while providing specialized services such as management training, accounting, marketing and quality control. Similar commitments appear in article 75 (2) (3) of the European Union’s Association Agreement with Latvia, which incorporates additional provisions dealing with links via European business cooperation networks and a commitment to supply technical assistance, especially for institutional back-up for SMEs, “regarding financial, training, advisory, technological and marketing services”.

Article 74 in the chapter on “Investment and Private Sector Development Support” of the Cotonou Agreement specifies that “Cooperation shall, through financial and technical assistance, support the policies and strategies for investment and private sector development as set out in this Agreement”. The “Investment Promotion” article (Cotonou Agreement, 2000, p. 49) calls specifically to “support capacity building for domestic investment promotion agencies and institutions involved in promoting and facilitating foreign investment”. Provisions in Title III on “Technical Cooperation” call for technical cooperation that will “favour the transfer of know-how and increase national and regional capabilities”. Assistance should strengthen ACP consulting firms and organizations, encourage exchange arrangements involving both ACP and European Union consultants and “support intra-ACP technical assistance in order to promote the exchange between the ACP States of technical assistance, management and professional expertise” (*ibid*., 2000, p. 51).

In article 21 on “Investment and private sector development”, the Cotonou Agreement calls

for cooperation to "promote business development through the provision of finance, guarantee facilities and technical support". Among other objectives, this assistance contemplates "encouraging inter-firm linkages, networks and cooperation including those involving the transfer of technology and know-how at national, regional and ACP-EU levels, and partnerships with private foreign investors". Similarly, article 23 on "Economic sector development" pledges cooperation to support policy and institution reforms and investments to provide access to the "development of scientific, technological and research infrastructure and services; including the enhancement, transfer and absorption of new technologies " (*ibid*., p. 21).

C. Technology transfer

Technology transfer represents a conceptual step beyond the sharing of know-how entailed in most technical assistance programmes, implying a more substantial application to business operations. Measures to transfer technology may still be aimed initially at developing or strengthening a host Government's receptive capabilities to attract and utilize newer commercial technologies, including through regulatory reforms that establish the framework for transferring competitive privately-held technology. The impact of HCMs on the transfer of technology ranges from prohibition to promotion. Some HCMs restrict technology transfer for national security or economic competitiveness reasons. On the other hand, HCMs can also promote the transfer of technology to developing countries in a manner that advances developmental objectives.

One of the most extensive treatments of this subject comes in the draft International Code of Conduct on the Transfer of Technology. Among its principles, this document asserts that "States should co-operate in the international transfer of technology in order to promote economic growth throughout the world, especially that of the developing countries... It is understood that special treatment in transfer of technology should be accorded to developing countries". Chapter 6 of the draft Code then elaborates on "Special treatment for developing countries", addressing specifically three areas in which Governments of developed countries should take action. With the objective of promoting transfer of technology, developed country Governments should:

> "6.1 ...facilitate and encourage the initiation and strengthening of the scientific and technological capabilities of developing countries;
> 6.2 ...assisting in the promotion of transfer of technology to developing countries B particularly to the least developed countries B . . . as a part of programmes for development assistance and co-operation; and
> 6.3 ...take measures in accordance with national policies, laws and regulations to encourage and to endeavour to give incentive to enterprises and institutions in their countries, either individually or in collaboration with enterprises and institutions in developing counties, particularly those in the least developed countries."

The 20 specific measures called for under these three categories incorporate a range of programmatic support actions, including:

- "facilitate access by developing countries to available information regarding the availabilities, description, location and, as far as possible, approximate cost of technologies...;
- facilitating access, as far as possible, to available scientific and industrial research data;
- co-operate in the development of scientific and technological resources in developing countries, including the creation and growth of innovative capacities;
- co-operate in the establishment or strengthening of technology transfer centres;
- provide training for research, engineering, design and other personnel from developing countries engaged in the development of national technologies or in the adaptation and use of technologies transferred;
- provide assistance and co-operation in the development and administration of laws and regulations with a view to facilitating the transfer of technology;
- grant credits on terms more favourable than the usual commercial terms for financing the acquisition of capital and intermediate goods in the context of approved development projects involving transfer of technology transaction.
- assist in the development of technological capabilities of the enterprises in developing countries, including special training as required by the recipients."

Results from the Uruguay Round negotiations include an example of how international agreements can be linked to these types of HCMs in ways that facilitate technology transfer through FDI-related mechanisms. The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) recognizes in article 66(1) "the special needs and requirements of least-developed country Members". Relevant provisions include a statement in Article 66(2) that "Developed country Members shall provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least-developed country Members in order to enable them to create a sound and viable technological base"**.** Subsequently, Article 67 of the Agreement continues: "In order to facilitate the implementation of this Agreement, developed country Members shall provide, on request and on mutually agreed terms and conditions, technical and financial cooperation in favour of developing and least-developed country Members".

The European Union provides technical support in both China and the ASEAN region to improve intellectual property protection under the TRIPS Agreement, both to advance the interests of its investing firms and to promote technology transfer to developing countries. A similar motivation underlies the European Union's technical support to developing countries in following up the Uruguay Round Agreement on Technical Barriers to Trade. The European Union offers technical assistance to improve testing and certification capabilities in developing countries, espousing a belief that effective implementation of this agreement's standards should "increase the willingness of firms to engage in FDI" (UNCTAD and EC, 1996, p. 66).

The Energy Charter Treaty approaches the issue of HCMs and technology transfer without a special concern for developmental objectives. Under article 8, "the Contracting Parties agree to promote access to and transfer of energy technology on a commercial and non-discriminatory basis"; accordingly, the signatory countries "shall eliminate existing and create no new obstacles to the transfer of technology in the field of Energy Materials and Products and related equipment and services, subject to non-proliferation and other International Obligations". Article IV of the GATS focuses on "Increasing Participation of Developing Countries". The provision under paragraph 1(a)(b) calls for "the strengthening of their domestic services capacity and its efficiency and competitiveness" and "improvement of their access to distribution channels and information networks, with special priority given to the least-developed countries". Follow-up implementation of this provision is left vague, however, calling only for unspecified technical assistance at the multilateral level, provided by the secretariat, without reference to any promotional HCMs on the part of the developed countries. The United Nations Framework Convention on Climate Change and its Kyoto Protocol also has special provisions for financial assistance and technology transfer, particularly through the Global Environment Facility created under the Convention's article 4.3, to enable developing countries to meet their commitments (see chapters 2 and 16).

One of the most favourable provisions for the promotion of technology transfer to developing countries arises in the Lomé IV Convention. Article 85 states:

> "With a view to assisting the ACP States to develop their technological base and indigenous capacity for scientific and technological development and facilitating the acquisition, transfer and adaptation of technology on terms that will seek to bring about the greatest possible benefits and minimize costs, the Community, through the instruments of development finance co-operation, is prepared, inter alia, to contribute to: (a) the establishment and strengthening of industry-related scientific and technical infrastructure in the ACP States; . . . (e) the identification, evaluation and acquisition of industrial technology including the negotiation on favourable terms and conditions of foreign technology, patents and other industrial property, in particular through financing or through other suitable arrangements with firms and institutions within the Community. "

The Cotonou Agreement reaffirmed the importance of technology transfer objectives, calling for cooperation in the "development of scientific, technological and research infrastructure and services; including the enhancement, transfer and absorption of new technologies". Promotion of business development will include "encouraging inter-firm linkages, networks and cooperation including those involving the transfer of technology and know-how at national, regional and ACP-EU levels, and partnerships with private foreign investors" (Cotonou Agreement, 2000, pp.

20-21). In its work, the Centre for the Development of Enterprise is also charged with providing "support for initiatives that contribute to develop and transfer technologies and know-how and best practices on all aspects of business management" (*ibid*., Annex III, p. 24).

D. Financial and fiscal incentives

Financial incentives for outward FDI exist in various national programmes, where their formulation and operation suggest how such HCMs might be addressed in IIAs to support investment in developing countries. For example, Germany sponsors programmes that provide financial assistance for FDI in developing countries through both equity capital participation in FDI projects, through the German Finance Company for Investment in Developing Countries, and loans for German investors, from the Kreditanstalt für Wiederaufbau (UNCTAD and EC, 1996, p. 55). The Export-Import Bank of Japan employs an unusually broad array of financial incentives for FDI. In addition to making loans directly to Japanese enterprises for FDI or for operating overseas projects, the Bank can also provide loans to foreign Governments or banks to fund equity investments and loansto joint ventures with Japanese enterprises (UNCTAD, 1995, p. 317). Other Japanese programmes (the ASEAN Investment Co., the ASEAN Finance Corporation and the ASEAN Japan Development Co.) focus on regional FDI promotion, particularly for developing countries in Asia (UNCTAD and EC, 1996, p 55). Japan has financed the construction of an export processing zone in Nakhodka, eastern Russia, for use by Japanese TNCs, providing assistance that links aid, trade and FDI.

As far back as its 1972 document containing the "Guidelines for International Investment", the International Chamber of Commerce (ICC) offered support for these types of financial HCMs. In proposals directed to "The Investor' s Country's Government", the ICC endorsed special aid for economic and social infrastructure projects in developing countries that will facilitate private investment significant to the host country's economic development and foreign aid to support institutions providing managerial training that would foster more local participation in enterprises established in developing countries.

An example of a multi-variate approach is the European Community Investment Partners Scheme whose "objective is to encourage FDI by small and medium-sized European Union firms in countries throughout Asia, Latin America, the Mediterranean and South Africa" (UNCTAD and EC,1996, pp. 70). Operating from 1988 to 1999, this programme included large enterprises "if their projects are particularly interesting for the development of the host country". The programme used financial institutions and investment-promotion bodies in participating countries to support five facilities:

"1. identification of potential partners, similar to the pre-competitive actions under the Asia-Invest programme;
2. feasibility-study loans;
3. capital investment in companies or share-secured loans;
4. management assistance and training loans;
5. grants for privatization" (ibid.).

The privatization grants of this programme could also be used to support "build-operate-transfer, or build-operate-own, schemes in private infrastructure, utilities or environmental services".

Asia-Invest is another European Union programme that provides a range of financing initiatives, including the Business Priming Fund to assist SMEs with market entry and business cooperation (Asia-Invest Secretariat, 2001).

The Lomé IV Convention also provided for financial support mechanisms through the European Investment Bank and/or the Commission of the European Community. As outlined in Section 4, "Investment Support", this assistance was designed particularly to encourage SMEs and joint ventures, offering direct loans and other financing, including equity participation. Among other purposes, the programme offered often-critical support for the early stages of a prospective investment project and could, through article 268(9), "finance specific studies, research or investment for the preparation and identification of projects; provide assistance, including training, management and investment-related services … and, where appropriate, contribute to the start-up costs, including investment guarantee and insurance premiums, necessary to ensure that the investment decision is taken ".

The scope of the European Investment Bank's operations was progressively extended several times to cover more developing countries and economies in transition. Bank funding often favours joint venture FDI; projects with significant technology transfer from the European Union; environmental improvements; and investments furthering regional integration. The Bank may

finance up to one-half of projects in infrastructure, manufacturing, agro-industry, mining, energy and tourism, with special emphasis given to projects bringing environmental improvements (UNCTAD and EC, 1996, p. 72). At the level of international institutions, the International Finance Corporation also provides loan financing and equity participation FDI in order to foster developmental objectives (see chapter 27).

The Cotonou Agreement continued the Lomé IV Convention's recognition of the role that financing measures play in translating policy positions into practical actions. Article 76 on "Investment finance and support" states: "Cooperation shall provide long-term financial resources, including risk capital, to assist in promoting growth in the private sector and help to mobilise domestic and foreign capital for this purpose". Particular activities singled out for financial implementation support include some types of the measures already discussed:

"a. grants for financial and technical assistance to support policy reforms, human resource development, institutional capacity-building or other forms of institutional support related to a specific investment. ..; investment facilitation and promotion. . .;

b. advisory and consultative services to assist in creating a responsive investment climate and information base to guide and encourage the flow of capital" (Cotonou Agreement, 2000, pp. 49-50).

In addition, the Agreement provides for "risk-capital for equity or quasi-equity investments, guarantees in support of domestic and foreign private investment and loans or lines of credit", as well as "loans from the Bank's own resources" (*ibid*., p. 50). The Investment Facility is authorized to use its resources for "guarantees and other credit enhancements which may be used to cover political and other investment-related risks, both for foreign and local investors or lenders". This support is also intended "to have a catalytic effect by encouraging the mobilisation of long-term local resources and attracting foreign private investors and lenders to projects in the ACP States" (*ibid*., Annex II, pp. 7-10). Funds to support these undertakings are committed in the Agreement's Financial Protocol, pledging financial assistance over five years amounting to EURO 15,200 million (*ibid*., Annex I, p. 3).

Fiscal incentives revolve primarily around tax HCMs and the application of transfer pricing policies. Regional investment agreements among developing countries often contain provisions on tax incentives that guarantee tax-free asset transfers or provide reduced tax levels for qualifying preferred investors. In its formulation of a draft provision on the "promotion and encouragement of investments", the Asian-African Legal Consultative Committee suggested under article 2(1) the use of "appropriate incentives, wherever possible, which may include such modalities as tax concessions and investment guarantees ".

Tax provisions in home countries can also act as disincentives to FDI in developing countries. Home countries may use a residence basis to claim tax revenue from foreign source income, setting up the potential for double taxation of such income. Although the relevant HCM may grant credits for taxes paid abroad to relieve the double tax burden, the credit system may actually offset the impact of FDI incentives provided in many developing countries through lower tax rates, which would reduce the creditable tax burden. Essentially, the home country tax authority would appropriate the tax benefit granted the investor by the host country' s lowered tax rate, thereby nullifying the FDI incentive effect of such a development policy. This problem can be alleviated if the home country adopts a tax-sparing policy that grants the investor a tax credit for the amount of taxes that would have been paid the host country, absent the use of the tax incentive. Many developed countries, with the notable exception of the United States, have been willing to accept tax-sparing provisions in double taxation treaties signed with developing countries. This approach, in effect, grants the host country some influence over the effective application of tax HCMs in its treaty partner. The ICC essentially endorsed tax-sparing provisions in its 1972 Guidelines for International Investment, proposing under paragraph 2(e) of chapter IV that home country Governments "should refrain from frustrating the effects of development reliefs granted by host countries in respect of new investment by affording appropriate matching reliefs".

Similar difficulties can arise from the application of transfer pricing policies in tax HCMs. A home country's tax authority may re-allocate a TNC's pricing standards in ways that increase tax liability in the home country. The

OECD's Model Tax Convention, essentially taking the opposite tack represented by tax-sparing policies, recommends that the host country adjust downward the tax charged a TNC's foreign affiliate in order to avoid double taxation. Such a response, of course, would decrease the tax revenue obtained by a host country Government. When transfer pricing policies reflected in HCMs differ from the policies adopted in host developing countries, HCMs may thereby serve as a disincentive or obstacle to FDI flows to those developing countries.

E. Investment insurance

Investment insurance provided by agencies of home country Governments represents one of the earliest and most direct examples of how HCMs can promote FDI to developing countries. Of course, this insurance is also intended to benefit the home country's TNCs, protecting them against political and other risks that most private insurance companies will not cover. Such risk is generally higher in developing countries, so the practical effect of these HCMs is to support FDI in developing countries.

For example, the United States Overseas Private Investment Corporation (OPIC) extends coverage for United States FDI in developing countries that sign an Investment Incentive Agreement creating a framework for OPIC's activities. The model agreement affirms as its objective to "promote the development of the economic resources and productive capacities " of the developing country "through investment support. . .in the form of investment insurance and reinsurance, debt and equity investments and investment guarantees" (UNCTAD, 1998a, p. 297). In Lomé IV, under article 260, the contracting parties "affirm the importance of concluding between States, in their mutual interest, investment promotion and protection agreements which could also provide the basis for insurance and guarantee schemes". Article 2 of the Asian-African Legal Consultative Committee Revised Draft of Model Agreements for Promotion and Protection of Investments also cites investment guarantees as an appropriate FDI incentive that should be offered to investments in other contracting states.

The same type of investment insurance can be supported or provided through regional and international bodies. The Cotonou Agreement reaffirms the importance of investment protection and calls investment guarantees "an increasingly important tool for development finance". The Agreement states that "co-operation shall therefore ensure the increasing availability and use of risk insurance as a risk-mitigating mechanism in order to boost investor confidence in the ACP States". Support is to cover reinsurance schemes, partial guarantees for debt financing and national and regional guarantee funds. Launching a new initiative, the Agreement calls for the ACP-EU Development Finance Cooperation Committee to "undertake a joint study on the proposal to set up an ACP-EU Guarantee Agency to provide and manage investment guarantee programmes" (Cotonou Agreement, 2000, p. 50).

The Convention Establishing the Inter-Arab Investment Guarantee Corporation was approved in 1974. As stated in the preamble, signatory countries sought "to promote the flow of capital between their territories in order to finance their development efforts for the benefit of their peoples". Recognizing that Arab investors can play an important role in this development if reasonable security is assured, the Convention endeavoured "to provide such security against the non-commercial risks which may confront inter-Arab investment and which are difficult for the investor to avert". The Corporation was authorized to provide both direct insurance and reinsurance for inter-Arab FDI, providing reasonable compensation for losses caused by covered risks.

The most important instrument in this field is the Convention Establishing MIGA, approved in 1988. MIGA' s objective, under article 2, is "to encourage the flow of investments for productive purposes among member countries, and in particular to developing member countries". In its preamble, the Agency's operating premise is "that the flow of foreign investment to developing countries would be facilitated and further encouraged by alleviating concerns related to non-commercial risk". Therefore, MIGA works as a complement to national and regional FDI guarantee programmes as well as private insurers to issue guarantees, including coinsurance and reinsurance, against non-commercial risk (box 3).

Box 3. MIGA: operational highlights for fiscal year 1999

"For the first time in its history, MIGA issued more than $1 billion in guarantee (insurance) coverage in a single fiscal year. The $1.3 billion of coverage issued in 72 guarantee contracts during fiscal 1999, insures investment projects in 29 developing member countries... In total, MIGA has issued 420 guarantee contracts for $5.5 billion in issued coverage in 66 developing countries and transition economies. MIGA insurance has facilitated more than $30 billion in FDI in these countries".

The Agency also obtained approval in 1999 for an increase in its authorized capital resources. MIGA's capital base will be doubled in order to permit continued expansion of the Agency's services in encouraging the flow of FDI to developing countries and transition economies through its guarantee programme and investment marketing services. Among MIGA's many other activities during the year were: providing training for Tunisia's Foreign Investment Promotion Agency in preparation for an FDI promotion mission; assisting in organizing an Africa-Asia Business Forum for regional entrepreneurs to enhance trade and FDI cooperation; and providing advisors for China, Viet Nam and Thailand to improve FDI promotion capabilities and procedures.

Source: MIGA , 1999.

F. Market access regulations

Market access regulations embodied in HCMs pertain mainly to trade-related measures that can influence FDI decisions by affecting the export potential of actual or prospective FDI in developing countries. As components of a broader category of IRTMs, these HCMs may grant preferential market access to exports from specified countries, including particularly favoured developing countries. Such preferences create a trade-related incentive to locate FDI in favoured host countries compared to non-favoured host countries (including other developing countries) when a significant portion of the FDI project 's output is intended for export sale in the home country's market. Conversely, HCMs can also be used to restrict imports from foreign facilities, thereby discouraging potential FDI outflows that might otherwise seek comparative advantage production sites in developing countries where exports could competitively service the home country market.

Special import regimes (such as the Lomé Conventions' or the United States' Generalized System of Preferences programme) enhance the attractiveness of selected countries' investment climate by granting the favoured countries low or duty-free status for their exports. These HCMs can shape the pattern of FDI location decisions and thereby alter related trade flows, as occurred with cross-border *maquiladora* factories established to take advantage of sections 806/7 of the United States' tariff schedule which charge duty only on new value-added when goods, initially exported for final production or assembly, re-entered the United States market. TNCs have utilized such trade preference schemes to develop a variety of foreign production-sharing operations, lowering manufacturing costs by locating FDI in lower-wage developing countries that benefit from duty reductions on goods exported back to the United States.

For example, Mexico and Caribbean countries qualifying for preferential tariff reductions obtained most of a sharp outflow of FDI ($971 million to $1.3 billion) from United States' apparel firms from 1993-1997. During this period, the share of total apparel imports from Mexico and qualifying Caribbean countries rose from 16 per cent to 27 per cent while Asia's share declined. The investment pattern shifted again after Mexico's NAFTA benefits gave it a new trade advantage over FDI located in the Caribbean. The shift reportedly caused some 250 apparel plants to close in the Caribbean countries, with an accompanying loss of 123,000 jobs (ECLAC, 2000, pp. 180-184).

Rules-of-origin requirements are linked to trade preferences schemes for developing countries and can function in either a positive or negative fashion in terms of promoting beneficial FDI flows. When formulated in a positive manner, rules of origin can promote high quality FDI in favoured developing countries by restricting trade preferences to goods substantially produced in those countries. Unless rules of origin require a beneficial stage or level of value-added production in the developing country prior to export, corporations can be tempted to transship goods through a favoured export location rather than establishing significant new production facilities there. However, rules of origin that are too strict, or that specify particular stages of production in appropriate for a developing country's circumstances, can serve to restrict or nullify a trade preference system's potential advantages.

When defined in the context of a regional trade agreement, rules of origin can affect FDI location decisions by determining the relative trade

advantage granted to internal producers relative to production facilities located outside the trade area. For example, the North American Free Trade Agreement (NAFTA) rules of origin reportedly influenced United States TNCs to invest in new facilities in the home country market rather than lower-cost Asian investment sites and to shift production from Asia to Mexico. Similarly, a rules-of-origin definition that required locating the wafer fabrication stage of semiconductor manufacturer in the European Union, in order to avoid a 14 per cent tariff, reportedly increased such investment within the European Union, at the expense of less costly sites in Asia and the United States (see chapter 25).

No international consensus exists on substantive content standards for rules of origin, leaving each importing country to set its own regulations unilaterally or in bilateral or regional trade agreements. WTO discussions have included a longer-term objective of developing harmonized rules of origin for member countries. Progress thus far is limited to an agreement only on general principles that individual countries should adopt rules-of-origin measures that are transparent; do not restrict, distort or disrupt international trade; are administered in a consistent, uniform, impartial and reasonable manner; and are based on a positive standard (stating what confers origin rather than what does not) (WTO, 1998). No direct consideration is given to the potential impact rules of origin may have on FDI.

Anti-dumping regulations constitute another HCM that can influence FDI by inhibiting competitive home market access for exports from a TNC's existing or prospective foreign facilities. Increased anti-dumping investigations and prosecutions over the past two decades have heightened business concern that a prospective FDI project in a developing country might run afoul of such regulations, threatening import penalties on intended export sales back to the home country market. This increased risk and uncertainty may cause TNCs to forgo otherwise beneficial and cost-effective FDI projects.

The restrictive impact of anti-dumping procedures may especially disadvantage FDI prospects for economies in transition. No consensus exists on the complicated procedures used by various countries to determine appropriate pricing strategies for imported products and, hence, whether unfair dumping is occurring. In countries with formerly centrally planned economies, a presumption that free market forces are not strong enough to generate accurate information on costs of production can lead the importing country to use imputed cost calculations in ways that make anti-dumping penalties more likely, thereby discouraging export-related FDI from locating in those host countries (Moran, 1998, pp. 110-111).

In the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade (GATT), 1994, a provision on Developing Country Members (Article 15) calls for special consideration of these countries needs in the administration of anti-dumping regulations:

> "It is recognized that special regard must be given by developed country Members to the special situation of developing country Members when considering the application of anti-dumping measures under this Agreement. Possibilities of constructive remedies provided for by this Agreement shall be explored before applying anti-dumping duties where they would affect the essential interests of developing country Members" (WTO, 1994, p. 163).

Application of this preferential standard to HCMs that, in practice, administer anti-dumping procedures is not specified, leaving follow-up implementation indeterminate, in the hands of importing country regulators. No express consideration is given to the impact that anti-dumping duties can have on FDI flows to developing countries.

Product certification standards, whether specified unilaterally or agreed upon in some form of regional trade agreement, comprise another HCM affecting market access that can influence FDI decisions and location patterns. When HCMs require that imported products meet specific standards in such areas as product safety, quality or environmental impact, the detailed specification of those standards, as well as the nature of the certification process, can function to preclude or disadvantage market access for exports from FDI projects whose viability depends upon effective and competitive access to the home country market. International trade rules are only just beginning to address the many sectoral and issue-specific permutations for HCMs in this area, and no particular attention is being paid to the potential for distortions to FDI locations decisions, as opposed to trade flows. In the meantime, these market-access effects can influence corporate FDI decisions by shaping profit projections for existing or potential foreign facilities, perhaps discouraging

FDI that otherwise might be drawn to developing countries with comparative production advantages.

G. Extraterritorial controls

Extraterritorial controls represent one method of implementing HCMs, including some types of measures already discussed, that raise special cross-cutting issues where concerns can arise regarding how HCMs are administered. Examples of the extraterritorial extension of HCMs are found historically in fiscal measures, competition policy and trade regulations, while new debates are emerging with regard to labour and environmental regulations. When national controls are extended unilaterally, outside the territorial boundaries of a home country, the extraterritorial application of those HCMs intrude upon the legal jurisdiction of another sovereign country. The issue of extraterritorial legal application raises broad issues involving the conflict of sovereign national laws that cannot be covered in depth in this chapter. However, a few FDI-related aspects of this issue merit attention.

The international business community urged restrictions on the extraterritorial extension of HCMs in the ICC Guidelines for International Investment. That document, under paragraph 2 of chapter V, proposed that home Governments "Should not seek to interfere with the legal order of the host country by extending the application of its national laws, directives and regulations to the investor's operations in the host country". A similar position is taken in the Pacific Basin Charter on International Investments which, under the heading "Legislation", states that "Governments should respect the jurisdictional integrity of those economies in which its nationals operate and should not attempt to extend to international enterprises the jurisdiction of their laws and regulations in such a way as to influence business activities in other economies ".

Among themselves, developing countries have adopted treaty provisions that proscribe an extraterritorial application of HCMs. For example, article 17-12 of the Treaty on Free Trade Between the Republic of Colombia, the Republic of Venezuela and the United Mexican States provides that "No Party may, with respect to the investments of its investors constituted and organized according to the laws and regulations of another Party, exercise jurisdiction or adopt any measure which results in the extraterritorial application of its laws or constitutes a hindrance to trade between the Parties or between a Party and a non-Party". A similar provision is found in Mexico's Free Trade Agreements with Costa Rica and Nicaragua, respectively.

Rather than prohibiting extraterritorial applications, the OECD's Declaration on International Investment and Multinational Enterprises adopts a Decision on Conflicting Requirements that calls upon member countries to minimize the imposition of conflicting regulations on TNCs. An elaboration of that Decision endorses moderation and restraint in contemplating new legislation or enforcement actions involving jurisdictional claims that would conflict with other sovereign countries. Consultation based on a respect and accommodation for the interests of other countries is advocated. The revised OECD Guidelines for Multinational Enterprises, adopted on 27 June 2000, continued this policy position with a statement of principle that "When multinational enterprises are subject to conflicting requirements by adhering countries, the governments concerned will cooperate in good faith with a view to resolving problems that may arise" (OECD, 2000a, p. 3).

These principles on conflicting requirements are reflected in bilateral cooperation agreements on antitrust matters between the United States and Germany, Australia, Canada and Brazil, as well as bilateral cooperation accords on bribery between the United States and the European Union. However, such principles are usually found only in agreements among OECD member countries and, therefore, do not constitute a general standard for how regulatory HCMs might impact on developing country interests. With regard to antitrust policy, the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices offers a somewhat nuanced standard with regard to how regulatory HCMs should be administered. A provision granting "preferential or differential treatment for developing countries" suggests that "States, particularly developed countries, should take into account in their control of restrictive business practices the development, financial and trade needs of developing countries, in particular of the least developed countries". This provision would implicitly cover the extraterritorial application of anti-competitive HCMs in developing countries as well as potentially adverse extraterritorial impacts on developing countries that may arise from applying anti-competitive controls nationally.

A few other IIAs contain provisions addressing HCMs that also seek to limit the extraterritorial effects of regulatory controls, whether or not the controls would necessarily involve a formal application of national law outside the home country's borders. For example, the Canada-Chile Free Trade Agreement contains a provision on financial transfers related to an investment that places a restriction on the use of HCMs that might force investors to transfer earnings to the home country. Article G-09(3) states that "Neither Party may require its investors to transfer, or penalize its investors that fail to transfer, the income, earnings, profits or other amounts derived from, or attributable to, investments in the territory of the other Party". The APEC Non-Binding Investment Principles, under the heading "Removal of Barriers to Capital Exports", endorses a more general statement "that regulatory and institutional barriers to the outflow of investment will be minimized".

Recent discussions on labour relations and environmental issues also suggest how HCMs in these areas might affect FDI. Few such HCMs have thus far been extended extraterritorially, but national debates occur in some countries regarding whether TNCs should be forced to comply with home country labour and environmental standards, wherever their TNCs operate. Attempts in the European Community, Canada and the United States to apply employment standards to TNCs that continued operations in the formerly apartheid south Africa suggest how such HCMs might work (see chapter 17). The preference given in some contemporary FDI promotion programmes to projects incorporating environmental improvement standards (UNCTAD and EC, 1996, p. 72) show how HCMs could be structured to extend home country priorities, even without an extraterritorial application of regulatory controls on the country's TNCs.

* * *

A review of IIAs reveals some useful approaches in linking agreement provisions to HCM actions. Promotional efforts appear best coordinated and developed within the context of regional arrangements between developed and developing country areas, whereas bilateral treaties often leave host developing countries at a disadvantage in seeking a balanced level of mutual commitment. Agreements between and among developing countries suggest several new avenues for enhancing cooperative FDI promotion. In general, however, the potential impact of HCMs remains largely within the unilateral discretion of developed home countries where their impact on development may have been a concern secondary to the interests of the home country and its own TNCs. Discussions of IIAs may offer an opportunity to open this third point of the investment triangle to a somewhat more international consideration, including particularly the nature of HCMs and how they may be addressed in IIAs in ways that enhance their beneficial impact on development.

Section III
Interaction with other Issues and Concepts

The concept of HCMs relates to other issues included in IIAs that are discussed in these volumes (table 1). This section discusses briefly the nature of the most significant points of interaction.

Table 1. Interaction across issues and concepts

Issue	Home country measures
Admission and establishment	0
Competition	+
Dispute settlement (investor-State)	0
Dispute settlement (State-State)	+
Employment	+
Environment	+
Fair and equitable treatment	0
Host country operational measures	0
Illicit payments	+
Incentives	++
Investment-related trade measures	++
Most-favoured-nation treatment	++
National treatment	0
Scope and definition	0
Social responsibility	+
State contracts	0
Taking of property	+
Taxation	++
Transfer of funds	+
Transfer of technology	++
Transfer pricing	++
Transparency	+

Source: UNCTAD.
Key: 0 = negligible or no interaction.
+ = moderate interaction.
++ = extensive interaction.

- **Incentives.** Discussions regarding IIAs normally address this issue as it relates to host country incentives offered to attract FDI,

where the debate focuses on whether or when such incentives actually work. The concept also applies to incentives that can be offered by capital-exporting countries through HCMs used to promote FDI to various developing countries. Financial and fiscal incentives in the forms of grants, loans, equity participation and tax exemptions or reductions comprise important elements of FDI promotional efforts extended in the context of national or regional development assistance. Although investment incentives may distort FDI flows under certain circumstances, such incentives may also be needed to overcome market imperfections. The rationale for these types of HCMs incentives is similar to the justification for host developing countries offering incentives to attract FDI. Just as developing countries may require special and differential treatment in any IIA provisions governing incentives to attract inward FDI, capital-exporting nations that employ HCMs to promote FDI to developing host countries may also merit special exemptions from possible restrictions. In fact, HCMs incentives that promote FDI for developmental purposes may be preferable to host country incentives to attract FDI, since the cost of the incentive is borne by the capital-exporting country rather than the capital-importing country.

- **Investment-related trade measures.** Some HCMs fall into the category of trade measures that have an impact on FDI. These HCMs can be used to promote FDI to developing countries, such as granting special duty preferences to imports from developing countries, thereby enhancing that country's attractiveness as a site for export-related TNC investment. Conversely, HCMs may also comprise trade regulations, such as anti-dumping standards or rules-of-origin definitions, that discourage FDI by threatening import penalties that offset the comparative production advantages offered by prospective investment sites in host developing countries.
- **Most-favoured-nation treatment.** The issues concerning HCMs raised in this chapter relate to MFN treatment primarily in the negative, i.e. HCMs that promote FDI to developing countries generally accord preferential treatment only to selected host countries and, therefore, do not act under the MFN principle. Some promotional HCMs even differentiate within the general category of developing countries and grant a preferred status to the least developed countries only. A completely non-discriminatory application of the MFN principle to HCMs would, indeed, preclude the possibility of conferring special and differential treatment on developing countries in the context of promotional FDI activities.
- **Taxation.** Taxation regulations in a home country can affect the prospective profitability of FDI, thereby influencing the potential for FDI, including to developing host countries. Specific taxation HCMs, such as foreign tax credit systems and tax sparing provisions, can be used to promote FDI, particularly for development purposes. The applicability of specific HCMs and the nature of their impact is often determined through the negotiation of bilateral taxation treaties.
- **Transfer pricing.** The administration of transfer pricing regulations by home country tax authorities can influence the distribution of income among a TNC's foreign affiliates, affecting the potential tax revenue due to different countries. The impact of HCMs dealing with transfer pricing policies can thereby positively or negatively influence the profitability of FDI in specific host countries, including developing countries. Lacking an international agreement on transfer pricing policies and practices, bilateral taxation treaties can be used to reach agreement on the application of transfer pricing standards and procedures in specific home-host country relationships.
- **Transfer of technology.** Technology transfer can be encouraged or restricted by the operations of HCMs. Development assistance programmes by capital-exporting countries may include specific provisions or preferences supporting FDI that incorporates technology transfer to spur the economies of host developing countries. Technical assistance elements can help improve a developing country's capacity to receive and employ newer technologies as well as to comply with the requirements of accords such as the TRIPS agreement or various environmental pacts. Because advanced technologies generally emerge from, and are transferred by, TNCs from the more developed countries, their HCMs can be instrumental in determining the extent and conditions under which technology is transferred to host developing countries.

Conclusion: Economic and Development Implications and Policy Options

The concept of HCMs has traditionally attracted little attention in the context of IIA discussions, but this topic represents an important element for the development impact of IIAs on host developing countries. By definition, HCMs are undertaken by home country Governments. All home countries have measures that affect FDI flows. HCMs in developed home countries can influence both the magnitude and quality of FDI flows to developing countries. These measures, which are overwhelmingly unilateral in their design and application, differ widely in scope and strength. Hence, if common policy positions and implementation commitments were undertaken in conjunction with international agreements, the resulting standards could significantly influence the substance and administration of HCMs as they affect FDI flows, especially to developing countries. IIA provisions addressing HCMs could lend greater transparency, predictability and stability to the manner by which HCMs influence development concerns.

This section outlines a few of the ways in which the consideration of HCMs might enter into discussions on IIA issues, including policy options developing countries might favour to advance their development objectives. Most options suggested are not mutually exclusive and could be chosen conjointly, although decisions regarding relative priorities among them might prove necessary during the course of any negotiations. The options range across a continuum from the absence of any provisions addressing HCMs to detailed policy provisions linked to specific implementation commitments.

An evaluation of included options would cover two related but distinguishable dimensions. One consideration is the scope (variety and number) of policy measures that might be incorporated in IIAs; a second element is the relative strength of the commitment undertaken, including the specification of implementation and follow-up monitoring mechanisms. In the context of IIAs, the practical effectiveness of provisions addressing HCMs can be indicated by both the relative strength of the language used for policy commitments and the level of detail set forth on the programmatic follow-up required to implement an agreement. The more precise and directive the policy language and the more directly linked such statements are to specific follow-up processes, the more the results are likely to benefit developing countries.

A. Option 1: no provision on HCMs

Although the range of HCMs affecting FDI is broad, few IIAs currently address many of these measures. One option is simply to follow the bulk of past practice by not including provisions relating to HCMs from consideration in IIAs. This approach would place maximum emphasis on national sovereignty over policy decisions. Home country Governments, predominately in the developed countries, would retain full unilateral control over the design, formulationand implementation of their own HCMs, including the impact on FDI flows. Any measures adopted to promote FDI to developing countries could be tailored to favour only those host countries selected by each individual home country Government. These HCMs also could be expected generally to promote the interests of the home country's TNCs, with beneficial impacts on the home country' s economy.

B. Option 2: hortatory statements on HCMs

Where IIAs do currently address HCMs, the provisions seldom employ more than vague or simply hortatory language in their policy provisions. A second option, therefore, is for IIAs to incorporate broad, hortatory declarations regarding general policy positions or goals. For example, provisions might recognize the contribution that increased FDI can make to economic growth in developing countries and state that home countries endorse or even encourage such FDI. A somewhat more activist position might proclaim an intention to promote FDI flows to developing countries, with or without a qualifying phrase about whether such flows should be directed by market forces, but lacking any specified follow-up commitments.

C. Option 3: general policy declarations linked to agreed joint follow-up activities

Home country policy positions regarding FDI promotion to developing countries are often vaguely formulated and problematic in their

implementation. An option in IIA negotiations is to link general policy language to agreement on joint follow-up procedures that would provide substantive implementation through more specific coordinated and cooperative undertakings.

For example, although BITs contain binding obligations regarding the protection of FDI, most treaties between developed and developing countries contain, at best, only hortatory policy language regarding HCMs to encourage FDI flows to the host country partner. However, some BITs and regional economic agreements signed among developing countries contain clearer references to promotional responsibilities, often linked to an agreement on joint discussions and activities between the countries' respective investment promotion agencies. Greater attention might be paid in IIAs to how the language of policy declarations regarding FDI promotion could be linked to specific HCM implementation commitments. Approaches that build on joint programmatic undertakings, such as cooperative information exchange, assisted outreach to home country business groups, and FDI seminars and missions, could spur home country follow-up while involving the host country more actively in the planning, design and implementation of shared promotional activities.

Policy statements in other types of international agreements can present the same challenge of linking general policy language to follow-up implementation. The GATS represents a significant achievement in terms of incorporating a stated policy position in the preamble that highlights the development of developing countries as one of the agreement's primary goals, followed by more specific commitments, particularly in article IV, that seeks to increase the participation of developing countries in trade in services. This article is drafted as a "shall" commitment rather than the more typical "best endeavours" provision usually attached to agreements that call for special and differential treatment for developing countries. In practice, this improved policy language has not yet been translated into the realization of negotiating priorities anticipated by developing countries (Shahin, 1999).

When the GATS commitment were reaffirmed in the Cotonou Agreement of June 2000 by the signatories of that Agreement, a list of targeted service industries was included that indicates how specific sectoral goals could help guide implementation actions. Defining these types of goals regarding developmental objectives, including FDI promotion, could increase the significance of declaratory policy statements in IIAs by linking them to practical programmatic implementation or follow-on negotiations.

A related consideration is how HCM implementation procedures might address general TNC conduct standards that might be specified in IIA provisions. For example, some BITs restrict TNC benefits, such as FDI protection, to investments that conform with host country laws. The BIT between Australia and Indonesia specifies that the investment must be made "in conformity with the laws, regulations and investment policies applicable from time to time" (UNCTAD, 1998a, p. 36). This general HCM standard, administered by home country regulations, can help ensure that only FDI desirable for development purposes will receive treaty protection. National investment guarantee programmes can effectively deny compensation claims for expropriations in cases in which an investor has violated host country law. Such standards might be considered a recognition of minimum investor responsibilities to any host country, as agreed in IIA provisions and enforced through HCM implementation procedures.

When IIAs promote FDI for development purposes, follow-up programmes offering incentives such as financial or fiscal assistance might also link such assistance to TNC performance standards related to the anticipated developmental effects. For example, projects receiving preferential treatment because of their proposed technology transfer benefits should be expected to actualize such plans, or forfeit the promotional benefit. Joint follow-up and monitoring activities might incorporate an integral role for the host developing country in assessing relevant TNC performance relative to these development objectives.

D. Option 4: binding provisions on specific HCMs, with follow-up mechanisms

A fourth option for IIA negotiations is to extend their scope by moving beyond general language to incorporate binding provisions on specific HCMs. The breadth of such an approach would depend on the number and variety of HCMs addressed and the strength of the provisions would vary with their specificity as well as the nature of associated follow-up and monitoring mechanisms. Possible candidates for inclusion can be found in the earlier section on "Stocktaking and analysis".

Five types of HCMs merit separate discussion regarding how IIA provisions might deal with them.

1. Option 4a: delivery mechanisms for FDI financial assistance.

IIAs could seek improved coordination among the multiplicity of HCMs in various capital-exporting countries that provide financial assistance aimed at supporting FDI to developing countries. Some efforts are unilateral initiatives while other HCMs operate in support of international development assistance programmes. Unilateral national programmes retain maximum discretion and control in the hands of the capital-exporting country and can place significant and inefficient burdens on developing countries that confront procedural "red tape" in complying with the requirements of each national programme. Effective coordination is also sometimes lacking among the various governmental and inter-governmental financial assistance programmes.

Negotiating objectives for IIAs could include provisions to help improve coordinated delivery of financial assistance for FDI promotion while minimizing inefficient restrictions, such as "tied aid" limitations, often placed on unilateral or bilateral assistance mechanisms. Provisions designed to increase the participation of developing countries in governance decisions regarding assistance programme operations could enhance their effectiveness through a more cooperative partnership approach (OECD, 2000b, pp.18-19). Linked financial assistance programmes could place clear priority on addressing the developing countries' requirements. In "A Guide to Donor Support", the OECD's Development Assistance Committee recognized that "Historically, donors have tended to provide assistance in ways benefiting both donor and recipient country enterprises in this area: greater emphasis should be placed on appropriately responding to recipient country enterprise needs "(OECD, 1995a, p. 20).

A related evaluation and choice could also be made in IIAs regarding whether or how to apply the MFN principle in provisions that set priorities or criteria for determining the recipients of financial assistance for FDI promotion. Certainly a distinction can be made between developed and developing countries on the same basis as countries qualify for special and differential treatment under various trade accords or international development aid. However, some FDI promotion programmes give priority attention to the least developed countries. Financial assistance is also sometimes granted on a preferential basis to FDI projects in specific industries or with certain firms, especially SMEs. Many HCMs also tailor development assistance mechanisms to advance specific policy goals, such as channeling FDI promotional funds to support projects that foster environmental protection. The rationale and administration of preferential country or project criteria as specified in an IIA could be analysed carefully and established in a transparent fashion, with full developing country participation in setting the priorities given to meeting core development objectives. Ongoing monitoring of programme implementation and periodic reevaluation of the agreed criteria could help assure effective attainment of expected results.

2. Option 4b: fiscal HCMs as regards taxation and transfer pricing.

The scope of IIAs could be expanded to incorporate specific fiscal measures that promote FDI. Currently, fiscal issues tend to be decided through unilateral HCMs or negotiated in the context of bilateral taxation treaties, where host developing countries are often at a disadvantage in discussions with capital-exporting developed countries. An option in IIA negotiations is to seek the inclusion of specialized provisions on taxation issues, such as tax sparing, that could implement general policy pledges for special and differential treatment favouring developmental objectives. Similar provisions might address transfer pricing issues, ratifying adjustment mechanisms that will not result in a loss of tax revenue for developing host countries, thereby endorsing a developing country exception from the approach promoted in the OECD's Model Tax Convention. Practical implementation of IIA policy positions on taxation and transfer pricing issues could benefit from follow-up commitments to greater information sharing and technical assistance, perhaps patterned on provisions in the TRIPS and GATS agreements, in order to improve administrative capabilities in host developing countries relative to the global operations of TNCs.

3. Option 4c: technical assistance to meet policy commitments.

Some HCMs offer technical assistance that is designed to increase a host developing country's capabilities to implement international commitments, such as the TRIPS Agreement, that will improve the overall investment climate. Developed country Governments generally have a self-interest in providing this type of technical assistance to assure developing countries are able

to implement various international agreements. Nevertheless, in negotiating IIA commitments, a developing country's policy obligations could be made clearly contingent on the actual provision of technical assistance that is fully sufficient to implement specified standards. This explicit link between policy commitment and implementation capability would strengthen the assurance of follow-up actions to support IIA implementation while enhancing technical administration skills within host developing countries.

4. Option 4d: technology transfer through coordinated development priorities.

Promoting effective technology transfer through IIAs may require a coordinated approach among developed and developing countries regarding development priorities and implementation strategies, both of which would affect the nature, magnitude and impact of technology transfer provisions. By encompassing technology measures in IIAs, developing countries can participate more fully in shaping sectoral and project priorities for transfer of technology projects and programmes. Traditionally, HCM priorities are set primarily by unilateral home country decisions that generally assist FDI that will offer some proportionate mix of mutual benefits for both home and host countries. Increased consultation and coordination in designing promotional priorities in IIAs can help assure maximum developmental impact from assisted technology transfer projects.

The scope of IIA provisions covering HCMs could include both capacity-building activities and support for direct, project-based technology transfers. Policy commitments on investment promotion could help enhance a host developing country's receptive capacity for FDI that would embody or require the use of newer, demanding technologies, including sophisticated telecommunications or quality testing facilities. Other provisions might directly target FDI projects with a significant technology transfer component for preferential treatment by HCMs that offer financial or other promotional support programmes. Conversely, the scope of IIA provisions could also include standards and procedures that seek to curtail or minimize HCMs that restrict technology transfer by TNCs, particularly where no persuasive national security interests are involved. Monitoring, research and periodic consultations regarding the development impact arising from different forms of technology transfer could help inform and guide the use of promotional HCMs.

5. Option 4e: FDI impacts from market-access HCMs.

The investment impact of trade-related HCMs that affect market access has not been widely recognized and, therefore, as with other types of IRTMs, has seldom been addressed in IIAs. An option to broaden the scope of IIA negotiations could encompass provisions to encourage rules-of-origin definitions that maximize the beneficial effects of trade preference schemes for developing countries while minimizing their use to restrict home country market access in ways that discourage export-related FDI projects in developing countries. Procedures that incorporate developing country input into the formulation of regulatory HCM definitions applying rules-of-origin criteria could strengthen the link between trade preference goals and actual outcomes, helping insure that chosen criteria most appropriately support the developing countries' socio-economic objectives.

Negotiations on IIAs could also consider specifying that countries applying anti-dumping, rules-of-origin or product-certification regulations consider how their actions may affect FDI prospects for developing countries. Policy provisions could include a specific reference to the special situation of developing countries, similar to article 15 in the GATT anti-dumping agreement. To strengthen implementation, an additional step might be to establish an applied follow-up procedure such as requiring an FDI-impact statement as part of the process of formulating such regulations or assessing punitive duties. Both international trade and IIA discussions could address the FDI impacts on developing countries from how trade-related HCM shape market access, but the full significance of these effects may not be fully appreciated if viewed only from a traditional trade policy perspective.

E. Evaluate extraterritorial HCM applications and impacts

The possible extraterritorial reach of HCMs presents a cross-cutting consideration for how options related to HCMs might be incorporated into IIAs, rather than a separate option in itself. The generally preferred policy approach for developing countries has been to favour a prohibition on extraterritorial law applications, not least because only the largest developed countries have historically possessed the effective power to enforce such claims, often on smaller, developing

countries. Some current instruments reflect this developing country position, such as Mexico's treaties with several Latin American neighbours that prohibit the extraterritorial extension of home country law. By contrast, developed home countries have pursued a different policy approach in efforts to minimize conflicting requirements, such as through the OECD Decision on this topic, without attempting a prohibition on extraterritoriality claims.

A policy dilemma may arise as more developing countries move into the role of serving as both a home and a host country. Generalized prohibitions on extraterritoriality could foreclose potential options for home developing countries, including the possibility to claim a share of tax revenue generated by their TNCs' foreign affiliates or otherwise monitor and supervise their activities. Conversely, the ability of developed home countries to regulate their own TNCs' foreign operations could, under certain circumstances, be administered in ways that promote developmental objectives. For example, IIA provisions on financial or fiscal HCMs might call for home country monitoring and regulatory efforts aimed at preventing TNC involvement with improper or illegal capital flight from host developing countries.

Similar exceptions may arise even with regard to issues, such as labour standards, where developing countries are concerned about proposals to extend home country regulatory standards to cover the operations of foreign affiliates. Although such extraterritorial applications could constitute an unwelcome infringement on national sovereignty in most cases, exceptional circumstances are conceivable; for example, most countries supported applying TNC workplace standards such as the Sullivan principles to oppose South Africa's former apartheid policies. A critical distinction in IIA provisions between a general principle of extraterritorial restraint and the possibility for exceptional applications might rest on the existence of genuine international consensus on a common global standard. Nevertheless, both the substance and procedure of how IIAs might address extraterritoriality issues merit a careful evaluation of possible options, particularly relative to their potential impact on developing country interests.

Notes

1. For an analysis of FDI promotional policies and programmes in both developed and developing countries, see UNCTAD, 1995, chapter VII. That chapter contains more detail on examples of specific national programmes than can be included in this chapter.
2. For example, the original development-promotion goals of the United States' Overseas Private Investment Corporation (OPIC) have been progressively modified to exclude coverage of FDI projects that might harm United States' domestic business or employment interests. Similarly, FDI-related components in development assistance packages offered by developed countries can include requirements that "tie" the aid to projects that clearly benefit home country business and national interests.
3. Unless otherwise noted, all instruments cited herein may be found in UNCTAD, 1996a, 2000a, 2001a, 2002a and 2004a.

Appendix

Outcome of the UNCTAD Expert Meeting on Home Country Measures held in Geneva from 8 to 10 November 2000

1. The Expert Meeting on Home Country Measures discussed a range of issues for consideration by the Commission on Investment, Technology and Related Financial Issues pursuant to paragraphs 123 and 118 of the Bangkok Plan of Action (TD/386). Experts made presentations and exchanged views on national experiences and best practices in six broad categories of major types of existing home country measures used by both developed and developing countries to promote outward FDI, including transfer of technology.
2. Experts noted that 90 per cent of all FDI originates in developed countries, but that developing countries are increasingly becoming home countries as well.
3. For each of the identified measures, the expert debate focused on (a) stocktaking; (b) rationale; (c) analysis; (d) best practices; and (e) effectiveness and possible improvements. Experts noted that:

(a) Home country measures (HCMs) are all policy measures taken by the home countries of firms that choose to invest abroad designed to encourage FDI flows to other countries. Their formulation and application may involve both home and host country Government and private sector organizations.
HCMs exist at the national, regional and multilateral levels and involve a broad variety of measures, ranging from information provision, technical assistance and capacity-building, to financial, fiscal and insurance measures, investment-related trade measures, and measures related to the transfer of technology. Given this variety, HCMs have to be adaptable and flexible, since "no one size fits all".

(b) HCMs are applied for a variety of reasons, including to allow companies to exploit better their competencies and competitive advantages, to further the mutual benefit and co-operation of home and host countries; to further the economic integration of the home country into the world economy; to overcome market access problems; to utilize better domestic exports; to overcome domestic supply-side problems (especially in the area of raw materials, labour and technology); and to strengthen regional cooperation in the promotion of outward investment.

(c) HCMs can exert influence on the flow of FDI and technology particularly to and between developing countries and the impact these flows have on development. This influence can be increased through tailor-made approaches and regional and country targeting. The effectiveness of HCMs is enhanced by an enabling environment in host countries, especially legal security.

(d) Best practices in the area of HCMs include:
  - (i) providing accurate, up-to-date and high quality information in the appropriate languages to companies on investment opportunities, especially by modern methods, including the Internet. Experts noted that best practice in this area included the inter-active linking of home and host country sources. Failure to provide the right information at the right time can have a negative impact;
  - (ii) instituting regular home-host country exchanges, including through the financing of home country personnel in investment-support and business-facilitation functions in host countries;
  - (iii) promoting creative mechanisms to overcome cultural and linguistic gaps, e.g. undertaking FDI promotion training programmes in home countries, including support service and language training and utilizing chambers of commerce and industry associations;
  - (iv) making effective use of interregional exchange forums on issues related to investment promotion, involving outward FDI institutions and investment promotion agencies;
  - (v) providing financial assistance to the investor, including equity support, particularly for small and medium-sized enterprises (SMEs) and for investment in least developed countries (LDCs);
  - (vi) providing investment insurance coverage, particularly for political and country risk;

(vii) agreements on investment promotion and protection, as well as on the avoidance of double taxation;

(viii) providing "after-care" support services to outward investors, such as bridging loans to foreign affiliates facing unexpected crises in host countries;

(ix) improving market access, such as Generalized System of Preferences (GSP) schemes, the Africa Growth and Opportunity Act of the United States and the European Commission's proposals concerning market access for LDCs;

(x) encouraging technology transfer and supporting host countries ' absorptive capacity.

These best practices ought to be emulated, where appropriate, and applied in a co-operative spirit. International arrangements can, and in some areas already do, provide a framework in some areas.

(e) Factors that could contribute to an increased effectiveness of HCMs include:

(i) effective coordination of all aspects of each home country' s efforts, especially for the benefit of their SMEs, so as to increase awareness of investment opportunities, particularly in developing countries;

(ii) greater transparency, minimization of bureaucracy and simplification and standardization of application and implementation procedures, so as to maximize HCMs' utilization. This is especially important in assistng LDCs that lack the capacity to take full advantage of available HCMs;

(iii) collaboration, both bilaterally and multilaterally, between home and host country institutions, such as investment promotion agencies and industry associations, including cooperative training;

(iv) supporting the establishment of industrial infrastructure in host countries, through e.g. the establishment of consortia involving firms from several home countries to invest in major infrastructure projects in developing countries;

(v) a facilitating role by home country Governments to build capacity in host countries to receive and benefit from investment;

(vi) ensuring that HCMs and national, regional and international financial assistance programmes (official development assistance) are mutually supportive;

(vii) effective implementation of international commitments relating to technology and its transfer, including the Agreement on Trade-related Aspects of Intellectual Property Rights (the TRIPS agreement), by host and home countries.

4. Experts noted that in light of the above, home countries, including the private sector, should be invited to develop further their efforts to encourage FDI flows particularly to and between developing countries, and especially to the least developed countries.

5. Experts also noted that host countries, including their private sectors, should be invited to take advantage of the opportunities arising from HCMs and should actively seek to develop linkages between their own inward investment promotion efforts and HCMs offered by home countries. In this context, experts noted that the World Association of Investment Promotion Agencies (WAIPA)is an institution that provides for the exchange of information among investment promotion agencies.

6. UNCTAD should provide a signposting service to relevant home country reference sources on outward investment measures, including through a periodically updated *Handbook on Outward Investment Agencies and Institutions* . It should encourage countries contemplating new or updated HCMs to draw on this information, so as to help increase their effectiveness. In the context of its assistance in improving the enabling environment, UNCTAD should help developing countries in particular in their efforts to make effective use of all HCMs.

7. Experts requested the secretariat to expand the compendium of relevant provisions in agreements pertaining to the transfer of technology to cover also regional and bilateral agreements. In addition, experts identified some issues that could be considered for further intergovernmental deliberation. In particular, research would be desirable into what measures Governments had taken to implement the provisions of international agreements on transfer of technology. "

Source: UNCTAD, 2000b.

[1] Paragraph 123: "to study existing home country measures that could be considered in programmes to support efforts of developing countries to attract FDI and benefit from it". Paragraph 118 "identify and disseminate information concerning existing home country measures that encourage transfer of technology in various modes to developing countries, in particular least developed countries" (TD/386) (UNCTAD, 2000c).

Chapter 23. Transfer of Technology*

Executive summary

This chapter discusses the issue of technology transfer in the context of international investment agreements (IIAs). It is an issue that has generated debate for many years. Given the centrality of technology to development, and the necessity of technology acquisition by developing countries as a means of furthering development, it is desirable that such countries should be able to benefit from the generation, transfer and diffusion of the best available technology. Unfortunately, this has not always been the case. In particular, the fact that most of the world's advanced technology is generated privately by transnational corporations (TNCs), whose principal research and development (R&D) activity is located in developed countries, creates an asymmetry between technology possession and the location of technological need. The result is a gap between the technology developed and owned by firms in developed countries and that which can be obtained and utilized by developing countries.

This reality has generated numerous policy responses. In particular, policies for the encouragement of technology transfer have evolved over the years and have been the subject of provisions in IIAs. This chapter places such policies in a wider context. As shown in section I, the encouragement of technology transfer cannot be seen in isolation. It is a policy that is closely related to the broader treatment of proprietary knowledge through intellectual property laws; to the structure of the market, and the conduct of transactions, which may impact on the competitive process in relation to the generation, transfer and dissemination of technology; and to host country measures designed to control the process of technology generation, transfer and diffusion through performance requirements.

In the light of the above, two broad policy approaches to technology issues are identified in section II. One is a regulatory approach, which, though preserving the essential characteristics of intellectual property rights, seeks to intervene in the market for technology so as to rectify perceived inequalities in that market as between the technology owner and the technology recipient. The latter is seen as the weaker bargaining party. This can be remedied through regulatory intervention in technology transfer transactions, through, for example, the outlawing of provisions in technology transfer transactions that may be seen unduly to favour the technology owner. Coupled with such policies may be a discretion on the part of the receiving country to impose performance requirements on the technology owner as a condition for the transfer transaction to take place. Such policies have, in the past, been adopted by developing host countries and have informed the content of a number of international instruments. These are surveyed in section II.

A contrasting approach sees the transfer of technology as being best undertaken in a market-based environment. Thus the emphasis is not on regulation or intervention in the technology transfer process, but more on the creation of conditions for a free market transfer of technology. The principal features of this approach are a reliance on the protection of private rights to technology based on intellectual property laws; the absence of direct intervention in the content or conduct of technology transfer transactions, save where these violate principles of competition law by reason of their market-distorting effects and/or by their use of unreasonable restrictive trade practices; and by the prohibition, or highly proscribed use, of technology-related performance requirements. More recent IIAs display such an approach and are also covered in section II.

Section III considers the interaction of technology transfer issues with other issues covered by IIAs. In particular, there is strong interaction between technology transfer and scope and definition questions, admission and establishment, the most-favoured-nation standard, national treatment and fair and equitable treatment, taxation, environment, host country operational measures, funds transfer and competition.

Section IV concludes by outlining seven possible options concerning the role to be played by provisions on technology in IIAs. These are

* The chapter is based on a 2001 manuscript prepared by Peter Muchlinski. The final version reflects comments received from Ümit D. Efendioglu, Assad Omer and Pedro Roffe.

considered in the light of the market for technology and the position of developing countries therein. The seven options are: no coverage of technology issues; limited coverage of technology issues: control over technology-related performance requirements; limited coverage of technology issues: permissible technology transfer requirements; wide "regulated" coverage of technology issues; wide "market-based" coverage of technology issues; a "hybrid" approach; and the regional industrial policy approach.

Introduction

The transfer of technology to developing countries has been one of the most discussed areas of international economic relations in the past thirty or more years. In particular, the role of TNCs in the process of developing, applying and disseminating technology across national borders to such countries has generated special interest. One result has been the institution of numerous policy initiatives at the national, regional and multilateral levels. These have, in turn, produced a significant number of legal provisions both in national law and in international instruments. It is the purpose of this chapter to analyse the provisions on technology transfer that are found in international instruments, with special focus on IIAs. Technology has always been important to economic well-being; the current technological context makes it critical to development. It is rapidly transforming all productive systems and facilitating international economic integration. An analysis of IIAs and the transfer of technology to developing countries has to take account of this changing context. That is done in the first part of section I below.

Any discussion of investment by TNCs and technology needs a sound understanding of two basic issues: first what is actually meant by the terms "technology" and "technology transfer" and, secondly, how firms in developing countries actually become proficient in using technology. As to the first, "technology" can be defined in various ways.[1] The present concern is to identify, for legal purposes, a definition that encompasses all forms of commercially usable knowledge, whether patented or unpatented, which can form the subject matter of a transfer transaction. The UNCTAD draft International Code on the Transfer of Technology (the draft TOT Code), in its definition of "technology transfer",[2] describes "technology" as "systematic knowledge for the manufacture of a product, for the application of a process or for the rendering of a service", which does not extend to the transactions involving the mere sale or mere lease of goods" (UNCTAD, 1985, chapter 1, para.1.2.). This definition clearly excludes goods that are sold or hired from the ambit of "technology". Thus it is the knowledge that goes into the creation and provision of the product or service that constitutes "technology", not the finished product or service as such.

Such knowledge should be seen as encompassing both the technical knowledge on which the end product is based, and the organizational capacity to convert the relevant productive inputs into the finished item or service, as the case may be. Consequently, "technology" includes not only "knowledge or methods that are necessary to carry on or to improve the existing production and distribution of goods and services" or indeed to develop entire new products or processes, but also "entrepreneurial expertise and professional know-how" (Santikarn, 1981, p. 4.). The latter two elements may often prove to be the essential competitive advantage possessed by the technology owner.

"Technology transfer" is the process by which commercial technology is disseminated. This takes the form of a technology transfer transaction, which may or may not be covered by a legally binding contract (Blakeney, 1989, p. 136), but which involves the communication, by the transferor, of the relevant knowledge to the recipient. Among the types of transfer transactions that may be used, the draft TOT Code has listed the following:

"(a) The assignment, sale and licensing of all forms of industrial property, except for trade marks, service marks and trade names when they are not part of transfer of technology transactions;

(b) The provision of know-how and technical expertise in the form of feasibility studies, plans, diagrams, models, instructions, guides, formulae, basic or detailed engineering designs, specifications and equipment for training, services involving technical advisory and managerial personnel, and personnel training;

(c) The provision of technological knowledge necessary for the installation, operation and functioning of plant and equipment, and turnkey projects;

(d) The provision of technological knowledge necessary to acquire, install and use machinery, equipment, intermediate goods

and/or raw materials which have been acquired by purchase, lease or other means;

(e) The provision of technological contents of industrial and technical co-operation arrangements" (UNCTAD, 1996a, vol. I, p. 183).[3]

The list excludes non-commercial technology transfers, such as those found in international cooperation agreements between developed and developing countries. Such agreements may relate to infrastructure or agricultural development, or to international cooperation in the fields of research, education, employment or transport (Blakeney, 1989, p. 3). At the outset, technology transfer should be distinguished from technology *diffusion*. The latter is better seen as another benefit that the transfer of technology may bring to a host economy. This can be achieved by the fact that the introduction of a technology into a host country creates an awareness of that technology. That awareness may spill over into the economy as a whole. This may occur without any deliberate intent, simply through the passage of time, or it may occur as a result of deliberate policies on the part of the host country, such as training requirements for local personnel or the compulsory licensing of technology to local firms, or as a result of TNC strategy in the form of purchase of inputs, components and services from local firms, requiring the latter to become familiar with the technology involved so as to be able to perform the functions required by the TNC.

As to the second issue, recent work, including recent reports by UNCTAD, shows why importing and mastering technologies in developing countries is not as easy as earlier assumed (UNCTAD, 1999b). At an earlier stage in the debate on technology transfer to developing countries, it was assumed that the main issue to be resolved was the securing of access to new technology. What has become increasingly apparent since that time is that the mere possession of technology does not result in improved technical development or economic gain: the capacity to understand, interact with and learn from that technology is critical. Thus, in the contemporary context, the design of policies must rely on an understanding of the technology development process, the role of TNCs in this process, and their interactions with local learning (UNCTAD, 1999b, pp. 196-197). Furthermore, TNCs play an important role in the generation, transfer and diffusion of technology. This suggests the need to consider the market for technology and the determinants of transfer.

Thus section I, in explaining the relevant issues, deals, first, with the generation, transfer and diffusion of technology and, secondly, with the main policy issues arising in international rule-making. The chapter is selective in dealing with these issues. It does not cover the full range of normative issues related to the generation, transfer and diffusion of technology but rather deals with those issues that relate more strictly to the interface between foreign direct investment (FDI) and technology in the context of IIAs and other relevant instruments. More specifically, the chapter deals with the following questions: the treatment of proprietary knowledge; the transfer of technology process; competition issues; and technology-related host-country measures. It does not deal in detail with the increasingly important issue of environmentally sensitive technology; this is given the required fuller coverage in chapter 16.

Section II takes stock of the manner in which existing investment instruments have dealt with the main issues identified in section I. Here some clarification concerning scope is called for. The instruments to be covered include a range of instruments not directly related to FDI. Similar difficulties were faced in the preparation of other chapters, such as *Environment*, *Employment* and *Social Responsibility*, where the substantive issue goes beyond the narrower questions of the promotion and protection of investors and their investments, and extends to regulatory standards of behaviour for TNCs. Such standards are often to be found in instruments other than IIAs. Hence, to ensure a full and accurate coverage of the relevant provisions that might be of importance to negotiators dealing with technology transfer issues, a wider range of instruments and draft instruments has been examined

Section III considers the interaction with other issues and concepts. Technology transfer as a cross-cutting issue interacts with most of the concepts in the other chapters in these volumes. However, it has a more relevant interaction with admission and establishment in relation to technology screening procedures, scope and definition, standards of treatment (most-favoured-nation treatment, national treatment and fair and equitable treatment), host country operational measures, taxation, transfer of funds, competition and the environment.

The last section of the chapter deals with economic and development implications and policy

options with specific focus on how IIAs could enhance the role of FDI in the generation, transfer and diffusion of technology.

Section I
Explanation of the Issue

As noted in the introduction, this section deals, first, with the economic context in which the process of technology transfer through FDI occurs, emphasizing the role of TNCs therein as the main generators, transferors and diffusers of technology. Secondly, it explores the main policy issues resulting from those features, namely the treatment of proprietary knowledge; the regulation of technology transfers; competition issues; and technology-related host-country measures.

A. The role of TNCs in the generation, transfer and diffusion of technology

One of the most important contributions that host developing countries seek from TNCs investing in their economies is technology. This is because a large proportion of the generation of commercially significant technology takes place within TNCs that, accordingly, play a significant role in its transfer and diffusion. Indeed, the international market for technology is dominated by such firms. This has a significant impact on the policy options available for dealing with technology issues in IIAs, as will be further explored in section IV of this chapter. For the present, it is enough to consider the role of FDI undertaken by TNCs in the generation, transfer and diffusion of technology.

1. Technology generation

The impact of FDI on technology generation in developing countries has so far been limited. TNCs tend to centralize their research and development (R&D) facilities in their home countries and a few other industrially advanced countries (UNCTAD, 1999b, pp. 199-202). On the whole, developing countries continue to attract only marginal portions of foreign affiliate research, and much of what they get relates to adaptation and technical support rather than innovation. Indeed, the majority of developing countries does not have the technological infrastructure to make it economical for TNCs to set up local R&D facilities (UNCTAD, 2000d, pp. 173-174). On the other hand, a number of firms from developing countries are emerging that specialize in niches of opportunity for R&D in such areas as biotechnology, information technology or new areas of services (UNCTAD, 1999b, p. 196), while there are also some instances of TNCs accessing scienceand technology resources in some developing countries for their R&D activities (Reddy, 2000). Given the greater willingness on the part of TNCs to move their technological assets around the world, such enterprises may offer useful allies for TNCs from both developed and developing countries in the evolution of new technologies.

2. Technology transfer

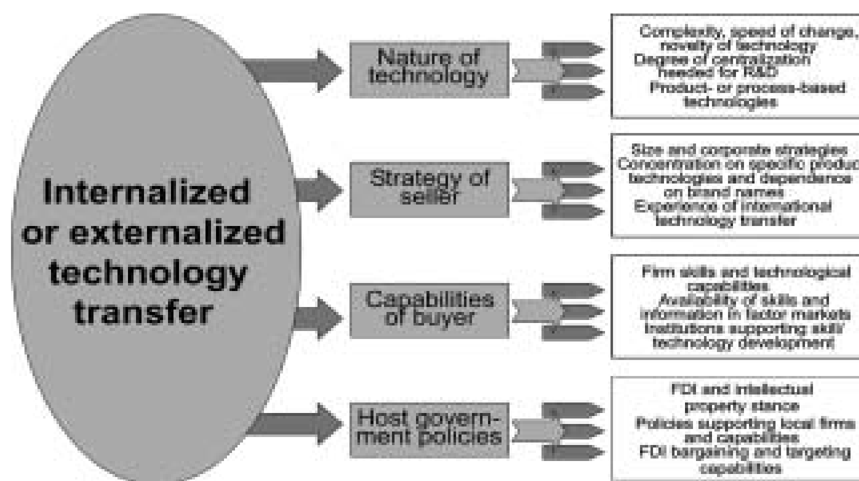
TNCs are among the main sources of new technology for developing countries. TNCs transfer technologies directly to foreign host countries in two ways: internalized to affiliates under their ownership and control, and externalized to other firms (UNCTAD, 1999b, p. 203). Internalized transfer takes the form of direct investment and is, by definition, the preserve of TNCs. It is difficult to measure and assess directly the amounts of technology transferred in this manner. However, even when measured by payments for royalties and licence fees (a partial measure, since these do not include the cost of technology provided outside of contractual arrangements), a substantial part of technology payments is estimated to be made intra-firm. Furthermore, the trend towards the forging of strategic alliances between competing firms for the development and application of new technologies has created networks within which technology is transferred, and has tended to blur the distinction between internalized and externalized technology transfer.

Externalized modes of transfer by TNCs take a variety of forms: minority joint ventures, franchising, capital goods sales, licences, technical assistance, subcontracting or original equipment-manufacturing arrangements. TNCs are not the only type of firm that can supply technology by some of these means. Purely national firms can also transfer technology through such means. However, TNCs are very important in high-technology areas and in providing entire packages, including not only the technology but also management, marketing and other factors that can

make the technology work to its best limits (UNCTAD, 1999b, p. 203).

What determines the mode of technology transfer? This can be answered by reference to a number of variables. The most important of these are the nature of the technology, in that internalized transfer is more likely in highly complex and fast-moving technology areas so that a firm can retain control over its competitive advantage as the developer and owner of the technology in question; the business strategy of the seller, as when he/she decides that establishing an affiliate with the exclusive global mandate to produce a particular product line is the best way to exploit its competitive advantages; the capabilities of the buyer, in that an externalized transfer assumes the existence of a competent licensee, the absence of which may require an internalized transfer to a new affiliate (often at higher cost and risk than licensing to a third party) where projected demand for the product or service involved justifies such expenditure; and host government policies that may stipulate the licensing of technology to local partners as the only permitted mode of TNC participation. These factors are listed more fully in figure I.1.[4].

Figure I.1. Determinants of the mode of technology transfer



Source: UNCTAD, 1999b, p. 204.

From a purely commercial perspective, it may be desirable to allow TNCs a "free choice of means" in determining whether to transfer technology internally or externally. However, from a development perspective there may be certain advantages and disadvantages stemming from the choice of transfer mode. Naturally, this discussion assumes the possibility of a choice: where no suitable external recipient exists, an internalized transfer becomes the only feasible way forward. This can occur either through the establishment of a new affiliate in a host country, or through the acquisition of a local firm that can be turned into a suitable recipient (UNCTAD, 2000d, pp. 174-176). Given the existence of a commercially feasible choice, the advantages to development from an internalized transfer include:

- the provision of financial resources along with technology;
- the possibility of expanding the technological base of the host economy (though this is not exclusive to internalized transfer);
- the use of advanced technology that may not be available through externalized transfer or the use of mature technology applied in an international production network;
- greater speed of transfer;
- access to the technological assets of a TNC providing essential components as well as offering learning opportunities for the host economy.

By contrast, the disadvantages of internalized transfer include:

- The host economy must pay for the entire "package" brought by a TNC which, in addition to technology, may include brand names, finance, skills and management. Internalized transfer may prove more expensive than externalization, especially where local firms already possess these other components of the package.
- The retention of technology and skills within the network of a TNC may hold back deeper learning processes and spillovers into the local

economy, especially where the local affiliate is not developing R&D capabilities.

Thus, where a choice exists between internal transfers to foreign affiliates or external transfers to local technology recipients, governments may wish to intervene to affect the terms of transfer associated with each modality, as, for example, where incentives are offered to TNCs for the transfer of advanced technical functions. Another approach is to upgrade the capacity of the host economy to receive and benefit from technology transfer (UNCTAD, 1999b, p. 210).

3. Technology diffusion

The use of new technology by a recipient is only one of its benefits that the recipient's economy obtains from that technology. Another, often larger, benefit is the diffusion of technology and skills within the host economy. Many forms of diffusion are not priced or paid for in markets. They are externalities that arise involuntarily or are deliberately undertaken to overcome information problems. Thus, in response to the presence of TNCs, local firms and industries may become linked into the technological processes of those firms through "demonstration effects", as where domestic firms seek to imitate the technology applied by TNCs, and to compete with TNCs by improving their technological capabilities and raising productivity. Even more importantly, diffusion can occur through cooperation between foreign affiliates and domestic suppliers and customers, leading to technology transfer to vertically linked firms and service providers (UNCTAD, 2001b). Furthermore, labour mobility from foreign affiliates to domestic firms, particularly of highly skilled personnel, can stimulate technological development.

On the other hand, such spillover effects may not be inevitable, as where a TNC closely guards its competitive advantage in its technology, whether through its retention within the TNC network, and/or through limited skills transfer to employees and/or through restrictive terms in employee contracts, preventing them from revealing technical secrets or from working for direct competitors for a set period of time.

B. Main policy issues

In the light of the above, what are the main issues that arise in relation to the generation, transfer and diffusion of technology in a host country? To answer this question, one needs to consider the type of policy measures used by Governments to influence technology development. In the first place, the generation, transfer and diffusion of technology should not be seen as a linear process: in practice, each of these phases influences the others in a multidirectional way.

Secondly, at the domestic level, countries have used a variety of policy instruments to influence and strengthen the generation, transfer and diffusion of technology (Omer, 2001). These policy instruments included regimes for the protection of intellectual property rights (IPRs), competition laws, performance requirements (e.g. joint venture and local R&D requirements) and a variety of promotion instruments (e.g. fiscal and financial incentives, training facilities). Furthermore, certain developing countries, notably in Latin America, experimented during the 1970s with specialized technology transfer laws, whose aim was to regulate the content of technology licensing agreements with a view to ensuring that the development objectives of a host country economy would not be undermined by unequal terms in technology transfer transactions.

At the international level, and particularly in the context of IIAs, the following policy issues can be discerned: the treatment of proprietary knowledge; encouraging technology transfer; competition and technology transfer; and technology-related host-country measures. The chapter thus focuses on these issues. It should be noted that, just as the processes of generation, transfer and diffusion of technology are interrelated issues, the policy issues that have dominated IIAs should be seen as interrelated as well. For example, it was the acceptance of the proprietary nature of technology, particularly as regards patentable knowledge, by TNCs and their home governments that was at the heart of the debates on the content of a new regime for the transfer of technology to developing countries under the draft TOT Code. The developing countries questioned this assumption and put forward the alternative view that technology was in the nature of a necessary public good in relation to the development of less developed countries and that, therefore, some of the private property related assumptions of the international system for the protection of intellectual property should be amended in the interests of developing countries (Muchlinski, 1999a, pp. 438-444). The intention was not to alter the existing arrangements on IPRs as such, in that the draft TOT Code encouraged each country

adopting legislation on the protection of IPRs to ensure that these be effectively protected. Rather, it was to make certain that the terms of a technology transfer agreement were not of a kind that would effectively prevent a recipient in a developing host country from the unrestricted use of the technology, and its attendant know-how, after the expiry of the agreement and that host developing countries would be free to pursue their industrial policies as they saw fit, including, where deemed necessary, through the imposition of performance requirements upon technology transferors (Roffe and Tesfachew, 2001, p. 389).

1. Treatment of proprietary knowledge

IPR regimes have been the classical policy instruments to influence the generation, transfer and diffusion of technology and international rule-making has preponderantly focused on the protection of IPRs. International rule-making in this field has a long-standing tradition (Blakeney, 1989). It has mainly centred on avoiding or lessening the consequences arising from disparities among domestic intellectual property laws as to the formal and substantial requirements of protection through basic principles aimed at:

- avoiding discrimination towards foreigners as regards IPR protection; and
- attenuating the territorial character of IPRs which obliges enterprises willing to expand operations to foreign countries to seek protection in each of them on the basis of differing formal and substantive requirements and procedures.

The protection of IPRs was not traditionally linked to the operation of foreign firms in a host country. Advocates of stronger IPRs hold that increased protection together with adequate enforcement mechanisms would increase FDI flows and associated technology transfer to developing countries (Beier, 1980). However, empirical evidence on this is rather mixed. Some authors suggest that stronger IPRs are likely to have a positive impact on FDI while others are more cautious (Minta, 1990, p. 43; UNTCMD, 1993a; Ferrantino, 1993; Kondo, 1995; Mansfield, 1994 and 1995; Maskus and Yang, 2000).

Due to the increasing importance of technological assets as a source of competitive advantage for TNCs, IPR protection has been incorporated into the multilateral trading system. The TRIPS Agreement is perhaps the most prominent example of such incorporation. In relation to IIAs, the treatment of proprietary knowledge raises the following main issues:

- the link between protection of IPRs and FDI flows;
- enforcement of IPRs;
- the issue of exhaustion and parallel imports;
- compulsory licensing.

The first of these issues asserts that, in order to stimulate the flow of inward FDI, a host country must ensure the protection of the foreign investors' competitive advantage by offering legal protection of the IPRs by which that advantage is obtained. Thus the first aim of any international regime must be to ensure that mutual recognition and protection of IPRs exist. That entails the second issue, how IPRs are to be enforced. Here the major concern is to ensure that IPRs have equivalent protection in all jurisdictions in which an owner uses those rights. Turning to the third issue, the principle of exhaustion as applied in Europe, and its equivalent in the United States, the first sale doctrine, were developed to circumscribe the scope of the exclusive rights granted to title-holders. Thus, according to this principle, which was developed mainly through case law in different jurisdictions, once owners of IPRs (whether a patent, trademark, copyright or design) have placed protected products on the market, they are no longer entitled to control the subsequent marketing stages of those products, beyond what might be legitimately required to protect the subject-matter of the rights. The aim of this principle is to prevent the abuse of the monopoly over the first placement of a protected product or process enjoyed by an IPR owner by means of the prevention of parallel trade in that product or process by third parties. This may occur, for example, where owners use their IPRs to prevent third parties from trading freely in a given product even though they had acquired it legitimately in the course of their business, especially where they had been granted the right to use the IPRs concerned by way of a licence from the owners, or where the goods were acquired in a jurisdiction where no IPR protection for those goods had been recognized and the goods had been freely placed on that market by the IPR owners.

As regards compulsory licensing, this involves an authorization to exploit an invention given by a public authority, in specific cases defined by law. The aim is to prevent IPR owners from preventing third parties from gaining access to those goods or technology by relying on their exclusive rights over the IPRs in question. The effect might be to deprive consumers and the economy in general of the possibility of benefiting

from the exploitation of the protected goods or technology, to the detriment of economic welfare and technical progress. This issue could also be seen in the context of competition as discussed in the relevant section below.

2. Encouraging technology transfer

The encouragement of technology transfer to developing countries has been a recurrent issue on the international economic agenda of the past three decades. The draft UNCTAD Code of Conduct on the Transfer of Technology addressed the issue from various perspectives: the legitimization of specific domestic policies to promote the transfer and diffusion of technology; rules governing the contractual conditions of transfer of technology transactions; special measures on differential treatment for developing countries; and measures that would strengthen international cooperation.[5] The approach was to concentrate on the supply side of the market and to remedy constraints on the acquisition of technology by developing countries caused by the domination of the international technology market by TNCs. In particular, it was proposed to liberalize trade in technology and to introduce guidelines on the terms and conditions of transfer of technology to developing countries. This approach concentrated on the transfer of technology per se, rather than on its diffusion. However, as will be discussed further in the next subsection, this approach has been overtaken by other developments, mainly in relation to the enhancement of competition in the transfer of technology.

More recently the transfer of environmentally sound technologies has been added to the agenda of IIAs in the context of technology transfer. One of the results of recent international agreements on environmental matters has been a greater emphasis on the need for TNCs to ensure that the technology they transfer to developing countries in particular is conducive to good environmental management. This is to be achieved not only through the transfer of environmentally sound technologies, but also through the transfer of environmentally sound management practices. These aspects of technology transfer are more fully discussed in the chapter on *Environment* (chapter 16).

At a more general level, one of the main policy issues facing developing countries in the era of globalization and liberalization is to determine how far they can go in adopting market-oriented strategies in order to attract FDI and ensure economic growth, and at the same time assess the extent of the limitations that need to be applied to such strategies if damage is not to be done to their economies in the short to medium term. Transfer of technology is a microcosmic reflection of this larger issue. Most developing countries, despite strenuous efforts, remain net consumers rather than producers of technology. They still pay more in royalties and licence fees than they earn from their efforts to attract technology. Thus finding the right balance is the crux of the matter.

3. Competition-related questions

As pointed out above, earlier attempts at the multilateral regulation of technology transfer concentrated on defensive measures that could remedy dysfunctions in the international market for technology or influence the functioning of the market with a view to better achieving development goals. Today, however, defensive measures are less in favour on the grounds that market imperfections are best addressed by measures aimed at improving the contestability of such markets. Hence competition policy acquires a greater significance vis-à-vis market interventions that seek to modulate in a mandatory manner the conditions under which technology transfer takes place (UNCTAD, 1999b, p. 222).

The main interface between the generation, transfer and diffusion of technology and competition law relates to the control of restrictive business practices in licensing agreements – one of the major objectives of the draft TOT Code. The abandonment of the draft TOT Code was due to the then continuing disagreement between developing and developed country models of technology transfer regulation. The former wished to take an economic regulation oriented approach which concentrated on the review of clauses in technology licensing agreements with a view to the prohibition of those clauses seen as inimical to the development process and/or likely to take advantage of the weaker bargaining position of the local technology recipient. The latter saw the issue primarily as one of ensuring effective competition in the transfer of technology and, accordingly, held the view that only those clauses that could be seen as unreasonable restrictions on the freedom of the recipient to compete, or which placed unreasonable restraints on the competitive freedom of third parties, would be regulated. These two policy goals do not necessarily produce the same results. For example, a reasonable tie-in clause might be acceptable on a competition-based analysis, but may be seen as a barrier to the development of

local supply chains in the context of a developing country economy (Muchlinski, 1999a, pp. 433-436).

Much of this debate has now been overtaken by the orientation of the TRIPS agreement. The new rules that it has introduced, which follow the competition-oriented model of technology transfer regulation, have made many instruments used in the past by the then newly industrializing countries difficult to apply (UNCTAD, 1999b, p. 223). Specialized technology transfer laws are perhaps the best example here. On the other hand, there is scope for competitiveness-oriented strategies to be adopted by developing countries to improve their ability to assimilate and develop technology (UNCTAD, 1999b, pp. 223-228; UNCTAD, 2001b).

4. Technology-related host-country measures

Once admitted into a country, foreign firms are subject to the host country's jurisdiction. Thus, industrial policies have traditionally been within the regulatory domain of the host country. Governments still retain a space to adopt industrial policies to attract FDI and to increase its benefit to the host economy. However, as has been pointed out in other chapters in these volumes, the legal regulation of FDI is now increasingly accepted as a matter of international concern.

Recent years have seen the emergence of limitations imposed upon host countries by international agreements as to the form in which some domestic policies are applied. In this regard, certain host country operational measures, aimed at inducing foreign investors to adopt a more active approach towards the transfer and dissemination of technology, may no longer be capable of being adopted by countries that have acceded to international instruments containing such limitations. This matter is given full coverage in the chapter on *Host Country Operational Measures* (chapter 14).

In terms of subject-matter, the following technology-related host-country measures may have an impact on the pace and direction of technology transfer to and dissemination in a developing host country:

- restrictions on employment of foreign professional and technical personnel, and requirements concerning the training of local personnel;
- transfer of technology requirements;
- restrictions on royalty payments;
- R&D requirements.

Each type of requirement aims to alter the conditions under which investors apply their technological capabilities in a host country context. Thus an investor may be required to limit the number of foreign professional and technical personnel and increase the number of local personnel who can be trained up to international standards. Equally, a host country may require that specific types of technology, seen as being of importance to the host economy in general and/or to the industry concerned, are transferred to the host country by a foreign investor. Furthermore, the level of royalty that is charged by a foreign investor for the transfer of the technology in question, whether to an affiliate or third-party recipient, may be subjected to scrutiny to ensure that the consideration that is being paid for access to that technology is reasonable. Finally, a host country may require that a foreign investor establishes a level of R&D activity in the host county so as to develop the technology in question in accordance with local needs and/or so as to offer higher value-added activities in the host country associated with the presence of that technology. As noted above, whether such measures can be taken by a host country now depends on the nature and content of that country's international commitments regarding the imposition of performance requirements upon foreign investors.

Section II
Stocktaking and Analysis

This section of the chapter takes stock of the manner in which investment-related instruments have dealt with the main issues identified in section I. As noted in section I, given the nature of this topic not only IIAs but also other international instruments, notably international IPR conventions, are examined.

A. Treatment of proprietary knowledge

1. The relationship between IPR protection and FDI flows

The importance of IPRs for the stimulation of investment flows is exemplified at the outset of an IIA where the definition provisions include such rights within the definition of "investments" to which the protective provisions of the agreement apply. This matter has been raised in the chapter on *Scope and Definition* (chapter 3). It will be further discussed in section III below.

A further factor to bear in mind is that, where an IIA refers to the national laws and regulations of a host country, these include its IPR laws. Thus, in the case of bilateral investment treaties (BITs), other than those concluded by the United States and Canada, it is common to include a provision making the entry and establishment of an investor and/or investment from the other contracting party subject to the laws and regulations in force in the receiving contracting party (UNCTAD, 1998a, pp. 46-50). Where such laws include IPR laws, then the investor/ investment is subject to any regulatory requirements contained in these laws. The resulting effect on FDI flows depends on the content of these laws.

In this regard the content of IPR conventions becomes significant. These instruments prescribe the main principles upon which the interaction of national IPR laws with foreign investors, who enjoy IPRs recognized under the laws of another country, should be conducted. The core principles to be found in the main international IPR conventions are summarized in box II 1.

What the content of international IPR conventions should be is a matter that has generated controversy over the years. In particular, the developing countries have not always been content to accept the major principles of IPR protection enshrined in conventions elaborated and subscribed to by the developed countries (Blakeney, 1989; Roffe, 2000). Furthermore, the presence of heightened IPR protection may not provide a clear impetus to FDI flows (UNTCMD, 1993a; Roffe, 2000, p. 411). Nonetheless, the TRIPS Agreement, which is regarded as the current benchmark paradigm of international IPR protection (Roffe, 2000, p. 408), provides in Article 7:

Box II.1. Main IPR principles in major international conventions

National treatment (Rome Convention, Article 2.1; Paris Convention, Article 2)
Right of priority (Paris Convention, Article 4)
Independence of patents obtained for the same invention in different countries (Paris Convention, Article 4bis)
Right to take legislative measures for the grant of compulsory licences (Paris Convention, Article 5)
Special provisions regarding developing countries (Berne Convention, Appendix)

Source: UNCTAD.

> "*Objectives.*
> The protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations" (UNCTAD, 1996a, vol. I., pp. 341-342).

This represents a clear endorsement of the beneficial effects of IPR protection for economic welfare. It should be read in the light of Article 8 of the TRIPS Agreement:

> "*Principles.*
> 1. Members may, in formulating or amending their laws and regulations, adopt measures necessary to protect public health and nutrition, and to promote the public interest in sectors of vital importance to their socio-economic and technological development, provided that such measures are consistent with the provisions of this agreement.
> 2. Appropriate measures, provided that they are consistent with the provisions of this Agreement, may be needed to prevent the abuse of intellectual property rights by right holders or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology" (UNCTAD, 1996a, vol. I., p. 342).

A broad, purposive interpretation of these two provisions suggests that members have, as a matter of principle, considerable discretion to impose competition policy and technology transfer related measures on foreign patent holders, provided the overall level of IPR protection conforms to that provided in the TRIPS Agreement (Trebilcock and Howse, 1999, pp. 322-323). However, it is not clear from these provisions how the protection of IPRs is to contribute to the transfer of technology to developing countries. Unless these provisions are construed as imposing some obligation on the part of technology-exporting countries, they will offer little more than aspirational hopes for developing countries. These issues are further considered in the light of TRIPS provisions, and provisions in other international instruments, in the ensuing subsections.

With regard to the basic standards that members of TRIPS are required to meet, these revolve around national treatment in Article 3 and most-favoured-nation treatment in Article 4. These obligations do not apply to procedures provided in

multilateral agreements concluded under the auspices of the World Intellectual Property Organisation (WIPO) relating to the maintenance and acquisition of IPRs (see TRIPS Agreement, Article 5, in UNCTAD, 1996a, vol. I, p. 341). Furthermore, the members' obligations under TRIPS, in relation to standards concerning the availability, scope and use of IPRs (Part II), enforcement (Part III) and acquisition and maintenance of IPRs and related *inter partes* procedures (Part IV), are subject to their obligations to comply with Articles 1 to 12 and Article 19 of the Paris Convention (1967), and nothing in the TRIPS Agreement may be read as derogating from the members existing obligations to each other under the Paris Convention, the Berne Convention, the Rome Convention and the Treaty on Intellectual Property in Respect of Integrated Circuits (see TRIPS Agreement, Article 2, in UNCTAD, 1996a, vol. I, p. 340). The substantive protection offered to IPR owners by the TRIPS Agreement is summarized in box II.2.

It should be noted that these obligations do not automatically apply to developing countries. Thus, while by virtue of Article 65(1) of the TRIPS Agreement, all members are entitled not to apply the Agreement before the expiration of one year from the entry into force of the WTO Agreement, Article 65(2) gives a developing country a further period of four years following the general transition period applicable to all members under paragraph 1. Thus, developing countries are entitled not to apply the Agreement for a period of five years after the entry into force of the WTO Agreement. Since the latter Agreement entered into force in 1995, the transitional period for developing countries expired in 2000. A developing country may also delay the application of the product patent protection provisions of the Agreement for a further five years where such protection extends to areas of technology that are not currently protectable in that country's territory. Under Article 66 (1) of the TRIPS Agreement, the least developed country members are exempted for ten years from the date of general application of the Agreement set out in paragraph 1, i.e. 11 years after the entry into force of the WTO Agreement. In addition, they may apply for further extensions of that exemption (UNCTAD, 1996a, vol. I, p. 368).

Box II.2. IPR protection in the TRIPS Agreement

The TRIPS Agreement sets standards relating to the protection of patents, copyright and related rights, trademarks and geographical indications, trade secrets and confidential information, integrated circuit design, and industrial design, and covers both substantive standards and specific issues of enforcement that are generally applicable to these. The following provisions are noteworthy:

Patents:

- Member States may not exclude any field of technology from patentability as a whole, and they may not discriminate as to the place of invention when rights are granted (Article 27).
- Domestic patent laws must provide a minimum term of 20 years of protection from the filing date. Such protection must depend on uniform conditions of eligibility, and specified exclusive rights must be granted (Article 33).
- The patentees' exclusive rights must include the right to supply the market with imports of the patented products (Article 28).
- Compulsory licensing remains available and can be granted under the existing law of a member country, subject to the conditions set forth in the Agreement (Article 31).

Copyright and related rights:

- Protection of works covered by the Berne Convention, excluding moral rights, with respect to expression and not the ideas, procedures, methods of operation or mathematical concepts as such (Article 9).
- Protection of computer programmes as literary works and compilations of data (Article 10).
- Recognition of rental rights, at least for phonograms, computer programmes and cinematographic works (except if rental has not led to widespread copying that impairs the reproduction rights) (Article 11).
- Recognition of rights of performers, producers of phonograms and broadcasting organizations (Article 14).

Trademarks and geographical indications:

- Strengthens several aspects of trademark law, including strengthening protection of service-marks and of well-known marks.
- Geographical indications are subject to the general principles (Part I) and to the provisions of enforcement (Part II).

Trade secrets and confidential information:

- Countries are required to protect information that is commercially valuable, secret and subject to measures to prevent unauthorized disclosure against unfair commercial practices.
- Countries must also protect secret data submitted to government authorities in connection with applications for the approval of pharmaceutical and agrochemical products.

/…

Box II.2 (concluded)

Integrated circuit design:

- Mandates compliance with core substantive provisions of the Treaty on Intellectual Property in Respect of Integrated Circuits of 1989 (Washington Treaty) (which is not yet in force). These provisions obliged WTO members to prohibit unauthorized imports, sales or commercial distribution of a protected layout design of an integrated circuit embodying such a design, or of an article incorporating an integrated circuit, for at least ten years, subject to a good faith exception.

Industrial design:

- Participating States are relatively free to draft domestic design protection laws with local objectives in mind. Although members must provide some form of design protection to satisfy both the TRIPS Agreement provisions and the Paris Convention (Article 5 quinquies), countries may resort either to an industrial property law or to copyright law for these purposes, and they need not protect fundamentally determined designs at all.
- Members must protect textile designs, however, either in a design law or in copyright law, and if *sui generis* laws are adopted for this or other purposes, they must protect appearance design against copying for at least a ten-year period.

Source: UNCTAD, 1996b.

2. Enforcement of IPRs

Part III of the TRIPS Agreement contains a comprehensive section on enforcement obligations and procedures. In particular, under Article 41, members must:

> "• Ensure that effective enforcement procedures are available under their law against any act of infringement of IPRs covered by this Agreement, including expeditious remedies to prevent infringements and deterrent remedies to prevent further infringements.
> • Apply such procedures in a manner that avoids the creation of barriers to trade.
> • Provide procedures that are fair and equitable, not unnecessarily complicated or costly, or entailing unreasonable time-limits or delays.
> • Decisions should be reasoned and in writing, and available to the parties and will be based only on evidence in respect of which the parties were offered an opportunity to be heard.
> • Decisions must be subject to judicial review" (UNCTAD, 1996a, vol. I, pp. 357-358).

These general principles are further elaborated in Articles 42-61 of the TRIPS Agreement. The provisions in Part III of the TRIPS Agreement offer a significant inroad into domestic civil and administrative procedures (Trebilcock and Howse, 1999, p. 327). However Article 41(5) makes clear that this Part does not "create any obligation to put in place a judicial system for the enforcement of intellectual property rights distinct from that for the enforcement of law in general, nor does it affect the capacity of the Members to enforce their law in general. Nothing in this Part creates any obligation with respect to the distribution of resources as between enforcement of intellectual property rights and the enforcement of law in general" (*ibid.*).

3. Exhaustion of IPRs and parallel imports

The TRIPS Agreement, Article 6, deals briefly with the issue of exhaustion, stating that, "[f]or the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights". This provision is the result of a compromise. Traditionally each country has established its own policy on the treatment of parallel imports. During the Uruguay Round negotiations it was found to be impossible to agree on a global standard for national exhaustion of IPRs. Thus, Article 6 restricts any challenge to the treatment of parallel imports to violations of national treatment (Article 3) and most-favoured-nation treatment (Article 4) (Maskus, 2000, pp. 208-216). Equally, the text of the draft Multilateral Agreement on Investment (MAI) was inconclusive. There was no agreement on whether there needed to be any language on this issue to ensure that the MAI did not create new obligations in this area (UNCTAD, 2000a, vol. IV, p. 145).

On the other hand, regional economic agreements do deal with the doctrine of exhaustion and the treatment of parallel imports. For example, the Protocol of Harmonization of Norms of Intellectual Property in MERCOSUR on Matters of Trademarks, Geographical Indications and Denominations of Origin (Decision No 8/95) states in Article 13:

> "The registration of a trademark shall not prevent the free circulation of the trademarked products, legally introduced into commerce by the owner or with his authorization. The Party States oblige themselves to include in their respective legislation measures that provide for

the exhaustion of the right granted by the registration" (NLC, 1998).

This provision allows for a regional exhaustion of trademarks registered in MERCOSUR member countries. However, it does not create an international exhaustion regime. Thus parallel imports into MERCOSUR of a trademarked product that is marketed outside the region by or with the consent of the registered holder of the trademark may be prevented (Haines Ferrari, 2000, p. 30). This approach echoes the European Union (EU) doctrine of exhaustion of rights, which allows for parallel imports from other EU member States but does not extend this principle to imports from outside the EU.[6]

Decision 486 (2000) of the Andean Community also contains an exhaustion principle. Thus, under Article 54 thereof:

> "A patent shall not confer on its owner the right to proceed against a third party making commercial use of a product protected by a patent once that product has been introduced into the commerce of any country by the owner or another person authorized by the right holder or with economic ties to that patent owner.
>
> For the purposes of the preceding paragraph, two persons shall be considered to have economic ties when one of the persons is able to exercise a decisive influence on the other, either directly or indirectly, with respect to the exploitation of the patent or when a third party is able to exert that influence over both persons."

Article 54 goes on to assert that where a patent protects biological material that is capable of being reproduced, the patent coverage shall not extend to the biological material that is obtained by means of the reproduction, multiplication or propagation of the material that was introduced into the commerce as described in the first paragraph, provided that it was necessary to reproduce, multiply or propagate the material in order to fulfil the purposes for which it was introduced into commerce and that the material so obtained is not used for multiplication or propagation purposes. Finally, Article 55 makes clear that:

> "Without prejudice to the provisions stipulated in this Decision with respect to patent nullity, the rights conferred by a patent may not be asserted against a third party that, in good faith and before the priority date or the filing date of the application on which the patent was granted, was already using or exploiting the invention, or had already made effective and serious preparations for such use or exploitation.
>
> In such case, the said third party shall have the right to start or continue using or exploiting the invention, but that right may only be assigned or transferred together with the business or company in which that use or exploitation is taking place."

The principle of exhaustion is extended to other IPRs by Decision 486. Thus Article 131 states that:

> "registration of an industrial design shall not confer the right to proceed against a third party who makes commercial use of a product incorporating or reproducing the design once it has been introduced into the commerce of any country by the right holders or another person authorized by them or with economic ties to those right holders."

Article 131 continues by repeating, in relation to industrial designs, the definition of "economic ties" found in Article 54 in the case of patents. In relation to trademarks Article 158 states:

> "Trademark registration shall not confer on the owner the rights to prevent third parties from engaging in trade in a product protected by registration once the owner of the registered trademark or another party with the consent of or economic ties to that owner has introduced that product into the trade of any country, in particular where any such products, packaging or packing as may have been in direct contact with the product concerned have not undergone any change, alteration, or deterioration.
>
> For the purposes of the preceding paragraph, two persons shall be considered to have economic ties when one of the persons is able to exercise a decisive influence over the other, either directly or indirectly, with respect to use of the trademark right or when a third party is able to exert that influence over both persons."

Two general observations may be made as regards the content of these provisions. First, the reference to "any country" suggests that the Andean Community recognizes an international exhaustion principle, as the usual qualification restricting the principle to imports from other member countries is absent. Furthermore, the reference to "economic ties" connotes recent developments in the EU doctrine of exhaustion as interpreted by the European Court of Justice in relation to the exhaustion of trademarks, where the

economic ties between entities in different countries were considered to be of importance when determining whether the protected product had been placed on the market in the country of export with the consent of the IPR owner.[7]

4. Compulsory licensing

This issue is dealt with in major IPR conventions (Paris Convention). Thus Article 5.A of the Paris Convention provides that where a patent is considered to have been insufficiently worked within a country, within a specified time, that patent may be compulsorily acquired or compulsorily licensed to another enterprise. This aims to prevent an anti-competitive hoarding of patents (Blakeney, 1989, p. 16). Compulsory licensing is also covered in the TRIPS Agreement. Article 31 deals with the compulsory licensing of patents (UNCTAD, 1996a, vol. I, p. 352). This places certain conditions upon the granting of a compulsory licence. Of these, the most significant are:

- (i) Each case will be considered on its individual merits.
- (ii) The proposed user must have made efforts, prior to such use, to obtain authorization from the right holder on reasonable commercial terms and conditions and such efforts have not been successful within a reasonable period of time. This requirement is subject to waiver in case of national emergency or public non-commercial use.
- (iii) The scope and duration of such use will be limited to the purpose for which it was authorized.
- (iv) Such use will be non-exclusive and non-assignable.
- (v) It shall be authorized predominantly for the supply of the domestic market of the member authorizing such use.
- (vi) The authorization will be liable to be terminated if and when the circumstances which led to it cease to exist and are unlikely to recur. This is subject to the adequate protection of the legitimate interests of the persons so authorized.
- (vii) The right holder will be paid adequate remuneration.
- (viii) Decisions will be subject to judicial review.

Conditions (ii) and (v) may not apply where the use is permitted to remedy any anti-competitive practices (UNCTAD, 1996a, vol. I, p. 352).

Similar requirements can be found in NAFTA, which deals with the issue in Article 1709(10) (NAFTA, 1993, p. 674). The draft MAI indirectly referred to this matter in connection with expropriation issues. It was agreed that text was needed to ensure that certain IPR management and legal provisions did not constitute expropriation (UNCTAD, 2000a, vol. IV, p. 143).

A significant recent statement of the principles surrounding compulsory licensing can be found in Decision 486 (2000) of the Andean Community. The relevant provisions are reproduced in box II.3. The approach largely follows the matters contained in the TRIPS provision, though in somewhat more detail, explicable by the fact that this Decision aims to offer a framework in which the member countries can act on the issue.

Box II.3. Andean Community Decision 486 (2000)

"CHAPTER VII
On the Regime of Compulsory Licensing

Article 61.- At the expiry of a period of three years following a patent grant or of four years following the application for a patent, whichever is longer, the competent national office may grant a compulsory license mainly for the industrial manufacture of the product covered by the patent, or for full use of the patented process, at the request of any interested party, but only if, at the time of the request, the patent had not been exploited in the manner specified in articles 59 and 60, in the Member Country in which the license is sought, or if the exploitation of the invention had been suspended for more than one year.

Compulsory licenses shall not be granted if patent owners are able to give valid reasons for their failure to act, which may be reasons of force majeure or an act of God, in accordance with the domestic provisions in effect in each Member Country.

A compulsory license shall be granted only if, prior to applying for it, the proposed user has made efforts to obtain a contractual license from the patent holder on reasonable commercial terms and conditions and that such efforts were not successful within a reasonable period of time.

Article 62.- Decisions to grant a compulsory license, as stipulated in the previous article, shall be taken after the patent owners have been notified to present their arguments as they see fit within the following sixty days.

/…

Box II.3 (continued)

The competent national office shall specify the scope or coverage of the license, and in particular shall specify the period for which it is granted, the subject matter of the license, the amount of the remuneration, and the conditions for the payment thereof. The remuneration shall be set at an adequate level in accordance with the individual circumstances of each case and, in particular, the economic value of the authorization.

Opposition to a compulsory license shall not prevent its exploitation or have any effect on any periods that may be running. The filing of an objection shall not prevent the patent owner, in the meantime, from collecting the remuneration specified by the competent national office on the part unaffected by the objection.

Article 63.- At the request of the owner of the patent or the licensee, the conditions governing the compulsory license may be changed by the competent national office where new circumstances so dictate and, in particular, when the patent holder grants another license on terms that are more favorable than the existing ones.

Article 64.- The licensee shall exploit the licensed invention within a period of two years following the date the license was granted, unless that licensee is able to give valid reasons for inaction consisting of force majeure or an act of God. Otherwise, at the patent owner's request, the competent national office shall revoke the compulsory license.

Article 65.- Following the declaration by a Member Country of the existence of public interest, an emergency, or national security considerations, and only for so long as those considerations exist, the patent may be subject to compulsory licensing at any time. In that case, the competent national office shall grant the licenses that are applied for. The owner of the patent so licensed shall be notified as soon as is reasonably possible.

The competent national office shall specify the scope or extent of the compulsory license and, in particular, the term for which it is granted, the subject matter of the license, and the amount of remuneration and the conditions for its payment.

The grant of a compulsory license for reasons of public interest shall not reduce the right of the patent owner to continue exploiting it.

Article 66.- The competent national office may, either ex officio or at the request of a party, and after having obtained the consent of the national antitrust authority, grant compulsory licenses where practices are noted that are detrimental to the exercise of free competition, especially where they constitute an abuse by the patent owner of a dominant position in the market.

/…

Box II.3 (continued)

The need to correct anti-competitive practices shall be taken into account tin determining the amount of remuneration to be paid in such cases.

The competent national office shall refuse termination of a compulsory license if and when the conditions which led to the granting of the license are likely to recur.

Article 67.- The competent national office shall grant a license, upon request by the owner of a patent whose exploitation necessarily requires the use of another patent, and that right holder has been unable to secure a contractual license to the other patent on reasonable commercial terms. That license shall, without prejudice to the provisions of article 68, be subject to the following conditions:

a) the invention claimed in the second patent shall involve an important technical advance of considerable economic significance in relation to the invention claimed in the first patent;
b) the owner of the first patent shall be entitled to a cross-license on reasonable terms to use the invention claimed in the second patent; and,
c) the license authorized in respect of the first patent shall be non-assignable except with the assignment of the second patent.

Article 68.- In addition to the conditions provided for in the preceding articles, compulsory licenses shall be subject to the following:

a) they shall be non-exclusive and may not be sublicensed;
b) they shall be non-assignable, except with the part of the business or goodwill which permits its industrial use. This shall be evidenced in writing and registered with the competent national office. Otherwise, those assignments or transfers shall not be legally binding;
c) they shall be liable, subject to adequate protection of the legitimate interests of the persons so authorized, to be terminated if and when the circumstances which led to them cease to exist and are unlikely to recur;
d) their scope and duration shall be limited to the purposes for which they were authorized;
e) in the case of patents protecting semi-conductor technology, a compulsory license shall be authorized only for public non-commercial use or to remedy a practice declared by the competent national authority to be anti-competitive in accordance with articles 65 and 66;
f) they provide for payment of adequate remuneration according to the circumstances of each case, taking into account the economic value of the license, without prejudice to the stipulations of article 66; and,

/…

Box II.3 (concluded)

g) they shall be used predominantly for the supply of the domestic market.

Article 69.- Compulsory licenses that fail to comply with the provisions of this Chapter shall be devoid of any legal effect whatsoever."

Source: www.sice.oas.org.

In contrast to the above examples from multilateral and regional instruments, BITs are usually silent on the matter of compulsory licensing. However, where a BIT includes IPRs in its definition of protected investments, and where it covers not only direct but also indirect expropriations, the protection offered by the agreement may in itself be enough to cover compulsory licensing in the exceptional case where it can be shown that this has an expropriatory purpose and is carried out in breach of the protective standards of treatment contained in the BIT and in disregard of the relevant provisions of IPR agreements.

B. Encouraging transfer of technology

This area has seen some significant changes in the approach of international instruments that deal with technology transfer. At least three major approaches can be discerned. The first can be termed the "regulatory" approach. This seeks to encourage increased transfer of technology through collaboration between, in particular, developed and developing countries. It centres on the potentially unequal nature of a technology transfer transaction, especially where the recipient is an enterprise in a developing country. The underlying rationale for provisions displaying this approach is to control the potentially adverse economic consequences of such transfers for the weaker party, which include both the licensee in an external transfer and the developing host country in the case of all transfers. Hence the major features of such provisions include the protection of a host country's internal regulations on technology transfer and the outright prohibition of certain terms in technology transfer transactions that are detrimental to development goals.

The second approach may be termed the "market-based development" approach. Here the technology transfer transaction is not necessarily seen as one between unequal parties. Rather, the private property character of the technology is stressed and a TNC that (in most of these cases) owns the technology is seen as being free to transfer it by whatever means it sees fit. However, given the potential inequality of market power between the owner and recipient of the technology, this freedom for a TNC is subject to certain obligations not to abuse its market power, whether in the case of an external transfer to a licensee or in the course of internal transfers within the TNC network. This matter is considered in the next subsection as it is of sufficient importance to warrant separate and more detailed treatment.

In addition, this approach recognizes the potential asymmetry between developed and developing countries in the market for technology transfer, and so includes provisions that seek to encourage cooperation and assistance for developing countries in evolving their own technological base and R&D facilities, and the granting of incentives to TNCs by their home countries so as to encourage technology transfer to developing countries. Thus, it abandons the willingness to prohibit specific terms in technology transfer transactions that is characteristic of the "regulatory" approach, relying rather on competition rules to control abuses. The "regulatory" approach is characteristic of instruments concluded by developing countries in the 1960s and 1970s, of which the Andean Community's Decision 24 is the leading example. It can also be discerned in the provisions of the draft TOT Code. The "market-based development" approach is characteristic of more recent agreements and finds its fullest expression in the TRIPS Agreement (Roffe, 2000).

A variant of the second approach may be seen to be emerging in relation to environmental issues. As noted in section I, provisions for the transfer of environmentally sound technology to developing countries are increasingly common in international environmental agreements. For example, the United Nations Framework Convention on Climate Change and its Kyoto Protocol contain specific provisions with regard to the transfer and development of technology. These instruments have as their starting point the free commercial transfer of technology by TNCs, but subject to the need to ensure that such transfers are not harmful in environmental terms and that TNCs are encouraged to transfer environmentally sound technologies to developing countries which may otherwise have no opportunity to use them. For example, Article 19 of the Energy Charter Treaty

encourages the sharing of technical information on environmentally sound technologies and the transfer of such technologies subject to the adequate and effective protection of IPRs. Equally, the Biodiversity Convention establishes a link between "appropriate" access to and utilization of genetic resources, on the one hand, and "appropriate" transfer of relevant technology to developing countries (including those subject to patents and other intellectual property rights), on the other hand. This link is expressly acknowledged as part of the objectives of the Convention, which are:

> "the conservation of biological diversity, the sustainable use of its components and the fair and equitable sharing of the benefits arising out of the utilization of genetic resources, including by appropriate access to genetic resources, and by appropriate transfer of relevant technologies, taking into account all rights over those resources and to technologies, and by appropriate funding" (ILM, 1992, p. 64).

As these provisions are fully covered in these volumes by the chapter on *Environment* (chapter 16), no further mention will be made of them here. (For ease of reference, annex table 1 contains a list of selected instruments in the area of environment and their technology-transfer provisions.)

The third approach, which may be termed the "intra-regional technology development" approach, has been adopted in regional economic development agreements between developing countries. These agreements differ from the "regulatory" model in that they concentrate on the encouragement of intra-regional technology development and transfer whether through regional industrial policies or through the establishment of specialized regimes for regional multinational enterprises. They do not deal as such with technology transfer by investors from outside the region. Nor can these agreements be seen as examples of the "market-based development" approach in that they are firmly committed to the development of member country sponsored industrial development policies. However, they may be closer in spirit to this approach as these regional agreements do not subject the inward transfer of technology by investors from outside the region to strict regulatory controls.

1. The "regulatory" approach

This approach was followed in the national laws and policies of numerous countries during the 1970s, following a model well established in Japan and the Republic of Korea (Omer, 2001, pp. 301-303). It is most fully exemplified on the regional level by the Andean Community's policy on technology imports, as contained in Decision 24 of 31 December 1970, the "Common Regulations Governing Foreign Capital Movement, Trade Marks, Patents, Licences and Royalties", which has since been superseded (UNCTAD, 1996a, vol. II, p. 454). The aims of Decision 24 included the strengthening of national undertakings in the Andean Community so as to equip them to participate actively in the subregional market. One means by which this was to be achieved was to ensure that national undertakings had "the fullest possible access to modern technology and contemporary managerial innovations" (UNCTAD, 1996a, vol. II, p. 455). This, in turn, was to be achieved by way of a system of screening of technology transfer agreements by the authorities of the member countries. Thus, under Article 18 of Decision 24:

> "Every agreement relating to the import of technology or to patents and trade marks shall be examined and submitted for approval to the competent authority of the member country, which shall assess the effective contribution of the imported technology by estimating the benefits likely to be obtained from it, the price of the goods in which it is embodied, and any other quantifiable effect it may have" (UNCTAD, 1996a, vol. II, p. 460).

Such national regulation was to be subject to certain guiding principles contained in Decision 24. Thus, Article 19 prescribed that certain minimum provisions had to be included in a technology transfer agreement regarding the particular form of transfer, the contractual value of the transfer and the duration of the agreement. Article 20 prohibited the authorization of the conclusion of technology transfer agreements where these contained certain conditions. These included undertakings in relation to the purchase of capital goods, intermediate products, raw materials or other forms of technology, or in relation to the employment of staff designated by the transfer or undertaking; resale price maintenance provisions;

production restrictions; no competing technology use clauses; technology purchase options and grant backs favourable to the transferor; and royalty payments on unused patents and other conditions of equivalent effect. Also, export restrictions on products containing the transferred technology were not permitted. Article 21 ensured that royalty payments could not be treated as transfers of capital, and that such transfers between affiliates in a TNC would be subject to tax.

Alongside this screening procedure, Decision 24 established a programme for the encouragement of regional technological development and for the adaptation and assimilation of existing technologies. To this end, the member countries would be obliged to monitor technological developments in particular industries so as to identify the most useful technologies and processes, and a system of incentives for the production of technology, export promotion schemes for products incorporating regional technology, and preferential purchasing programmes for such products within the region were to be established (Decision 24, Articles 22-24, in UNCTAD, 1996a, vol. II, p. 461). Finally, under Article 25 certain restrictive conditions in trademark licensing agreements were prohibited, and under Article 26 the Andean Commission was enabled to declare that certain production processes or groups of products would not be able to enjoy patent privileges in any member country. This covered both future and existing privileges.

Decision 24 was superseded by Decision 220, which was in turn superseded by Decision 291 of 21 March 1991, which now represents Andean Community policy in this area (UNCTAD, 1996a, vol. II, p. 447). While this latter Decision mainly concerns the reform of the Andean Community member States' policies on inward FDI, it retained, in Chapter IV, certain provisions on technology imports that display some features of the regulatory approach taken in Decision 24. The major difference is that the Andean Commission leaves more freedom to member countries to formulate their national laws in this field. Thus, under Article 12 of Decision 291, member countries shall register, with the relevant national agency, contracts for technology licensing, technical assistance, technical services, basic and special engineering and other technological contracts, as defined in the applicable national laws. That agency shall then evaluate the effective contribution of the imported technology by estimating its probable uses and the cost of goods incorporating the technology, or by otherwise measuring the specific impact of the technology. Decision 291 retains similar provisions to those found in Decision 24 concerning the minimum clauses to be contained in a technology transfer agreement, although it adds a requirement to identify the parties, with specific mention of their nationality and domicile. Article 14 then reproduces the same list of "blacklisted" clauses that should not be included in technology transfer agreements as those found in Article 20 of Decision 24. However, this is done with the important difference that, in place of the absolute prohibition found in Article 20 of Decision 24, Article 14 of Decision 291 requires only that member countries "shall ensure" that technology importation contracts do not contain these clauses. In addition, Article 15 of Decision 291 liberalizes the prohibition on the treatment of royalties on transferred technology as capital investment, and allows this subject to the payment of tax on the royalties. Finally the programme on regional technological development, established by Decision 24, is no longer mentioned in Decision 291.

The regulatory approach to the encouragement of technology transfer to developing countries was a significant feature of initiatives on the regulation of TNCs undertaken by various United Nations bodies in the 1970s and 1980s.[8] Thus United Nations General Assembly Resolution 3202 (S-VI), the Declaration on the Establishment of a New International Economic Order, requires respect for the principle of "giving to the developing countries access to the achievements of modern science and technology, and promoting the transfer of technology and the creation of indigenous technology for the benefit of the developing countries in forms and in accordance with procedures which are suited to their economies" (UNCTAD, 1996a, vol. I, p. 50). This principle is given some form by United Nations General Assembly Resolution 3202 (S-VI), the Programme of Action on the Establishment of a New International Economic Order, which asserts that all efforts should be made to formulate an international code of conduct for the transfer of technology corresponding to the needs and conditions prevalent in developing countries, to give improved access on the part of developing countries to modern technology; to adapt that technology to their needs; to expand significantly the assistance from developed to developing countries in R&D programmes and in

the creation of suitable indigenous technology; to adapt commercial practices governing technology transfer to the requirements of developing countries and to prevent the abuse of rights of sellers; and to promote international cooperation and R&D in exploration and exploitation, conservation and the legitimate utilization of natural resources and all sources of energy. In addition, the Programme of Action envisages, as part of the agenda for the regulation of and control over the activities of TNCs, an international code of conduct for TNCs which would aim *inter alia* "to bring about assistance, transfer of technology and management skills to developing countries on equitable and favourable terms" (UNCTAD, 1996a, vol. I, pp. 53-54). In a similar vein, United Nations General Assembly Resolution 3281 (XXIX), the Charter on the Economic Rights and Duties of States, provides in Article 13(4) that "All States should co-operate in research with a view to evolving further internationally accepted guidelines or regulations for the transfer of technology, taking fully into account the interests of the developing countries" (UNCTAD, 1996a, vol. I, p. 64).

Following on from these policy-making United Nations resolutions, the draft United Nations Code of Conduct on Transnational Corporations contained a general provision on technology transfer that exemplifies the "regulatory" approach to this issue. Under paragraph 36 of the draft Code, TNCs have the following duties:

"• To conform to the technology transfer laws and regulations of the countries in which they operate.
- To co-operate with the authorities of those countries in assessing the impact of international transfers of technology in their economies and consult with them regarding various technological options which might help those countries, particularly developing countries, to attain their economic and social development.
- In their transfer of technology transactions, including intra-corporate transactions, to avoid practices which adversely affect the international flow of technology, or otherwise hinder the economic and technological development of countries, particularly developing countries.
- To contribute to the strengthening of the scientific and technological capacities of developing countries, in accordance with the science and technology policies and priorities of those countries and to undertake substantial R&D activities in developing countries and make full use of local resources and personnel in this process" (UNCTAD, 1996a, vol. I, pp. 168-169).

The draft Code of Conduct ends by referring to the applicability of the relevant provisions of the draft TOT Code for the purposes of the draft Code of Conduct, thereby emphazising the supremacy of the specialized code in relation to issues concerning technology transfer.

The draft TOT Code, which was negotiated under the auspices of UNCTAD between 1976 and 1985, represents the high benchmark for a model of provisions espousing the "regulatory" approach to technology transfer (UNCTAD, 1996a, vol. I, p.181; see also Patel et al., 2001). This is exemplified, in particular, by the objectives and principles of the draft TOT Code in Chapter 2 and by the provisions on the national regulation of technology transfer transactions in Chapter 3. These are reproduced in full in box II.4. In particular, emphasis is placed, in the objectives section of Chapter 2, on the encouragement of technology transfer transactions involving developing countries, under conditions in which the bargaining positions of the parties are balanced so as to avoid abuses of a stronger position and thereby to achieve mutually satisfactory agreements. Furthermore, the "unpackaging" of technology is recommended, as are the specification of restrictive business practices from which parties to technology transfer transactions ought to, or be obliged to, refrain and the laying down of an appropriate set of responsibilities and obligations of parties to transfer of technology transactions, taking into account not only their legitimate interests but also differences in their bargaining positions. All of these objectives are consistent with a "regulatory" approach to technology transfer.

As for the principles underlying the draft TOT Code, these too include provisions that further a regulatory agenda. Thus, *inter alia,* States are said to have the right to adopt all appropriate measures for facilitating and regulating the transfer of technology and to enjoy recognition of the principles of sovereignty and political independence and sovereign equality of States in this process. Furthermore, among the fundamental elements in the process of technology transfer and development, the draft TOT Code includes facilitating and increasing access to technology, particularly for developing countries, under

mutually agreed fair and reasonable terms and conditions and the recognition of the protection of IPRs granted under national law.

Box II.4. Draft International Code of Conduct on the Transfer of Technology (1985 version)

"Chapter 2
Objectives and Principles

2. The Code of Conduct is based on the following objectives and principles:

2.1. Objectives

(i) To establish general and equitable standards on which to base the relationship among parties to transfer of technology transactions and governments concerned, taking into consideration their legitimate interests, and giving due recognition to special needs of developing countries for the fulfilment of their economic and social development objectives.

(ii) To promote mutual confidence between parties as well as their governments.

(iii) To encourage transfer of technology transactions, particularly those involving developing countries, under conditions where bargaining positions of the parties to the transactions are balanced in such a way as to avoid abuses of a stronger position and thereby to achieve mutually satisfactory agreements.

(iv) To facilitate and increase the international flow of technological information, particularly on the availability of alternative technologies, as a prerequisite for the assessment, selection, adaptation, development and use of technologies in all countries, particularly developing countries.

(v) To facilitate and increase the international flow of proprietary and non-proprietary technology for strengthening growth of the scientific and technological capabilities of all countries, particularly developing countries, so as to increase their participation in world production and trade.

(vi) To increase the contributions of technology to the identification and solution of social and economic problems of all countries, particularly the developing countries, including the development of basic sectors of their national economies.

(vii) To facilitate the formulation, adoption and implementation of national policies, laws and regulations on the subject of transfer of technology by setting forth international norms.

(viii) To promote adequate arrangements as regards unpackaging in terms of information concerning the various elements of the technology to be transferred, such as that required for technical, institutional and financial evaluation of the transaction, thus avoiding undue or unnecessary packaging.

(ix) To specify restrictive [business] practices from which parties to technology transfer transactions [shall] [should] refrain. *

/…

Box II.4 (continued)

(x) To set forth an appropriate set of responsibilities and obligations of parties to transfer of technology transactions, taking into consideration their legitimate interests as well as differences in their bargaining positions.

2.2. Principles

(i) The Code of Conduct is universally applicable in scope.

(ii) States have the right to adopt all appropriate measures for facilitating and regulating the transfer of technology, in a manner consistent with their international obligations, taking into consideration the legitimate interests of all parties concerned, and encouraging transfer of technology under mutually agreed, fair and reasonable terms and conditions.

(iii) The principles of sovereignty and political independence of States (covering, inter alia, the requirements of foreign policy and national security) and sovereign equality of States, should be recognized in facilitating and regulating transfer of technology transactions.

(iv) States should co-operate in the international transfer of technology in order to promote economic growth throughout the world, especially that of the developing countries. Co-operation in such transfer should be irrespective of any differences in political, economic and social systems; this is one of the important elements in maintaining international peace and security and promoting international economic stability and progress, the general welfare of nations and international co-operation free from discrimination based on such differences. Nothing in this Code may be construed as impairing or derogating from the provisions of the Charter of the United Nations or actions taken in pursuance thereof. It is understood that special treatment in transfer of technology should be accorded to developing countries in accordance with the provisions in this Code on the subject.

(v) The separate responsibilities of parties to transfer of technology transactions, on the one hand, and those of governments when not acting as parties, on the other, should be clearly distinguished.

(vi) Mutual benefits should accrue to technology supplying and recipient parties in order to maintain and increase the international flow of technology.

(vii) Facilitating and increasing the access to technology, particularly for developing countries, under mutually agreed fair and reasonable terms and conditions, are fundamental elements in the process of technology transfer and development.

(viii) Recognition of the protection of industrial property rights granted under national law.

(ix) Technology supplying parties when operating in an acquiring country should respect the sovereignty and the laws of that country, act with proper regard for that country's declared development policies and priorities and endeavour to contribute substantially to the development of the acquiring country. The freedom of

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Box II.4 (continued)

parties to negotiate, conclude and perform agreements for the transfer of technology on mutually acceptable terms and conditions should be based on respect for the foregoing and other principles set forth in this Code.

Chapter 3
National regulation of transfer of technology transactions

3.1 In adopting, and in the light of evolving circumstances making necessary changes in laws, regulations and rules, and policies with respect to transfer of technology transactions, States have the right to adopt measures such as those listed in paragraph 3.4 of this chapter and should act on the basis that these measures should:
(i) Recognize that a close relationship exists between technology flows [and] the conditions under which such flows are admitted and treated;
(ii) Promote a favourable and beneficial climate for the international transfer of technology;
(iii) Take into consideration in an equitable manner the legitimate interests of all parties;
(iv) Encourage and facilitate transfers of technology to take place under mutually agreed, fair and reasonable terms and conditions having regard to the principles and objectives of the Code;
(v) Take into account the differing factors characterizing the transactions such as local conditions, the nature of the technology and the scope of the undertaking;
(vi) Be consistent with their international obligations.

3.2. Measures adopted by States including decisions of competent administrative bodies should be applied fairly, equitably, and on the same basis to all parties in accordance with established procedures of law and the principles and objectives of the Code. Laws and regulations should be clearly defined and publicly and readily available. To the extent appropriate, relevant information regarding decisions of competent administrative bodies should be disseminated.

3.3. Each country adopting legislation on the protection of industrial property should have regard to its national needs of economic and social development, and should ensure an effective protection of industrial property rights granted under its national law and other related rights recognized by its national law.3.4.Measures on regulation of the flows and effects of transfer of technology, finance and technical aspects of technology transactions and on organizational forms and mechanisms may deal with:

Finance
(a) Currency regulations of foreign exchange payments and remittances;
(b) Conditions of domestic credit and financing facilities;
(c) Transferability of payments;
(d) Tax treatment;
(e) Pricing policies;

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Box II.4 (concluded)

Renegotiation
(f) Terms, conditions and objective criteria for the renegotiation of transfer of technology transactions;
Technical aspects
(g) Technology specifications and standards for the various components of the transfer of technology transactions and their payments;
(h) Analysis and evaluation of transfer of technology transactions to assist parties in their negotiation;
(i) Use of local and imported components;
Organizational forms and mechanisms
(j) Evaluation, negotiation, and registration of transfer of technology transactions;
(k) Terms, conditions, duration, of transfer of technology transactions;
(l) Loss of ownership and/or control of domestic acquiring enterprises;
(m) Regulation of foreign collaboration arrangements and agreements that could displace national enterprises from the domestic market;
(n) The definition of fields of activity of foreign enterprises and the choice of channels, mechanisms, organizational forms for the transfer of technology and the prior or subsequent approval of transfer of technology transactions and their registration in these fields;
(o) The determination of the legal effect of transactions which are not in conformity with national laws, regulations and administrative decisions on the transfer of technology;
(p) The establishment or strengthening of national administrative mechanisms for the implementation and application of the Code of Conduct and of national laws, regulations and policies on the transfer of technology;
(q) Promotion of appropriate channels for the international exchange of information and experience in the field of the transfer of technology. ”

Source: UNCTAD, 1996a, vol. I, pp. 184-188.
Note: * Text under consideration.

Chapter 3 of the draft TOT Code (box II.4) also stresses the right of States to regulate technology transfers in any of the ways listed in paragraph 3.4. thereof, subject to a non-binding obligation[9] to take into account the six requirements listed in paragraph 3.1.

The regulatory approach of the draft TOT Code continues in its treatment of restrictive business practices in Chapter 4 (to be discussed in the next subsection), and through the laying down of detailed provisions concerning the responsibilities and obligations of the parties to a technology transfer agreement in Chapter 5. These start with an exhortation to the parties to be responsive to the economic and social objectives of the respective countries, and particularly those of the technology-acquiring country, when

negotiating and concluding such an agreement. Furthermore, the parties should observe fair and honest business practices in their dealings. Chapter 5 goes on to enumerate various specific matters that should be considered by the parties at the negotiating phase, including the use of locally available resources, rendering of technical services and unpackaging. As to fair and honest business negotiating practices, Chapter 5 of the draft TOT Code recommends that both parties should negotiate fair and reasonable terms and conditions in good faith, offer relevant information to each other, keep secret confidential information received from the other party and cease negotiations if no satisfactory agreement can be reached. Chapter 5 then continues with provisions concerning the need to disclose relevant information about the development needs and regulatory environment of the recipient's country and about the nature of the technology concerned. Chapter 5 concludes with a list of mutually acceptable contractual obligations that should be included in the agreement. These relate to access to improvements, confidentiality, dispute settlement and applicable law, description of the technology, suitability for use, rights to the technology transferred, quality levels and goodwill, performance guarantees, transmission of relevant technical documentation, training of personnel and provision of accessories, spare parts and components, and liability (UNCTAD, 1996a, vol. I, pp. 194-195).

The draft TOT Code ends with three chapters dedicated to improving the access of countries, particularly developing countries, to technology. Thus, Chapter 6 offers provisions for the special treatment of developing countries by developed countries; Chapter 7 provides for international collaboration with a view to facilitating an expanded international flow of technology aimed at strengthening the technological capabilities of all countries; and Chapter 8 envisages an international institutional machinery for the development of the TOT Code to be placed under the auspices of UNCTAD. Of these, Chapter 6 in particular needs closer examination (box II.5).

In essence, Chapter 6 urges the Governments of developed countries, directly or through international organizations, to facilitate and encourage the initiation and strengthening of the technological capabilities of developing countries through the types of measures listed in box II.5. Thus an expectation of information exchange and cooperation in the technology transfer field is envisaged. This entails taking into account requests from developing countries concerning *inter alia* the establishment of research assistance programmes, the development of new laws and regulations, work on specific projects and access to favourable finance and credit. Furthermore, developed countries should encourage their enterprises to become involved in such activities through government-led programmes.

Box II.5. Draft International Code of Conduct on the Transfer of Technology (1985 version)

"Chapter 6
Special treatment for developing countries

6.1. Taking into consideration the needs and problems of developing countries, particularly of the least developed countries, governments of developed countries, directly or through appropriate international organizations, in order to facilitate and encourage the initiation and strengthening of the scientific and technological capabilities of developing countries so as to assist and co-operate with them in their efforts to fulfil their economic and social objectives, should take adequate specific measures, *inter alia*, to:

(i) facilitate access by developing countries to available information regarding the availabilities, description, location and, as far as possible, approximate cost of technologies which might help those countries to attain their economic and social development objectives;

(ii) give developing countries the freest and fullest possible access to technologies whose transfer is not subject to private decisions; *

(iii) facilitate access by developing countries, to the extent practicable, to technologies whose transfer is subject to private decisions; *

(iv) assist and co-operate with developing countries in the assessment and adaptation of existing technologies and in the development of national technologies by facilitating access, as far as possible, to available scientific and industrial research data;

(v) co-operate in the development of scientific and technological resources in developing countries, including the creation and growth of innovative capacities;

(vi) assist developing countries in strengthening their technological capacity, especially in the basic sectors of their national economy, through creation of and support for laboratories, experimental facilities and institutes for training and research;

(vii) co-operate in the establishment or strengthening of national, regional and/or international institutions, including transfer centres, to help developing countries to develop and obtain technology and skills required for the establishment, development and enhancement of their technological capabilities including the design, construction and operation of plants;

/…

Box II.5 (continued)

(viii) encourage the adaptation of research and development, engineering and design to conditions and factor endowments prevailing in developing countries;
(ix) co-operate in measures leading to greater utilization of the managerial, engineering, design and technical experience of the personnel and the institutions of developing countries in specific economic and other development projects undertaken at the bilateral and multilateral levels;
(x) encourage the training of personnel from developing countries.

6.2.Governments of developed countries, directly or through appropriate international organizations, in assisting in the promotion of transfer of technology to developing countries - particularly to the least developed countries - should, as a part of programmes for development assistance and co-operation, take into account requests from developing countries to:
(i) contribute to the development of national technologies in developing countries by providing experts under development assistance and research exchange programmes;
(ii) provide training for research, engineering, design and other personnel from developing countries engaged in the development of national technologies or in the adaptation and use of technologies transferred;
(iii) provide assistance and co-operation in the development and administration of laws and regulations with a view to facilitating the transfer of technology;
(iv) provide support for projects in developing countries for the development and adaptation of new and existing technologies suitable to the particular needs of developing countries;
(v) grant credits on terms more favourable than the usual commercial terms for financing the acquisition of capital and intermediate goods in the context of approved development projects involving transfer of technology transactions so as to reduce the cost of projects and improve the quality of technology received by the developing countries;
(vi) provide assistance and co-operation in the development and administration of laws and regulations designed to avoid health, safety and environmental risks associated with technology or the products produced by it.

6.3. Governments of developed countries should take measures in accordance with national policies, laws and regulations to encourage and to endeavour to give incentives to enterprises and institutions in their countries, either individually or in collaboration with enterprises and institutions in developing countries, particularly those in the least developed countries, to make special efforts, inter alia, to:
(i) assist in the development of technological capabilities of the enterprises in developing countries, including special training as required by the recipients;
(ii) undertake the development of technology appropriate to the needs of developing countries;
(iii) undertake R and D activity in developing countries of interest to such countries, as well as to

/…

Box II.5 (concluded)

improve co-operation between enterprises and scientific and technological institutions of developed and developing countries;
(iv) assist in projects by enterprises and institutions in developing countries for the development and adaptation of new and existing technologies suitable to the particular needs and conditions of developing countries.

6.4. The special treatment accorded to developing countries should be responsive to their economic and social objectives vis-a-vis their relative stage of economic and social development and with particular attention to the special problems and conditions of the least developed countries."

Source: UNCTAD, 1996a, vol. I, pp. 195-197.
Note:* The term "private decision" in the particular context of this chapter should be officially interpreted in the light of the legal order of the respective country.

2. The market-based development approach

This approach is best exemplified by the technology transfer related provisions of the TRIPS Agreement. As noted in the previous section, Articles 7 and 8 of the TRIPS Agreement provide that the protection of IPRs should contribute to the promotion of technological innovation, and the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations. This policy is further developed in Article 66 (2) of the TRIPS Agreement whereby "[d]eveloped country Members shall provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least developed country Members in order to enable them to create a sound and viable technological base". This is to be reinforced through an obligation, under Article 67, for developed country members to provide, on request and on mutually agreed terms and conditions, technical and financial cooperation in favour of developing and least developed country members in order to facilitate the implementation of the TRIPS Agreement.

However, notwithstanding these specific provisions on technology transfer, the main thrust of the TRIPS Agreement is the protection of IPRs based on the principles described in section A above and on competition related provisions to be described in section C below. The underlying policy is centred on the belief that the

encouragement of technology transfer is best achieved in an environment in which IPRs are fully protected as private commercial property and in which the market for technology is maintained in as competitive a condition as possible. Thus the emphasis has shifted away from the regulation of technology transfer transactions in the interests of the weaker party – normally the recipient in the developing country – towards a more open market-based model in which increased technology transfer to developing countries is to be encouraged through the proper operation of the market, coupled with assistance and cooperation on the part of developed countries. Thus this is not an approach that completely abandons governmental action on policy. Rather, there is a move away from the regulatory control of transactions by recipient developing country Governments towards the encouragement of increased levels of technology transfer through governmental programmes, and incentives to firms, on the part of developed country Governments.

A similar approach can be found in the Energy Charter Treaty, the General Agreement on Trade in Services (GATS) and the recently revised OECD Guidelines for Multinational Enterprises. Thus Article 8 of the Energy Charter Treaty calls upon signatories "to promote access to and transfer of technology in the field of energy technology on a commercial and non-discriminatory basis to assist effective trade in Energy Materials and Products and Investment and to implement the objectives of the Charter subject to their laws and regulations, and to the protection of intellectual property rights". This provision continues by requiring the signatories to eliminate existing obstacles to the transfer of technology in this field and to create no new ones (UNCTAD, 1996a, vol. II, pp. 553-554).

In the field of services, Article IV (1) (a) of the GATS Agreement recognizes that, in order to increase the participation of developing countries in world trade, further negotiations should be pursued to strengthen their domestic services capacity, their efficiency and competitiveness, "*inter alia* through access to technology on a commercial basis". Furthermore, developed country members should establish contact points with developing and least developed country members to supply information concerning, among other things, the availability of services technology (GATS Article IV (2)(c), in UNCTAD, 1996a, vol. I, p. 290). In relation to the objectives set out in Article IV of the GATS, Article XIX makes clear that developing country members are able to make the liberalization of market access to foreign service providers subject to conditions that aim to achieve those objectives. Thus a degree of developing host country regulation over entry conditions is accepted where this is likely to enhance a given country's access to technology. Finally, the GATS Annex on Telecommunications commits developed country members, where practical, to making available to developing countries information on telecommunications services and developments in telecommunications technology to assist in strengthening their domestic telecommunications services sector.

Other WTO instruments may also be mentioned briefly, in that their terms seek to contribute to the promotion of technology transfer from developed to developing countries. Thus the Agreement on Subsidies and Countervailing Measures includes, within its definition of non-actionable subsidies in Article 8, matters of import to technology transfer such as research activities, assistance to disadvantaged regions and the adaptation of existing facilities to new environmental requirements. Similarly, the Agreement on Technical Barriers to Trade recognizes, in its preamble, the positive contribution that international standardization of technical requirements can make to the transfer of technology from developed to developing countries. Article 11 of the Agreement goes on to encourage developed country members to give technical assistance to developing country members in the field of standardization, while Article 12.4 specifically accepts that developing countries may adopt technical standards aimed at the preservation of indigenous technology and production methods and processes compatible with their development needs.

The OECD Guidelines for Multinational Enterprises also follow a market-based development approach. Thus chapter VIII of the Guidelines encourages enterprises to adopt, where practicable, practices that permit the transfer and rapid diffusion of technologies and know-how, with due regard to the protection of IPRs (OECD, 2000a, p. 26). Although the Guidelines do not specifically mention developing countries, given that enterprises are expected to "[c]ontribute to economic, social and environmental progress with a view to achieving sustainable development" (ibid., p. 19; chapter II, General Policies, paragraph 1), the Guideline on Science and Technology can

be read with the special needs of developing host countries in mind. This is reinforced by the OECD's Commentary on the Science and Technology Guideline, which states that access to technology generated by TNCs is "important for the realization of economy wide effects of technological progress, including productivity growth and job creation, within the context of sustainable development" (*ibid*., p. 52). Accordingly, when the Guidelines refer to the need for enterprises to "perform science and technology development work in host countries to address local market needs, as well as employ host country personnel in a [science and technology] capacity and encourage their training, taking into account commercial needs" they can be understood as introducing development-oriented considerations that ought to be taken into account by enterprises when determining their science and technology policy. This is reinforced by paragraph 1 of chapter VIII, which states that enterprises should:

> "Endeavour to ensure that their activities are compatible with the science and technology (S &T) policies and plans of the countries in which they operate and as appropriate contribute to the development of local and national innovative capacity" (OECD, 2000a, p. 26).

It is arguable that, insofar as TNC involvement in host country science and technology policy is concerned, the text of the Guidelines suggests that an element of regulation is desirable as a supplement to market-based policies. Equally, although the Guidelines do not differentiate between developed and developing host countries – and so do not require more favourable treatment of the latter – should TNCs observe the above provisions in their science and technology operations in developing countries, this may go some way to meeting the special needs of such countries. However, it should not be forgotten that the Guidelines are voluntary instruments and so no binding obligations are imposed on TNCs. It is within the discretion of TNCs to decide how they will discharge their obligations in this regard. On the other hand, there is nothing in the Guidelines to rule out binding commitments in this area being required of TNCs as a matter of national law, provided that these do not violate other international agreements to which a country is party. Thus the OECD Guidelines, though supporting a discretionary approach on the part of TNCs in relation to their science and technology obligations, do not appear to regard a degree of regulation in this regard as being incompatible with a predominantly market-based approach to technology transfer issues.

The adoption of a market-based approach to technology transfer issues can also be discerned in the various cooperation agreements concluded by the EU with developing countries. The Fourth Lomé Convention of 1989 contained numerous commitments on the part of the EU to assist in the transfer and acquisition of technology by the developing States parties to the Convention in a variety of fields, including agricultural and industrial cooperation, energy and tourism (UNCTAD, 1996a, vol. II, p. 385). The more recent Cotonou Agreement of 2000 revises this approach, further emphasizing the market-led policy on technology transfer. Accordingly, under Article 23 (j) cooperation between the EU and developing contracting parties in the field of economic sector development includes the development of scientific, technological and research infrastructure and services, including the enhancement, transfer and absorption of new technologies. This is to be achieved in the context of the general policy behind the Cotonou Agreement to encourage developing country parties to integrate more fully into the global economy. Of particular relevance also is the commitment of all parties, in Article 46, to ensuring an adequate and effective level of protection of IPRs and other rights covered by the TRIPS Agreement. This includes an agreement to strengthen cooperation on the preparation and enforcement of laws and regulations in this field, the setting up of administrative offices and the training of personnel (EC, 2000). In a similar vein, agreements concluded between the EU and Latin American economic integration groups contain a commitment to economic cooperation that includes the encouragement of technology transfer.[10]

Finally, although almost all BITs are silent on the question of technology transfer, it should be noted that the Dutch model agreement of 1997 states, in its preamble, that "agreement upon the treatment to be accorded to investments [by the nationals of one Contracting Party in the territory of the other Contracting Party] will stimulate the flow of capital and technology and the economic development of the Contracting Parties" (UNCTAD, 2000a, vol. V, p. 333). Thus the Dutch model agreement makes a clear connection between the promotion and protection of investors and their investments and the stimulation of technology transfer. In that sense, it could be said

that such a policy may be seen as part of the market-based development approach, as it aims for the creation of market conditions conducive to increased investment which, in turn, may lead to increased transfers of technology as part of the investment process.

3. The intra-regional technology development approach

As noted above, certain intra-regional economic integration agreements contain provisions encouraging the development and transfer of technology by enterprises operating within the region. These may be divided into two main groups: general provisions stressing cooperation in areas relevant to the development and transfer of technology within the region, and specialized provisions establishing regional multinational enterprises, which in turn have an obligation to develop technology and transfer it across the region.

As to the first group, certain recent agreements concluded by African States display provisions that encourage, in general terms, the development of industrial policies that may facilitate the evolution of intra-regional technology. Thus the Treaty Establishing the African Economic Community of 1991 calls upon the Community to harmonize national policies on science and technology and to promote technical cooperation and the exchange of experience in the field of industrial technology and implement technical training programmes among member States (Articles 4(2)(e) and 49(h), in UNCTAD, 2000a, vol. V, pp. 16-18). A similar commitment can be found in Article 26 (3)(i) of the Revised Treaty of the Economic Community of West African States (ECOWAS) of 1993 (UNCTAD, 2000a, vol. V, p. 40), and in Articles 100 (d) and 103 (2) of the Treaty Establishing the Common Market for Eastern and Southern Africa (COMESA) of 1993 (UNCTAD, 1996a, vol. III, p. 102).

As to the second group of provisions, a good example comes from the COMESA Treaty. Under Article 101 (2) (iv), the multinational industrial enterprises that are to be set up under the Treaty are expected to enhance the "development or acquisition of modern technology, managerial and marketing experience" (UNCTAD, 1996a, vol. III, p. 103). Equally the Multinational Companies Code in the Customs and Economic Union of Central Africa (UDEAC) of 1975 states that multinational companies are set up under this agreement *inter alia* for the purpose of "encouraging and facilitating the transfer of technology by associating national counterparts with the activities and studies of foreign experts" (Chapter 1.1(g), in UNCTAD, 1996a, vol. II, p. 175). The above-mentioned African Economic Community Treaty also envisages, in Article 48(2)(b), the creation of African multinational enterprises in priority industries, as does Article 26(2)(b) of the Revised ECOWAS Treaty. Finally, the Agreement for the Establishment of a Regime for CARICOM Enterprises should be mentioned in that, according to its preamble, this regime was established in part to further the development of a regional technological capacity in the production of goods and services on a regional basis for both the regional and extra-regional markets (UNCTAD, 1996a, vol. II, p. 267). More recently, the Protocol amending the CARICOM Treaty in the Field of Industrial Policy re-emphasized, in the preamble, the "imperatives of research and development and technology transfer and adaptation for the competitiveness of Community enterprises on a sustainable basis". It would appear that this organization is now moving towards a general regime of market-led industrial development, in which specific policies for technology transfer are giving way to general policies on market-led, internationally competitive and sustainable production of goods and services (UNCTAD, 2000a, vol. IV, pp. 219-226).

C. Competition-related provisions

The control of restrictive business practices (RBPs) in technology transfer agreements has contributed to the development of important provisions on this matter in international instruments. Indeed, as noted in section I, it was disagreement over the nature and extent of such control that was at the heart of the non-adoption of the draft TOT Code. At least two major approaches to this question can be identified. The first, which belongs to the "regulatory" model of encouraging technology transfer mentioned in the previous subsection, requires that RBPs that interfere with the full, open and effective transfer of technology should be prohibited, even though there may be good economic reasons for permitting a degree of restriction on the freedom of the technology recipient to use the transferred technology as they wish. The second approach, which follows as part of the "market-based development" model

discussed above, bases the control of RBPs in this area upon a test of whether the restriction in question is reasonable, taking account of the interests of both the transferor and the recipient.

The first approach is exemplified in the draft TOT Code. It contained a more specific treatment of RBPs in relation to technology transfer in its Chapter 4 (box II.6). This part of the draft Code was to prove one of the hardest to negotiate and, indeed, the failure to agree on its terms was a major reason for the eventual non-adoption of the Code. The essence of the disagreement centred on whether certain restrictive terms commonly found in technology licensing agreements should be subjected to a competition law test based on reasonableness, in that such clauses should only be barred where their anti-competitive effects outweighed their pro-competitive effects, or whether they should be banned outright on the grounds that they represented the superior bargaining power of the technology owner and could act against the best interests of the technology recipient. The former position was taken by the major developed countries, while the latter position was championed by the developing countries (Davidow, 2001; Miller and Davidow, 2001; Roffe, 1998; Sell, 2001; and Verma, 2001). On the other hand, there was general agreement over the list of practices that should be subject to regulation. These included grant-back provisions, challenges to validity, exclusive dealing, restrictions on research, restrictions on the use of personnel, price fixing, restrictions on adaptations, exclusive sales or representation agreements, tying arrangements, export restrictions, patent pool or cross-licensing agreements and other arrangements, restrictions on publicity, payments and other obligations after expiration of industrial property rights, and restrictions after expiration of arrangements. However, there remained disagreement on the text relating to some of these practices, namely, export restrictions, publicity restrictions and restrictions after expiration of arrangements.

As can be seen from the developed country position regarding Chapter 4 of the draft TOT Code, the second, market-based approach to RBPs and technology transfer has existed for some time. Indeed, it may be said to have informed the UNCTAD Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices adopted by Resolution 35/63 (1980) of the General Assembly of the United

Box II.6. Draft International Code of Conduct on the Transfer of Technology (1985 version)

"Chapter 4 [a]

[The regulation of practices and arrangements involving the transfer of technology] [Restrictive business practices]
[Exclusion of political discrimination and restrictive business practices] [b]

Section A: (Chapeau) [c]

Section B: (List of practices) [d]

1. [Exclusive] ** Grant-back provisions [e]

Requiring the acquiring party to transfer or grant back to the supplying party, or to any other enterprise designated by the supplying party, improvements arising from the acquired technology, on an exclusive basis [or]* without offsetting consideration or reciprocal obligations from the supplying party, or when the practice will constitute an abuse of a dominant market position of the supplying party.

2. Challenges to validity [e]

[Unreasonably] ** requiring the acquiring party to refrain from challenging the validity of patents and other types of protection for inventions involved in the transfer or the validity of other such grants claimed or obtained by the supplying party, recognizing that any issues concerning the mutual rights and obligations of the parties following such a challenge will be determined by the appropriate applicable law and the terms of the agreement to the extent consistent with that law. [f]

3. Exclusive dealing

Restrictions on the freedom of the acquiring party to enter into sales, representation or manufacturing agreements relating to similar or competing technologies or products or to obtain competing technology, when such restrictions are not needed for ensuring the achievement of legitimate interests, particularly including securing the confidentiality of the technology transferred or best effort distribution or promotional obligations.

4. Restrictions on research [e]

[Unreasonably]**/*** restricting the acquiring party either in undertaking research and development directed to absorb and adapt the transferred technology to local conditions or in initiating research and development programmes in connection with new products, processes or equipment.

5. Restrictions on use of personnel e/

[Unreasonably] ** requiring the acquiring party to use personnel designated by the supplying party, except to the extent necessary to ensure the efficient transmission phase for the transfer of technology and putting it to use or thereafter continuing such requirement beyond the time when adequately trained local personnel are available or have been trained; or prejudicing the use of personnel of the technology acquiring country.

/…

Box II.6 (continued)

6. Price fixing [e]
[Unjustifiably]** imposing regulation of prices to be charged by acquiring parties in the relevant market to which the technology was transferred for products manufactured or services produced using the technology supplied.

7. Restrictions on adaptations [e]
Restrictions which [unreasonably]** prevent the acquiring party from adapting the imported technology to local conditions or introducing innovations in it, or which oblige the acquiring party to introduce unwanted or unnecessary design or specification changes, if the acquiring party makes adaptations on his own responsibility and without using the technology supplying party's name, trade or service marks or trade names, and except to the extent that this adaptation unsuitably affects those products, or the process for their manufacture, to be supplied to the supplying party, his designates, or his other licensees, or to be used as a component or spare part in a product to be supplied to his customers.

8. Exclusive sales or representation agreements
Requiring the acquiring party to grant exclusive sales or representation rights to the supplying party or any person designated by the supplying party, except as to subcontracting or manufacturing arrangements wherein the parties have agreed that all or part of the production under the technology transfer arrangement will be distributed by the supplying party or any person designated by him.

9. Tying arrangements [e]
[Unduly]** imposing acceptance of additional technology, future inventions and improvements, goods or services not wanted by the acquiring party or [unduly]** restricting sources of technology, goods or services, as a condition for obtaining the technology required when not required to maintain the quality of the product or service when the supplier's trade or service mark or other identifying item is used by the acquiring party, or to fulfil a specific performance obligation which has been guaranteed, provided further that adequate specification of the ingredients is not feasible or would involve the disclosure of additional technology not covered by the arrangement.

10. Export restrictions [c]

11. Patent pool or cross-licensing agreements and other arrangements
Restrictions on territories, quantities, prices, customers or markets arising out of patent pool or cross-licensing agreements or other international transfer of technology interchange arrangements among technology suppliers which unduly limit access to new technological developments or which would result in an abusive domination of an industry or market with adverse effects on the transfer of technology, except for those restrictions appropriate and ancillary to co-operative arrangements such as co-operative research arrangements.

/…

Box II.6 (concluded)

12. Restrictions on publicity [e]
Restrictions [unreasonably]** regulating the advertising or publicity by the acquiring party except where restrictions of such publicity may be required to prevent injury to the supplying party's goodwill or reputation where the advertising or publicity makes reference to the supplying party's name, trade or service marks, trade names or other identifying items, or for legitimate reasons of avoiding product liability when the supplying party may be subject to such liability, or where appropriate for safety purposes or to protect consumers, or when needed to secure the confidentiality of the technology transferred.

13. Payments and other obligations after expiration of industrial property rights
Requiring payments or imposing other obligations for continuing the use of industrial property rights which have been invalidated, cancelled or have expired recognizing that any other issue, including other payment obligations for technology, shall be dealt with by the appropriate applicable law and the terms of the agreement to the extent consistent with that law. [f]

14. Restrictions after expiration of arrangement [c]"

Source: UNCTAD, 1996a, vol. I, pp. 188-191 and p. 201.

Notes:
[a] In view of the continuing negotiations on the chapter, no attempt has been made to number the provisions of this chapter consistently with other chapters.
[b] Title of chapter 4 under consideration.
[c] For texts under consideration, see appendices A and D.
[d] With regard to practices 15 to 20, see appendix A.1 for text of agreed statement for inclusion in the report of the Conference, and for texts under consideration see appendix D.
[e] Text under consideration. See appendix A.
[f] The spokesmen for the regional groups noted that their acceptance of agreed language which makes reference to the term "applicable law" is conditional upon acceptable resolution of differences in the group texts concerning applicable law and national regulation of this Code.

In the present text, the following key is used to identify the sponsorship of a text, where the text is not an agreed one: Group of 77 text: *; Group B: **; Group D and Mongolia: ***. [Note added by the editor.]

Nations (The Set) (UNCTAD, 1996a, vol. I, p. 133; see further Miller and Davidow, 2001). The Set refers to all kinds of restrictive business practices adversely affecting international trade and economic development of developing countries. One of its objectives is directly related to the transfer of technology to developing countries, namely the attainment of greater efficiency in international trade and development of developing

countries through the encouragement of competition and innovation. In addition, certain types of conduct envisaged in the Set may affect the efficacy of transfer of technology transactions, particularly restrictions concerning where, or to whom, or in what form or quantities, goods supplied or other goods may be resold or exported; tying arrangements, whereby the recipient of the technology may be required by the transferor to obtain supplies of other related products or services, or spare parts or other intermediate goods or services, directly from the transferor or their designated supplier; and restrictions on parallel imports.

Moreover, the market-based approach has been used in more recent international instruments, which suggests that the debate that occurred in relation to Chapter 4 of the draft TOT Code has moved in the direction of a competition approach based on the test of the reasonableness of particular restrictive terms and conditions (Roffe and Tesfachew, 2001, p. 397). In particular, under Article 8 (2) of the TRIPS Agreement, States may adopt such measures as may be needed "to prevent the abuse of intellectual property rights by right holders or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology" provided that these are consistent with other provisions of the agreement, such as the non-discrimination provisions. This policy is reiterated in Article 40 of the TRIPS Agreement, which provides, as examples of the types of practices that may be controlled, exclusive grant-back conditions, conditions preventing challenges to the validity of IPRs and coercive package licensing. Article 40 adds that members shall enter, on request, into consulations with other members in cases where such abuses of rights are suspected (box II.7).

The NAFTA regime follows a similar approach: Article 1704 of NAFTA specifies that the parties are free to specify, in their domestic law, "licensing practices or conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition in the relevant market. A Party may adopt or maintain, consistent with the other provisions of this Agreement, appropriate measures to prevent or control such practices or conditions" (NAFTA, 1993, p. 671).

Box II.7. Agreement on Trade-related Aspects of Intellectual Property Rights

"*Article 40*

1. Members agree that some licensing practices or conditions pertaining to intellectual property rights which restrain competition may have adverse effects on trade and may impede the transfer and dissemination of technology.
2. Nothing in this Agreement shall prevent Members from specifying in their legislation licensing practices or conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition in the relevant market. As provided above, a Member may adopt, consistently with the other provisions of this Agreement, appropriate measures to prevent or control such practices, which may include for example exclusive grant back conditions, conditions preventing challenges to validity and coercive package licensing, in the light of the relevant laws and regulations of that Member.
3. Each Member shall enter, upon request, into consultations with any other Member which has cause to believe that an intellectual property right owner that is a national or domiciliary of the Member to which the request for consultations has been addressed is undertaking practices in violation of the requesting Member's laws and regulations on the subject matter of this Section, and which wishes to secure compliance with such legislation, without prejudice to any action under the law and to the full freedom of an ultimate decision of either Member. The Member addressed shall accord full and sympathetic consideration to, and shall afford adequate opportunity for, consultations with the requesting Member, and shall cooperate through supply of publicly available non-confidential information of relevance to the matter in question and of other information available to the Member, subject to domestic law and to the conclusion of mutually satisfactory agreements concerning the safeguarding of its confidentiality by the requesting Member.
4. A Member whose nationals or domiciliaries are subject to proceedings in another Member concerning alleged violation of that other Member's laws and regulations on the subject matter of this Section shall, upon request, be granted an opportunity for consultations by the other Member under the same conditions as those foreseen in paragraph 3."

Source: UNCTAD, 1996a, vol. I, pp. 356-357.

Furthermore, it should be noted that the OECD Guidelines for Multinational Enterprises recommend that enterprises should, "when granting licences for the use of intellectual property rights or when otherwise transferring technology, do so on reasonable terms and conditions and in a manner that contributes to the

long term development prospects of the host country" (Article VIII.4, OECD, 2000a, p. 26). Thus, the Guidelines supplement State rights to control RBPs in the field of IPRs with an exhortation that TNCs police their own negotiating practices and avoid the use of unreasonable terms and conditions. Interestingly, the Guidelines go beyond a pure market-based competition analysis and also mention the development prospects of a host country. Though ambiguous as to its precise meaning, this formulation suggests that development concerns may be relevant when determining whether certain terms are reasonable or not. As the Commentary to the Guidelines asserts, not only should TNCs ensure that the terms and conditions on which they sell or license technology are reasonable, but also they may want to consider how they can improve the innovative capacity of their foreign affiliates and subcontractors and add to the local scientific and technological infrastructure, and how they may usefully contribute to the formulation by host governments of policy frameworks conducive to the development of dynamic innovation systems (OECD, 2000a; Commentary on Science and Technology, para. 54). Such considerations will no doubt have an impact on what terms and conditions might be regarded as reasonable or unreasonable in the context of a sale or licensing of technology to a recipient in a developing host country.

D. Technology-related host-country measures

As part of their national industrial policy, host countries may impose measures on TNCs designed to further their economic and social policy goals. These measures are the subject of a separate chapter in these volumes (chapter 14). Such measures may be designed *inter alia* to improve the transfer and dissemination of technology into the economy of a host country. Of relevance here may be, for example, employment of foreign professional and technical personnel and training of local personnel requirements; conditions concerning royalty payments; research and development requirements; and transfer of technology requirements.

In relation to this final category, BITs concluded by the United States and, more recently, Canada contain a clause that prohibits performance requirements, including general technology transfer requirements, but which then specifically permits technology transfer requirements where these are imposed by the courts, administrative tribunals or competition authorities of the host contracting party to remedy an alleged violation of competition laws. Examples of such provisions are provided in box II.8.[11]

Box II.8. Technology transfer provisions in BITs

"Article V(2) (e) of the Canada/Philippines BIT of 1995

Neither Contracting Party may impose any of the following requirements in connection with permitting the establishment or acquisition of an investment or enforce any of the following requirements in connection with the subsequent regulation of that investment:

...

(e) to transfer technology, a production process or other proprietary knowledge to a person in its territory unaffiliated with the transferor, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority, either to remedy an alleged violation of competition laws, or acting in a manner not inconsistent with the provisions of this Agreement."

"Article VI (e) of the United States Model BIT of 1994

Neither Party shall mandate or enforce, as a condition for the establishment, acquisition, expansion, management, conduct or operation of a covered investment, any requirement (including any commitment or undertaking in connection with the receipt of a governmental permission or authorization):

...

(e) to transfer technology, a production process or other proprietary knowledge to a national or company in the Party's territory, except pursuant to an order, commitment or undertaking that is enforced by a court, administrative tribunal or competition authority to remedy an alleged or adjudicated violation of competition laws;"

Source: UNCTAD, 1998a, pp. 82, 291.

A similar clause is to be found in NAFTA Article 1106 (1) (f), which prohibits any party from imposing or enforcing any commitment related to the establishment, acquisition, expansion management, conduct or operation of an investment on an investor of a party or a non-party in its territory to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of the Agreement (UNCTAD, 1996a, vol. III, p. 75).

Article 1106 (2) goes on to exempt, from the prohibition in paragraph (1)(f), any measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements, although such measures will be subject to the prohibition on discrimination contained in the national treatment and most-favoured-nation treatment provisions of NAFTA. The NAFTA provisions were followed verbatim in the Canada-Chile Free Trade Agreement of 1996 (Article G-06 (1) (f) and (2), in UNCTAD, 2000a, vol. V, pp. 82-83).

A similar approach to technology transfer requirements was also put forward in the draft MAI provision on performance requirements, although an additional basis for allowing such a performance requirement was offered when such a requirement "concerns the transfer of intellectual property and is undertaken in a manner not inconsistent with the TRIPS Agreement" (UNCTAD, 2000a, vol. IV, pp. 121-122). This formulation was still the subject of discussions at the time the MAI was abandoned. Certain matters remained unresolved, including whether this wording covered future IPRs and moral rights and how this provision would relate to other agreements such as the Rome and Berne Conventions.

The above approach to the issue of technology transfer performance requirements was taken as a starting point for the formulation of a clause on this matter in an alternative International Agreement on Investment prepared by the Consumer Unity and Trust Society (CUTS) of India. Thus Article IV (1) (f) and (2) of this instrument reproduce, in essence, the same provisions as are found in NAFTA and the other agreements mentioned above. However there is one significant difference: Article 4 (7) declares that "Notwithstanding anything contained in paragraph 1, a Contracting Party shall be free to adopt a measure otherwise prohibited by that paragraph for compelling social or economic reasons" (UNCTAD, 2000a, vol. V, p. 420). CUTS explains this proviso by reference to the fact that many countries would find a harsh set of obligations in this area difficult to accept. Furthermore, "a prohibition against requiring a foreign investor to transfer its specialised technology to local citizens would, in effect, mean that the level of technology in the host country would remain stagnant for all times to come. If the host country extends certain benefits, it should, in its turn, be allowed to derive benefits also" (UNCTAD, 2000a, vol. V, p. 421). Thus the CUTS formulation offers an alternative approach based on a degree of regulation that is broader than that accepted by the North American formulation, which restricts regulatory intervention to competition-based or health, safety and environmental technology transfer requirements.

Finally, an alternative formulation, which preserves the full discretion of the host country to impose performance requirements, concerning *inter alia* technology transfer at the point of entry, is provided by the Asian-African Legal Consultative Committee Draft Model Agreement "B" for Promotion and Protection of Investments. Under Article 3(ii) thereof:

> "The investment shall be received subject to the terms and conditions specified in the letter of authorisation. Such terms and conditions may include the obligation or requirement concerning employment of local personnel and labour in the investment projects, organisation of training programmes, transfer of technology and marketing arrangements for the products" (UNCTAD, 1996a, vol. III, p. 129).

This approach is consistent with the regulatory model of technology transfer provisions discussed above.

* * *

This section has shown that the provisions of IIAs, and related instruments that deal with technology issues, display a shift in focus, offering a range of approaches to such issues. These approaches have been characterized as falling into two main categories: a regulatory model which seeks to control the conditions under which IPRs are protected and technology is transferred, and a market-based development model, which stresses the need to maintain as high a degree of freedom for technology owners to exploit their advantages in this area as they see fit, subject only to competition-based regulation. Furthermore, under this model, host countries are largely restricted in the nature and extent of performance requirements that they might impose in relation to the generation, transfer and diffusion of technology. Of course, these approaches are not mutually incompatible and it is possible to envisage a mixed approach that combines elements of regulation and market freedom. This is the case, it seems, in relation to the treatment of TNC obligations as regards the science and technology policies followed by the countries in which they operate. Furthermore, although competition controls may

be seen as part of the market-based development approach, they undoubtedly offer a discretion to host and home countries alike to act with a light or heavy touch in their regulation of the possible anti-competitive effects of technology transactions undertaken by TNCs. The implications of these approaches for the evolution of policy options for the formulation of technology-oriented clauses in IIAs will be further considered, in the context of their possible impacts on development, in section IV below.

Section III
Interaction with other Issues and Concepts

Section III considers the interaction with other issues and concepts. Technology as a cross-cutting issue interacts with most of the concepts in the other chapters in these volumes. However, it has a more extensive interaction with scope and definition, admission and establishment, standards of treatment, host country operational measures, transfer of funds, competition and the environment. This section will briefly explain these interactions.

Table III.1. Interaction across issues and concepts

Issue	Technology transfer
Admission and establishment	++
Competition	++
Dispute settlement (investor-State)	+
Dispute settlement (State-State)	+
Employment	+
Environment	++
Fair and equitable treatment	++
Home country measures	+
Host country operational measures	++
Illicit payments	+
Incentives	+
Investment-related trade measures	+
Most-favoured-nation treatment	++
National treatment	++
Scope and definition	++
Social responsibility	+
State contracts	+
Taking of property	+
Taxation	+
Transfer of funds	++
Transfer pricing	+
Transparency	+

Source: UNCTAD.
Key: 0 = negligible or no interaction.
+ = moderate interaction.
++ = extensive interaction.

Scope and definition. Transfer of technology can readily be included in the definition of an investment. This can be done by reference to the assets involved, for example the transfer of IPRs or know-how, or by reference to the underlying transaction. The draft TOT Code used both approaches (see Articles 1.2 and 1.3, in UNCTAD, 1996a, vol. I. p. 183). It also addressed the Code to all parties to transfer of technology transactions and to all countries and groups of countries, irrespective of their economic and political systems and their levels of development (Article 1.5, in UNCTAD, 1996a, vol. I. p. 183). By contrast, the TRIPS Agreement uses an asset-based approach covering all categories of intellectual property that are the subject of the Agreement in Sections 1 to 7 of Part II. These include: copyright and related rights, trademarks, geographical indications, industrial designs, patents, layout designs (topographies) of integrated circuits and undisclosed information. The asset-based approach is also followed in BITs, which usually include a wide definition of IPRs in their scope and application clauses.

Admission and establishment. The interaction between technology and admission and establishment can be considerable. In particular, where a host country has strong review mechanisms for inward FDI it may consider the effect of a particular investment on the generation, transfer and diffusion of technology as a significant part of the review. This may lead to a refusal of entry for the proposed investment where its contribution to these matters is considered to be negligible and there are no other compelling economic or social reasons for granting entry. Alternatively, the host country may admit an investment on certain conditions that require the investor to encourage the generation and/or transfer and/or diffusion of the technology. However, the more recent trend in national laws has been to liberalize conditions of entry and establishment for FDI and so such controls are now less common. Equally, certain BITs and regional investment agreements may prohibit the imposition of technology-related performance requirements, as noted and analysed in section II.

Standards of treatment. Any requirements for foreign investors as to their obligations in relation to technology issues will raise questions of their compatibility with standards of treatment commonly found in IIAs. Thus, where a host country imposes such requirements, their content, scope and application will have to conform with the national treatment standard, insofar as the treatment of domestic

investors engaged in a like activity is concerned, and with the MFN standard, as regards the treatment of other foreign investors engaged in a like activity. Equally, reference to these standards can lead to the prohibition of technology-related requirements on the ground of their incompatibility with the principle of non-discrimination that these standards embody. Indeed, as noted in section II, such prohibitions are common in certain bilateral and regional agreements.

Environment. The strong interaction between technology transfer and environmental issues was alluded to, and briefly considered, in section I. That interaction is fully discussed in the chapter on the *Environment* (chapter 16).

Host country operational measures. As noted above in relation to admission and establishment, host countries may impose measures on foreign investors related to technology at the point of entry. Such measures may also be imposed after entry as part of the internal regulation of a host country's economy. In either case the issue of their compatibility with standards of treatment will arise.

Transfer of funds. There is some interaction between technology transfer and the transfer of funds and **taxation** issues as they relate to the payment of, for example, royalties, commissions or lump sums for such transfers. They could be significant and of great relevance to host countries, investors and home countries as when a host country imposes royalty ceilings on technology transfer transactions.

Competition. The interaction between competition and technology issues is now so strong that the latter cannot be discussed in any detail without extensive reference to the former. Thus competition-related questions have been extensively discussed in section II.

Conclusion: Economic and Development Implications and Policy Options

A. The market for technology and its development implications

Technology, as defined in the Introduction, may be available in non-proprietary forms that can be generally accessed, for example, books or journals. However, the major concern that underlies the regulatory issues covered by the present chapter focuses on proprietary technology, that is technology that is capable of generating a profit exclusively for its owner and others who may be able to access it conditionally at a cost. Thus, the first significant feature of the market for commercial technology is that such technology is treated as the private property of its owner and not as a public good available for general use at little or no cost to its user.[12] Commercial technology is usually exploited through the application of intellectual property rights, which give the owner legally determined exclusive rights over the use and disposal of those rights, or by way of protected and restrictive contractual transfer as in the case of non-patentable know-how that is secret, where the contract itself may contain provisions that protect the know-how against abuse by the recipient through the device of restrictive clauses that control the recipient's freedom of action when applying the know-how. This process helps to increase the value of the technology to its owner by creating relative scarcity through legally restricted access to it. However, not all types of useful knowledge are so treated.

The generation and use of commercial technology are closely bound up with the technological infrastructure of a country. This includes the systems and knowledge at the disposal of the public and private organizations that fund the development and adaptation of technology, the public and private R&D organizations that conduct work on new and improved technology, the intermediaries who move the technology around the country and across its borders and the users who apply the technology in their business activities or who are the end consumers of products incorporating the technology in question.[13] Consequently, the states that possess the more developed systems for generating, delivering and using technology are likely to be the leading sources of proprietary technology (UNCTAD, 1999b, pp. 198-202).

TNCs are strongly influential in the operation of national and international technological infrastructures. They can be found operating at each stage of such a system in the most technologically advanced economies of the world. That this should be so stems from the fact that one of the main ownership-specific advantages of TNCs is their ability to "produce, acquire, master the understanding of and organize the use of technological assets across national boundaries".[14] Consequently, TNCs are a major force in shaping international markets for technology, particularly on the supply side. Their

influence on the demand side is also significant, given that increasing amounts of international technology transfers occur between related enterprises.

On the supply side, TNCs seek to exploit their proprietary technologies in commercial technology markets for maximum gain; for the world's major TNCs that includes also exploiting their dominant position in such markets. However, the degree of control exercised by these firms may vary according to the type of technology involved.[15] Thus firms operating in more mature technology industries such as footwear, textiles, cement, pulp and paper or food processing may be more willing to transfer their technology than firms operating in high technology areas such as aerospace, electronics, computers, chemicals and machinery. In the latter case, technology owners guard the source of their competitive advantage, making their technology available only on restrictive terms favourable to the earning of a monopoly rent. Furthermore, such considerations may create a preference for internalized transfer of technology within a network of TNC affiliates, rather than an externalized transfer to unaffiliated licensees. However, it would be a mistake to see all "high" technology markets as uncompetitive on the supply side. For example, in some newer high-technology industries, such as semiconductors or computers, the entry of smaller, innovative firms has stimulated choice in sources of technological supply, making for increased competition in that field, although in the long term concentration can be predicted to occur (van Tulder and Junne, 1988, chapter 2). Furthermore, as "high" technology matures into "conventional" technology, new entrants into the field can be expected. The competitive situation on the supply side of a market for technology is not, therefore, a static phenomenon, and each industry should be analysed on its own terms.

The demand side of the market is also conditioned by the nature of the technological infrastructure present in an economy in which a recipient is situated. Thus a distinction can be made between conditions in technologically advanced recipient countries and those in technologically less developed countries (see further Greer, 1981, pp. 56-60). Conditions in the former are characterized by an ability to absorb technology effectively through advanced production systems, a highly trained workforce, high demand for the technology concerned and the ability to pay for it. Furthermore, technologically advanced recipients are often in a stronger position to bargain over the terms of supply. Alternative local sources of technology that can compete with the technology on offer from outside are more likely to exist. Furthermore, there is a greater likelihood that the purchaser will itself be in a strong position to influence the market, as for instance in the case of another major corporation operating at the same level of the market as the supplier, or where it is a producer of competing products, or where it is in a quasi-monopolistic position, for example the postal and telecommunications authority of a major advanced country. In addition, in advanced countries, ensuring the existence of workable competition, even in highly concentrated technology markets, is a principal concern. Thus competition law plays a significant role in the regulation of technology transfers to such countries.

In comparison, the absorption of proprietary technology in countries with a weak technological base is more problematic. The absence of a sophisticated technological infrastructure and a relatively underdeveloped domestic industrial and R&D base have significant consequences for both supply and demand conditions. In particular, there is a high level of dependence on outside suppliers due to the lack of alternative, domestically generated technology. Purchasers are thus in a weak bargaining position which is exacerbated by the relative lack of information about technology caused by the absence of adequate numbers of skilled specialists who could evaluate the technology on offer. In such cases, the technology owner is often likely to enjoy a monopolistic position in relation to the recipient market and may be able to exact excessive prices and restrictions on the utilization of the imported technology.[5]

Furthermore, in these countries, it is less likely that a technology owner can introduce new technology by means other than direct investment through a controlled affiliate. This is because, in general, there are relatively few firms in developing countries that can act as licensees of advanced technology as compared with developed countries. Consequently, the conditions of technology transfer will often be determined by the overall objectives of the TNC as an integrated enterprise. These may be at variance with the interests of the importing economy, particularly to the extent that the transfer and use of technology within and under the control of the firm are less likely to result in its dissemination to potential

competitors, if any, in that economy. As commercial enterprises, TNCs in principle do not have an interest in transferring knowledge to and supporting innovation in foreign affiliates beyond what is needed for the production process or product in question. Developing countries therefore cannot expect that, by simply opening their doors to FDI, TNCs will transform their technological base. Conversely, countries could not expect that, by entering IIAs, the transfer of technology process will be facilitated. Deficiencies in technological learning and transfer in developing countries can mean that markets by themselves do not create technological dynamism. At best, they can lead to a better use of static endowments but not to the continuous upgrading that competing in the new context requires. To tap into their potential, host Governments therefore have a role to play in promoting local learning and developing skills and institutions.

On the other hand, more recent research suggests that TNCs may be more willing than in earlier decades to move their technological assets around the world so as to match them with immobile factors, and to forge new alliances and reorganize production relations (UNCTAD, 1999b, pp. 200-201). This could increase opportunities for developing countries to obtain and absorb technologies from other countries and enable at least the more advanced among them to take a more active part in the generation of new technology.

Potentially, TNCs have much to offer in developing local capabilities. What technologies and functions they actually transfer to particular locations, however, depends greatly on local capabilities. There is thus again a role for policy in upgrading capabilities to optimize the transfer of TNC technology and encourage its dissemination. Moreover, there is also a role for policy in attracting higher-quality FDI: providing better information to prospective investors and ensuring that their needs are met can be a vital tool of technology development. However, the new technological and policy context makes it more difficult to promote local technology development. The sheer pace of technological change makes technology strategies more risky and expensive. Not too many developing countries are in a position to create broad and deep domestic capabilities in the immediate future. In the case of developing countries, therefore, especially the least developed, host country efforts need to be complemented by international efforts to foster effective transfer of technology to these countries.

Concerns about the monopolistic tendencies of suppliers in developing country technology markets provided a major justification in the past for calls for greater regulation of international technology transfers in the interests of developing recipient countries. This gave rise to new kinds of legal regimes in the 1970s, based on specialized technology transfer laws, and to negotiations for the above-mentioned international code of conduct on technology transfer under the auspices of UNCTAD. However, the new rules of international trade, investment and the strengthening of protection of intellectual property rights have rendered many instruments used in the past by the then newly industrializing economies more difficult to apply. As regards industrial policy, for instance, it is becoming harder to give infant industry protection or subsidize targeted activities, and local content rules are being phased out. Nevertheless, with regard to technology policy, there is room for developing countries to provide technology support services and finance for innovation. Also, a number of policy options remain to strengthen the "supply side"; the main ones include minimization of business transaction costs, human capital formation, domestic enterprise development, cluster promotion, encouraging closer links between industry and research, and strengthening physical infrastructure. The experience of the developed countries shows that there is, indeed, a wide spectrum of policies that one can pursue to support local entrepreneurship and encourage technological development, especially through the promotion of linkages between foreign affiliates and domestic firms (UNCTAD, 2001b).

B. Policy options

IIAs could play a role in enhancing the generation, transfer and diffusion of technology to developing countries. On the other hand, such agreements could remain silent on technology issues, leaving such matters to national policy makers, other international agreements and international aid programmes subject only to general standards of treatment for foreign investors and their investments.

Against this background, and in the context of the development implications of the international market for technology, a number of policy options present themselves.

Option 1: No coverage of technology issues

This has been the traditional approach to such matters in the overwhelming number of IIAs. As noted in section II, most BITs do not mention technology as such. Thus, a technology-based transaction, involving the transfer of IPRs, will only be protected by an IIA to the extent that the IPRs in question are included in the definition of protected "investments". In such a case, the only legal effect of the agreement is to ensure that the transaction is given treatment that is in accordance with the international standards of treatment mentioned in the agreement in question.

The advantage of this approach for development is that it does not establish any specific restrictions or responsibilities on the part of a host country in relation to an investor providing the technology other than those standards of treatment already explicitly stated by the IIA. However, the disadvantage is that such an approach does not include any internationally agreed commitments in the agreement for the cooperation of TNCs, or their home Governments, in the promotion of the generation, transfer and diffusion of technology to the host country or for the control of undesirable terms and conditions in technology transfer transactions. Such an outcome could be qualified, however, through the inclusion of a provision along the following lines: "Each Party shall observe any obligation it may have entered into with regard to investments". Such a provision is to be found, for example, in the United States/Jamaica BIT in Article II(2)(C). The effect of such a provision is to incorporate into the BIT any applicable agreements between the Parties on technology transfer, although its original purpose is to render applicable to developing host countries any other obligations they have undertaken in respect of investments.

Option 2: Limited coverage of technology issues: control over technology-related performance requirements

As noted in section II, some BITs and regional investment agreements only deal with one aspect of technology-related issues, namely the control of technology-related performance requirements. These are prohibited except to the extent that they are based on a competition- related assessment of their economic effects by a judicial, administrative or other authority empowered to make such an assessment.

The principal implication for development is that a host country can only introduce performance requirements in the field of technology which serve to control the competitive conditions of the market in question. This may in itself be good for the economic development of the host country. However, more extensive requirements as to the generation, transfer and diffusion of technology, which go beyond competition-related matters, would be prohibited under this option. Thus, a developing country wishing to employ wider performance requirements, for example local personnel training requirements or the regulation of royalty payments by the technology recipient, may not be able to follow such a strategy should this prohibition exist in the IIA. This suggests a further option.

Option 3: Limited coverage of technology issues: permissible technology transfer requirements

In order to permit greater flexibility for a developing country to introduce certain limited performance requirements in the field of technology transfer, an IIA may include a provision that makes such requirements permissible provided that certain specified policy goals exist. Thus an agreement may make the requirement conditional on the receipt of an advantage to the investor, or on the technology in question being necessary for environmentally sound production. This option assumes, however, that the participating States have not bound themselves under other agreements to prohibit technology-related performance requirements.

One possibility in this regard is to link provisions on technology-related performance requirements with some of the provisions of the OECD Guidelines as regards science and technology, which, as was shown in section II, contain an acknowledgement that in certain circumstances it may be useful to regulate the conditions of technology transfer to ensure the proper development of the host country's science and technology base. Thus technology-related performance requirements that have as their purpose the development of a host country's science and technology base could be rendered permissible, or indeed, be encouraged by the investment agreement in question.

Option 4: Wide "regulated" coverage of technology issues

This approach was exemplified in section II by the draft TOT Code. The main features of this option are:

- The modification of the terms of technology transfer transactions to ensure the protection of the technology recipient against abuses of the perceived superior bargaining power of the

technology owner. This is done without denial of the validity of the technology owner's rights as an IP holder. Rather, the approach is to control and, where necessary to prohibit, certain clauses in a technology transfer transaction that are deemed incompatible with the weaker bargaining position of the recipient.

- The recipient' s country retains the discretion to impose performance requirements related to the transfer and diffusion of technology upon the transferor.
- The imposition of duties on TNCs and their home Governments actively to adopt policies conducive to the improved generation, transfer and diffusion of technology, especially to developing host countries.

The principal development implication of this option is that it enshrines, in an international instrument, the right of a host country to regulate the conditions of technology transfer and diffusion within its borders as it sees fit in the light of its economic policy priorities. It also creates duties upon TNCs and their home Governments to take positive steps to help developing countries to overcome their disadvantages in the international market for technology by way of obligations to cooperate with such countries and to encourage the increased generation, transfer and diffusion of useful technology to them.

The major disadvantage may be that such a regulated approach to the issue could be perceived as creating commercial disincentives for TNCs, as the principal owners of technology, against the dissemination of that technology to developing host countries. In particular, additional costs may arise as a result of intervention in the bargaining process through protective contractual requirements aimed at the promotion of the interests of independent local technology recipients. The imposition of extensive performance requirements could be perceived as limiting the commercial return on the transfer transaction. This could be possible whether the transfer is effected as an external transfer to a local recipient or as an internal transfer to a local affiliate.

Option 5: Wide "market-based" coverage of technology issues

This option, exemplified in section II by the TRIPS Agreement in particular, seeks to address the possible commercial disincentives that a strong regulatory approach might create. Thus the emphasis is not so much on the protection of the technology recipient as the weaker bargaining party in a technology transfer transaction, as on the preservation of a free bargaining environment subject mainly to competition considerations. Thus, the main features of this option are:

- A strong reaffirmation of the IPRs of the technology owner, subject only to a limited number of optional constraints based on:
  - The exhaustion of IPRs. Here it should be noted that so far no multilateral agreement has addressed this matter. Regional agreements that have done so do not recognize a general international right of exhaustion; rather, they limit the right to the territory of the regional group in question.
  - Compulsory licensing. Again such provisions are not present in all agreements.
  - Environmental and health concerns. Intervention in the enjoyment of IPRs may be motivated by a need to protect public health and the environment by encouraging the widest possible dissemination of environmentally sound technology based on IPRs which might otherwise remain under the sole control of the technology owner. The chapter on *Environment* deals further with this topic.
- The regulation of the terms of technology transfer transactions based only on competition-related concerns dealing with:
  - The competitive situation of a technology recipient, ensuring that its opportunities to act as an active competitor in the market are not unduly restricted by the technology transferor.
  - The competitive position of third parties, ensuring that the technology transferor does not use its dominant position in the market to create barriers to entry for actual and potential competitors, especially through the conclusion of networks of technology licensing agreements with chosen recipients.
- The prohibition of technology-related performance requirements subject to competition considerations as in option 2.
- In common with option 4, a recognition that the international market for technology can act against the interests of developing countries and that, therefore, it is desirable to impose certain obligations on TNCs and their home governments to promote the generation, transfer and diffusion of technology to developing countries. Such obligations can

take the form of binding or non-binding recommendations or exhortations to TNCs and/or their home governments.

- A recognition of the special position of developing countries in relation to the impact of full IPR protection on their economies through the inclusion of transitional provisions including, in particular, temporal exemptions from the full obligations to respect the protection of IPRs under national laws and policies.

The development implications of this option are not entirely certain due to the fact that although this option displays considerable faith in the ability of market forces to deliver technology and its attendant advantages to developing countries, provision is nonetheless made for the special position of such countries. Thus this option recognizes that a complete absence of intervention in the market is unlikely to aid the process of technology generation, transfer and diffusion to developing countries.

On the other hand, this approach may encourage such a process by reducing the incidence of extensive regulation in the process of negotiating technology transfers with independent recipients and in the setting up of direct investments involving such transfers. It would therefore be an attractive option for developing countries that wish to open their economies to FDI but also expect a degree of cooperation from TNCs and their home Governments in overcoming the structural disadvantages created by the international market for technology for developing countries.

Option 6: A "hybrid" approach

As noted at the end of section II, the differences between the regulated and market-based approaches to technology issues may not be very great in practice. A combination of regulatory and market-based provisions may be used in future IIAs dealing with technology questions. An important consideration in this regard concerns the relative legal force to be given to these respective types of clauses: are both regulatory and market-oriented clauses to be legally binding or not? For example, should a duty on the part of TNCs to cooperate in the technology and science policy of the host country, as stated, for example, in the OECD Guidelines for Multinational Enterprises (discussed in section II), have the same legal force as, say, a prohibition on technology-related performance requirements? There exists here a risk of asymmetrical legal force being given to different aspects of technology-related provisions in IIAs which negotiators should be aware of when considering their position on these matters.

One possible solution, from the perspective of encouraging the development of developing countries, would be to couch the obligation on the part of TNCs to cooperate in the technology and science policy of the developing host country in mandatory language, while provisions prohibiting technology-related performance requirements could be couched in exhortatory "best efforts" language, taking account of the special needs of developing countries.

Option 7: The regional industrial policy approach

As noted in section II, some regional economic integration organizations among developing countries have adopted special regimes for the generation, transfer and diffusion of technology *inter se*. Such an approach may enhance the opportunities for regional technological development, although much depends on the region's comparative economic advantages. Where this approach ignores foreign investors from outside the region it may risk excluding a significant source of technology. Negotiators must consider carefully the position of such investors in their scheme.

Notes

[1] See further Blakeney, 1989, pp. 1-2; Santikarn, 1981, pp. 3-6; and Ubezonu, 1990, pp. 24-39.

[2] The draft TOT Code definition is used in this chapter. Unless otherwise indicated, all instruments cited herein may be found in UNCTAD, 1996a, 2000a, 2001a, 2002a and 2004a.

[3] Draft TOT Code, Chapter 1, para. 1.3. During negotiations the Group of 77 countries wished to see these as mere examples of technology transfer transactions, while the major developed capital- and technology-exporting states, Group B, and the then socialist Group D, saw them as exhaustive.

[4] For a review of the origins and aftermath of the draft TOT Code, see Patel et al., 2001, especially the chapter by Roffe and Tesfachew; and UNCTAD, 1999b, p. 222, box VII.10.

[5] The provisions on IPRs in the North American Free Trade Agreement (NAFTA) are very similar in their principal features to those in the TRIPS Agreement. Accordingly, NAFTA will only be mentioned expressly where this adds to the analysis developed in the light of the TRIPS Agreement. See further NAFTA, 1993.

[6] See Case C-355/96 Silhouette vs. Hartlauer (1998), 2, CMLR 953.

[7] See IHT Internationale Heiztechnick v. Ideal Standard [1994], 3, Common Market Law Reports 857.

[8] In addition to the examples discussed in the text, see also the United Nations Convention on the Law of the Sea 1982 (United Nations Document A/CONF.62/122; reproduced in *International Legal Materials*, 21, 1261 (1982)) which contains extensive provisions on a regulatory regime for the transfer of technology in the fields of, *inter alia*, fisheries, marine scientific research and marine technology generally, including transfers to developing countries and to the Enterprise of the Deep Sea Bed Authority. Certain provisions relating to the transfer of technology were weakened by the 1994 New York Agreement Relating to the Implementation of Part XI of the Law of the Sea Convention in recognition of the need to re-evaluate some aspects of the regime in the light of, in particular, growing reliance on the market.

[9] The draft TOT Code states "should act on the basis that these measures should ..."

[10] See Framework Agreement for Cooperation Between the EU and the Cartagena Agreement and its Member Countries, 1993, Article 3 (UNCTAD, 2000a, vol. V, p. 187); and EU-MERCOSUR Interregional Framework Co-operation Agreement, 1993, Articles 11(2)and 16(2)(b) (UNCTAD, 2001c, pp. 162-164).

[11] On the other hand, the United States/Lithuania BIT of 1998 lacks such a clause. The only reference to prohibited performance requirements concerns export, local purchasing and any other similar requirements (Article II(6)). Technology requirements are not covered by the Agreement.

[12] See further Muchlinski, 1999a, pp. 427-429, on which the following paragraphs are based.

[13] See Anyos, 1979, pp. 195-212. See further van Tulder and Junne, 1988, especially chapters 6 and 7.

[14] Dunning, 1992a, p. 290. Dunning observed that, in the late 1980s, TNCs were accounting for between 75 per cent and 80 per cent of privately undertaken R&D in the world.

[15] See Greer, 1981, p. 48, citing Chudson, 1971, p. 18.

[16] See, for an economic analysis of this situation, Rodriguez, 1975.

Appendix
International Arrangements for Transfer of Technology: Outcome of the Expert Meeting (TD/B/COM.2/33, dated 7 August 2001)

1. The Expert Meeting on International Arrangements for Transfer of Technology examined a range of issues for consideration by the Commission on Investment, Technology and Related Financial Issues pursuant to paragraphs 117 and 128 of the Bangkok Plan of Action (TD/386).[1] Experts made presentations and exchanged views on experiences and best practices at the international and national levels.

2. Experts noted that, in the knowledge-based global economy, technology plays an ever-important role in economic development. The concerns of the international community with respect to enhancing the transfer of technology to developing countries, in particular to the least developed countries, as well as their technological capabilities, are reflected in several dozen international instruments. These instruments express the willingness of development partners to cooperate multilaterally. There has been some success in implementation, but more needs to be done. The availability of information on arrangements for transfer of technology is an essential requirement for sustained multilateral cooperation. In this connection, the *Compendium* on transfer of technology-related provisions[2] is a welcome contribution and should be continuously updated, as necessary, and widely disseminated, including through electronic media.

3. Experts also noted that most technology-related provisions are of a "best-efforts" nature. Governments, as well as civil society and the private sector, have an important role to play in the implementation of commitments, *inter alia* through public and private partnerships. In this connection, experts emphasized the importance of adequate protection of intellectual property in providing incentives for investment and transfer of technology in all countries, including in developing countries, taking into account the interests of producers, users and consumers.

4. Experts examined a number of best practices that can contribute to generating favourable conditions and opportunities for transfer of technology and capacity building. Some of these practices include the following:

(a) International instruments with built-in implementation mechanisms, including financial provisions and monitoring arrangements, have a promising implementation record and should be emulated. These instruments are relatively few and mainly for purposes of the public good, such as environmental protection. Nevertheless they can serve as a model in other areas such as infrastructure, health, nutrition and telecommunication;

(b) Ensuring the access, in particular of developing countries, to technological information, including information on state-of-the-art technologies on a competitive basis and on fair and equitable terms and conditions, in addition to information available from the public sources;

(c) Taking measures to prevent anticompetitive practices by technology rights holders or the resort to practices which unduly impede the transfer and dissemination of technology. Control of such practices is quite common in developed countries, but there is a lack of legislative measures in this regard in many developing countries. In particular, the development of relevant legislation at either the national or regional level is considered to be a promising option;

(d) Taking into account the possible short and medium-term costs, local working requirements, if applied in a manner that is consistent with the TRIPS Agreement and the Paris Convention, may be one way of enhancing transfer of technology;

(e) Making the TRIPS Agreement more conducive to transfer of technology, in accordance with its Articles 7, 8 and 40, including by reviewing its impact on transfer of technology and capacity building;

(f) Setting up of interministerial coordination committees at the national/regional level with regard to the interface between commitments

in the TRIPS Agreement and national implementation requirements with a view to adjusting the TRIPS standards to local innovation needs and to favouring their pro-competitive implementation. UNCTAD should assist interested countries in establishing such committees by undertaking a needs assessment in the context of the ongoing programme of science, technology and innovation policy reviews;

(g) Establishing a special trust fund, based on successful models, to promote research and development in developing countries and other activities in the area of technology with a view to assisting developing countries in benefiting from their various international commitments;

(h) Designing measures and specific incentives for home-country enterprises, including fiscal and other incentives, to promote transfer of technology, especially through FDI in developing countries. In this connection, the monitoring of implementation of the commitments in Article 66.2 of the TRIPS Agreement could contribute to building a sound and viable technological base in LDCs. UNCTAD should compile an illustrative list of home-country measures that might fulfil the requirements of Article 66.2;

(i) Supporting capacity-building, in particular in LDCs, through specific projects and programmes and by establishing a scientific and technological infrastructure on a cooperative basis for both the public and private research facilities so as to enable them to assess, adopt, manage, apply and improve technologies;

(j) Creating a hospitable domestic regulatory environment for foreign investment, along with intellectual property protection, encourages access to the newest technology. It has been observed that the transfer of technology is often most successful when accomplished by means of investment, specially by FDI. In this connection, technical cooperation should focus on technological capacity building with a view to enabling beneficiary countries to use intellectual property rights properly in ways that advance their national systems of innovation;

(k) Supporting transfer of technology and capacity building for enhancing the use of electronic commerce in developing countries, in particular by their small and medium sized enterprises, including enhancing the use of information and technologies in the public domain;

(l) The provision by host countries of an enabling environment for transfer of technology, taking into account the following considerations:
- Vocational training and recruitment of technical staff;
- Relationships with local public or private research centres and consultancy firms;
- Joint efforts by enterprises and Governments;
- Encouraging capacity building for assessing, adopting, managing, and applying technologies through *inter alia*: human resources development, strengthening institutional capacities for research and development and programme implementation, assessments of technology needs, and long-term technological partnerships between holders of technologies and potential local users.

5. UNCTAD should provide assistance to developing countries, in particular least developed countries, to strengthen their capacity for discussing and for negotiating technology transfer provisions in international instruments. UNCTAD should further explore ways and means for effective implementation of international commitments in the area of transfer of technology and capacity building.

Notes

[1] Paragraph 117: " UNCTAD should analyse all aspects of existing international agreements relevant to transfer of technology". Paragraph 128: "In the area of transfer of technology, UNCTAD should examine and disseminate widely information on best practices for access to technology".

[2] Compendium of International Arrangements on Transfer of Technology: Selected Instruments (UNCTAD/ITE/IPC/Misc.5).

Annex table 1. Technology transfer obligations under certain multilateral environment agreements (MEAs)

MEA	MEA objective	Obligation on State relevant to technology transfer
Basel Convention	To eliminate, as far as practicable, the generation of hazardous wastes and other wastes and to promote the sound management of hazardous wastes produced locally	*Article 10(2)(d)* The Parties shall cooperate actively, subject to their national laws, regulations and policies, in the transfer of technology and management systems related to the environmentally sound management of hazardous wastes and other wastes.
Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade	To address the need to strengthen national capabilities and capacities for the management of chemicals	*Preamble of Annex III:* Taking into account the circumstances and particular requirements of developing countries [...], in particular the need to strengthen national capabilities for the management of chemicals, including transfer of technology, providing financial assistance and promoting cooperation among the Parties. *Article 14(1)* The Parties shall facilitate the exchange of information [...] including toxicological, ecotoxicological and safety information. Article 14(2) The Parties [...] shall protect any confidential information as mutually agreed.
Vienna Convention	To protect and replenish the ozone layer by eliminating the production and use of ozone-depleting substances	*Article 4(2)* The Parties shall co-operate, consistent with their national laws, regulations and practices, taking into account in particular the needs of the developing countries, in promoting, directly or through competent international bodies, the development and transfer of technology and knowledge. *Article 4(1)* The Parties shall facilitate and encourage the exchange of [...] information. [...] Any such body receiving information regarded as MEA MEA objective Obligation on State relevant to technology transfer confidential by the supplying Party shall ensure that such information is not disclosed and shall aggregate it to protect its confidentiality before it is made available to all Parties.
Montreal Protocol - London Amendments	To control, reduce or phase out emissions of substances that deplete the ozone layer	*Article 10A* Each Party shall take every practicable step, consistent with the programme supported by the financial mechanism, to ensure that the best available, environmentally safe substitutes and related technologies are expeditiously transferred to [...] [developing countries] under fair and most favorable conditions.
Climate Change Convention	To stabilize greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system	*Article 4(5)* Developed country Parties [...] shall take all practicable steps to promote, facilitate and finance, as appropriate, the transfer of, or access to, environmentally sound technologies and know-how to other Parties, particularly developing country Parties, to enable them to

MEA	MEA objective	Obligation on State relevant to technology transfer
		implement the provisions of the Convention. [...] Developed country Parties shall support the development and enhancement of endogenous capacities and technologies of developing country Parties. [...]
Kyoto Protocol	To mitigate climate change (see objectives of the Climate Change Convention)	*Article 10(c)* To cooperate in the promotion of effective modalities for the development, application and diffusion of, and take all practicable steps to promote, facilitate and finance, as appropriate, the transfer of, or access to, environmentally sound technologies, know-how, practices and processes pertinent to climate change, in particular to developing countries, including the formulation of policies and programmes for the effective transfer of environmentally sound technologies [...] and the creation of MEA MEA objective Obligation on State relevant to technology transfer *Article 13(a)(i)* States should facilitate the exchange of information [...] concerning the management of chemicals, particularly through designated national governmental authorities and through intergovernmental organizations as appropriate.
London Guidelines	To protect human health and the environment	*Article 11(a)* States undertaking information exchange [...] should establish internal procedures for the receipt, handling and protection of confidential and proprietary information received from other States.
Desertification Convention	To combat desertification and mitigate the effects of drought, particularly in Africa	*Article 18(1)(b)* The Parties shall facilitate access to technology, in particular by affected developing country Parties, on favorable terms, including on concessional and preferential terms, as mutually agreed, [...] to technologies most suitable to practical application for specific needs of local populations, paying special attention to the social, cultural, economic and environmental impact of such technology.
Tropical Timber Agreement	To provide an effective framework for consultation, international cooperation and policy development among all members with regard to all relevant aspects of the world timber economy. To promote cooperation between members as partners in development reforestation, rehabilitation and forest management activities	*Chapter I - Objectives Article 1 (m)* To promote the access to, and transfer of, technologies and technical cooperation to implement the objectives of this Agreement, including on concessional and preferential terms and conditions, as mutually agreed.

MEA	MEA objective	Obligation on State relevant to technology transfer
Industrial Accidents Convention	To prevent, prepare for and respond to the effects of industrial accidents capable of causing transboundary	*Article 16.1 (a)* The Parties shall, consistent with their national laws, [...] facilitate the exchange of technology for the effects prevention of, preparedness for and response to the effects of industrial accidents, particularly through the exchange of available technology on various financial bases. *Article 22* The provisions of this Convention shall not affect the rights or the obligations of Parties [...] to protect information related to personal data, industrial and commercial secrecy, including intellectual property, or national security.

Source: Based on tables that appeared in unpublished UNEP papers prepared by the Center for International Environmental Law, Geneva, in 1999 and 2000.

Chapter 24. Competition*

Executive summary

The aim of this chapter is to examine how competition issues have been addressed in international investment agreements (IIAs) and other relevant instruments dealing with international investment.

In section I, the chapter identifies some of the main issues related to competition that arise in the context of foreign direct investment (FDI). First, it is necessary to determine the types of anticompetitive practices conducted by privately owned and operated undertakings, which are often referred to in international instruments as "restrictive business practices" (RBPs). Secondly, certain procedural issues arise in connection with competition rules and IIAs, in particular the issue of extraterritoriality and the issue of international cooperation in competition matters. The third major issue area addressed in the chapter deals with the development of harmonization measures, mainly those that seek to create a unified substantive and procedural system of competition regulation at the supranational level and those that seek substantive harmonization of national competition policies.

Section II reviews the various ways in which competition is addressed in IIAs, focussing on the key issues identified in section I. Section III highlights points of interaction between competition, on the one hand, and other general issues addressed in IIAs (i.e. those covered in other chapters in these volumes), on the other. Finally, in the conclusions, the chapter briefly examines the significance of different approaches to competition policy for economic development in individual countries and considers the various options open to negotiators when drafting competition provisions. The most basic choice is whether to include or to exclude provisions on this subject. Where the former choice is made, further alternatives exist as to how to deal with each of the issues identified in section I.

Introduction

The regulation of anti-competitive practices by private parties is an established aspect of economic regulation in national laws. By contrast, the linkage of competition issues to the concerns of investment liberalization in IIAs is a relatively recent phenomenon. It is the purpose of the present chapter to discuss the principal issues arising out of the relationship between competition and investment, to undertake a review of existing competition related provisions in IIAs and to offer policy options in this regard.

A fundamental point from which competition provisions in IIAs must start concerns the extent to which they are linked to FDI issues, or whether they are seen as self-contained. The Declaration of the first ministerial meeting of the World Trade Organization (WTO) in Singapore in 1996 recognized the relationship between investment and competition policy. However, the WTO has suggested a limited interconnection between the two disciplines through the establishment of two separate working groups on trade and competition and trade and investment (box 1).

The inputs of both Working Groups were considered at the WTO's Third Ministerial in Seattle in December 1999, and were ultimately included as subjects in the Report of the Fourth Ministerial in Doha in 2001. However, the Doha Ministerial Declaration did not suggest that there should be a practical interface between the two.

Typically, competition issues have been addressed in IIAs mainly in connection with technology transfer. More recently, a growing network of bilateral and inter-regional cooperation agreements, to handle potential international competition/antitrust conflicts of interest, has emerged, to which developing, as well as developed, countries are parties. Such agreements, along with certain trade instruments that deal with competition issues, as well as European Union

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* The chapter is based on a 2004 manuscript prepared by Peter Muchlinski that draws on a background study prepared by Cynthia Wallace. The final version reflects comments received from Philippe Brusick, Gesner Olivera Filho, Hassan Qaqaya, Pedro Roffe and Andreas Reindl.

(EU) association agreements, form the basis for potential further instruments with specific competition provisions.

Developed countries were the first to adopt competition laws and set up regulatory agencies. In 1980, fewer than 40 countries — mostly developed — had competition laws (UNCTAD, 1997a, p. 189). Since then more developing countries and economies in transition have adopted competition laws as well and set up agencies to administer them. By 1996 the number of economies with competition rules and authorities in place had reached 77 (UNCTAD, 1997a, p. 290). By the first half of 2003, some 93 economies had adopted competition rules and established competition agencies — in other words: almost half the world's economies (UNCTAD, 2003a, p. 135).

Box 1. WTO Singapore ministerial declaration on investment and competition

"20. Having regard to the existing WTO provisions on matters related to investment and competition policy and the built-in agenda in these areas, including under the TRIMs [Trade-Related Investment Measures] Agreement, and on the understanding that the work undertaken shall not prejudge whether negotiations will be initiated in the future, we also agree to:

- establish a working group to examine the relationship between trade and investment; and
- establish a working group to study issues raised by Members relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework.

These groups shall draw upon each other's work if necessary and also draw upon and be without prejudice to the work in UNCTAD and other appropriate intergovernmental fora. As regards UNCTAD, we welcome the work under way as provided for in the Midrand Declaration and the contribution it can make to the understanding of issues. In the conduct of the work of the working groups, we encourage cooperation with the above organizations to make the best use of available resources and to ensure that the development dimension is taken fully into account. The General Council will keep the work of each body under review, and will determine after two years how the work of each body should proceed. It is clearly understood that future negotiations, if any, regarding multilateral disciplines in these areas, will take place only after an explicit consensus decision is taken among WTO Members regarding such negotiations."

Source: WTO, 1996, para.20.

Some national laws in developing countries and economies in transition have followed developed country models. A significant number of laws in Central and Eastern Europe, moreover, have replicated the main provisions of the competition rules of the EU. This is especially so for economies in transition that have entered association agreements with the EU and that aspire, in due course, to full EU membership. For other countries, the 2002 United Nations Conference on Trade and Development (UNCTAD) Model Law on Competition (the Model Law) may provide a model. The Model Law reflects recent trends in competition legislation worldwide and is supplemented by related Commentaries that have proved to be important for the process (UNCTAD, 2002b). The text was also informed by the United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices adopted by the United Nations General Assembly at its thirty-fifth session on 5 December 1980 by resolution 35/63 (the United Nations Set), discussed more fully in section II below. Thus, attempts are being made to develop harmonized international approaches to competition law and policy. IIAs may also play a role in this process, as will be further discussed in the course of this chapter.

The present chapter proceeds by addressing the principal issues that arise out of the interaction of competition and investment matters in section I. This is followed by an analysis of the main types of competition related provisions in IIAs in section II. Section III examines the interactions between competition and other issues in IIAs, while section IV considers policy options available for dealing with competition issues in IIAs and their development implications.

Section I
Explanation of the Issue

A. Restrictive business practices

Competition policy deals with the regulation of certain types of anticompetitive practices conducted by privately owned and operated undertakings. These are often referred to in international instruments as "restrictive business practices" (RBPs). There are basically four main types of restrictive business practices that can have anti-competitive effects in the relevant market:

"horizontal" restraints, "vertical" restraints, practices by one or more firms in abuse of a dominant position, and anti-competitive mergers and acquisitions (M&As).[1] Each presents different issues and challenges, though they all share the common goal of preserving, as far as possible, the operation of a competitive market mechanism.[2] The reasons why these four main types of anti-competitive behaviour are regulated under competition rules will now be briefly described.

Collusion between otherwise independent firms can lead to distortions of market conditions. Such collusion can arise between competitors (horizontal collusion, often referred to as "cartelization" of the market) or between suppliers and/or producers and/or distributors (vertical collusion). Collusion between competitors may replace the market-based allocation of resources and the determination of prices with concerted action by private actors (whether suppliers, producers or distributors, as the case may be) that may undermine the capacity of the market to regulate these essential economic activities. Examples of such behaviour include concerted price fixing, market sharing arrangements, or agreed production quotas, or co-operation agreements. However, not all co-operative activities between competitors are necessarily caught. Thus, for example, joint ventures that may lead to the development of new products or technologies may be positively encouraged. Likewise, in cases of serious economic instability, co-operative restructuring arrangements between producers may be permissible. In addition, vertical co-operation is generally regarded as being less serious than horizontal co-operation so long as the market shares of the participants are relatively small, and the market is not highly concentrated among a small number of firms each operating a restrictive network of vertical arrangements for supply and/or distribution, as the case may be. Indeed, competition authorities in OECD countries are increasingly permissive towards vertical arrangements in the absence of significant market power as such arrangements may in fact allow for a more efficient allocation of responsibilities in vertical relationships.

Rules against the abuse of a dominant position (or "monopolization" of the market in United States terminology) seek to regulate anti-competitive behaviour carried out by a single economic undertaking that enjoys a dominant position on the market in question, or by more than one undertaking in such a position. Here, the reality of the market power of the undertaking(s) allows it (them) to act without taking into consideration the activities of its (their) nearest rivals, suppliers or distributors, and to ignore the interests of consumers. Examples of such behaviour include: monopolistic price rises that consumers have to bear in the absence of alternative suppliers, the imposition of unfair or discriminatory commercial terms upon suppliers and/or distributors, the use of predatory pricing to oust new entrants onto the market,[3] boycotts of firms that do not comply with the dominant firm's restrictive terms of doing business, the exclusive use of an essential commercial facility, or control over essential technologies or resources needed by competitors. However, it should be stressed that the mere possession of dominant market power is not in itself the mischief that competition policy seeks to control; rather it is the abuse of that power to achieve anti-competitive aims that is the object of regulation.

The main elements of what the regulator needs to establish so as to prove an abuse of a dominant position are as follows. First, a dominant position must be shown, either within the market as a whole or a substantial part of it. This, in turn, requires that a market analysis be undertaken, so as to establish the relevant product and geographical markets in which the dominant position is asserted. Economic analysis needs to be undertaken, based on the nature of the product in question; its use and application by consumers; its substitutability with other products on the part of consumers; and the nature of the supply side of the market, focusing on the ability of producers to move into the production of the product.[4] The dominant position may be held unilaterally by a single undertaking or collectively by more than one undertaking. The key issue here is whether the dominant undertaking(s) can act independently on the market without having to take account of the actions of competitors, customers or the interests of consumers. In the case of a supranational system of regulation, such as the European Commission (EC), the prohibition only applies where trade between member States is affected. Secondly, an abuse of the dominant position needs to be established. This is an issue of fact in each case, though, as will be shown in section II, competition provisions in international agreements may offer examples of the most egregious abuses.

The three preceding types of anti-competitive behaviour have in common one feature, namely that they are regulated *ex post*, that

is after the collusion or abuse of market dominance has arisen. However, the control of M&As usually and indeed preferably, occurs *ex ante*, that is before a merger or acquisition has taken place, though it can also apply *ex post* to unravel an already completed but otherwise anti-competitive merger or acquisition. The aim here is to limit, as far as is foreseeably possible, the creation of a dominant position that might lead to anti-competitive abuses, on the part of the merging undertakings, or as a result of the acquisition of one undertaking by another. This process requires an economic analysis of the existing market structure and its comparison with the structure that would result after the merger or acquisition takes place. If the degree of projected concentration of the market reaches a level in which a dominant position is acquired, then the merger or acquisition may have to be modified in accordance with the conditions placed upon it by the regulatory authority, or it may be barred outright.

Having considered the main types of RBPs, and the reasons for their regulation, the discussion now focuses on the relationship between FDI and competition. FDI, particularly in developing countries, may, in certain cases, have undesirable effects on competition, stemming especially from anti-competitive agreements or concerted practices, including hard-core cartels, abuses of dominant positions and cross-border M&As. Competition law and policy are particularly important for FDI, because economic liberalization results in greater reliance on market forces to determine the development impact of FDI. Host countries want to ensure that the reduction of regulatory barriers to FDI and the strengthening of standards of treatment of foreign investors are not accompanied by the emergence of private barriers to entry and anticompetitive behaviour of firms. The major difficulty in developing countries is adopting effective competition legal frameworks and monitoring and enforcement systems. Given the commitment of many countries, including developing countries, to the progressive liberalization of the conditions for FDI, competition policy acquires an especially important place in the regulatory framework. This is so for a number of reasons. First, there is the risk that foreign investors may drive domestic enterprises out of the market; secondly, if foreign investors are in a strong market position they may adversely affect domestic prices; thirdly, the competitive environment in the host country may need to be regulated so as to ensure that it remains an attractive destination for FDI. In particular, anti-competitive State aids to industry that can favour not only domestic but also certain foreign investors may need to be controlled, as may the activities of national monopoly suppliers. In addition, competition policy may help to ensure positive technology transfer by foreign investors.

In light of such considerations, the United Nations Set recognizes, in its Preamble, that RBPs have the capacity to “impede or negate the realization of benefits that should arise from the liberalization of tariff and non-tariff barriers affecting international trade” and affirms that “the adoption and efficient enforcement of competition legislation, including a merger-review system, can strengthen the way in which FDI liberalization can enhance market efficiency and consumer welfare and, ultimately, promote the development of developing countries”. Indeed, the Fourth United Nations Conference to Review All Aspects of the United Nations Set held in 2000 emphasized that, “without controls on anti-competitive practices, it is unlikely that all the benefits of liberalization and globalization will be passed on to consumers” (UNCTAD, 2000e, p. 2).

B. The main policy issues

In the light of the preceding discussion**,** certain issues related to competition can and do arise in the context of IIAs and related instruments:

1. Determining what amounts to a restrictive business practice

This issue can be sub-divided into three major parts: the addressee of a competition provision, definition of the major RBPs and RBPs that are actually covered by the provision.

a. Determining the subjects of competition provisions

An initial issue concerns the types of undertakings to which rules on RBPs apply. This is not a straightforward exercise. First, it is necessary to determine whether certain types of undertakings are to be excluded from the operation of competition rules. For example, the majority of national laws exclude trade unions from their purview. Similarly, intergovernmental co-operation arrangements, even if they lead to anti-competitive effects on the market, may be excluded. Secondly, it is necessary to offer a clear definition of what

constitutes an "undertaking" for the purposes of the provision. In particular, in relation to complex transnational corporation (TNC) groups, it is necessary to determine whether the group forms a single undertaking for the purposes of regulation. Failure to define the boundaries of that undertaking could result in the control of perfectly legitimate internal administrative acts within the group, to the detriment of the economic gains to efficiency from group organization. Most national competition laws do not treat a corporate group as a set of separate entities, but, rather, look to the underlying economic reality and treat the group as one undertaking. This is known as the "enterprise entity" doctrine. International agreements may need to determine whether they too include this doctrine.

b. Defining restrictive business practices

Above it was noted that there are four types of RBPs, namely, horizontal and vertical anti-competitive agreements, abuse of a dominant position and M&As. Competition provisions in international instruments use definitions of these practices that broadly follow the explanations given above in sub-section A. Examples of definitional provisions in existing agreements will be given in section II.

c. Which kinds of restrictive business practices are covered by the competition provision in an IIA?

A further related issue concerns determining which types of practices are to be covered by the terms of the agreement. For example, even the most advanced supranational competition policy system, that of the European Communities, did not cover M&As until 1989, some 32 years after the entry into force of the Treaty of Rome, which contained provisions covering only horizontal and vertical restraints and abuse of a dominant position. Another issue is whether or not to include certain further anti-competitive practices that do not come within the four main types discussed above. Thus, a trend has been emerging of including competition provisions in bilateral free trade agreements that are confined to the restriction of trade distorting anti-competitive practices. In addition, the question arises whether trade/investment distorting state aids and/or government owned enterprises and monopolies should be covered. Furthermore anti-competitive taxation practices, such as transfer pricing manipulations might be included (see further chapter 20). Equally, certain intellectual property issues associated with the transfer of technology have been the subjects of IIA provisions. Finally, certain international instruments have linked competition issues with development concerns. The choice of which RBPs to cover depends much on the policy behind the competition provision in question and the extent to which anti-competitive practices are to be covered by an IIA.

2. Procedural issues

In addition to the substantive issues discussed above, certain procedural issues arise in connection with competition rules. Two major interconnected issue areas can be identified: the issue of extraterritoriality and the issue of international cooperation in competition matters.

a. Extraterritoriality

Given the predominantly national and regional basis for competition regulation, there arises the risk that, in cases in which the anti-competitive practice under review has an international dimension, national competition/antitrust laws may be applied outside the limits of the jurisdiction of the regulating entity. This is known as the issue of "extraterritoriality" and has been defined as "a country's assertion of jurisdiction over activities occurring outside its borders" (Lao, 1994, p. 821). Indeed, it can be said that issues of extraterritorial jurisdiction first emerged in the field of competition/antitrust law (*ibid*). In particular, it has given rise to the "effects doctrine" as a justification for the unilateral extension of national or regional competition/antitrust law to cover anti-competitive conduct arising outside the jurisdiction in question. In essence, this doctrine asserts that an anti-competitive practice which occurs outside the jurisdiction of the regulating country and that has potential or actual distortive effects upon the internal market of that country, may justify that country to apply its competition rules outside its jurisdiction to the undertaking(s) participating in that practice (Wallace, 2002, pp. 700-701). Not infrequently, the assertion of such jurisdiction by countries has led to international protest or even conflict.

b. International cooperation in procedural matters

A closely related issue to that of extraterritoriality, and one that has seen the largest concentration of international arrangements in the competition field, is international cooperation in – and harmonization of – procedural matters pertaining to competition policy enforcement across national borders. In such instruments, cooperation is typically sought over information exchange, consultations, notification, dealing with extraterritorial evidence-gathering, and in resolving international jurisdictional questions on the basis of international comity. The focus of international efforts at multilateral cooperation on issues of competition law enforcement has been primarily in the area of M&As (including joint ventures). This may be partially due to the fact that merger control has been seen as the most difficult and controversial area, where the potential for jurisdictional conflict is the greatest, and most urgently calls for a coordinated approach. A further area of cooperation relevant to development issues is the provision of technical assistance for adopting, reforming or enforcing competition laws by countries which are more experienced in this field to those that are less experienced (UNCTAD, 2003b, p. 5).

3. Harmonization measures

The development of harmonization measures in IIAs is a third major issue area in the competition field. Such measures, as they appear in IIA provisions, can be divided into two main types. First, there are those that seek to create a common substantive and procedural system of competition regulation between the contracting parties. This approach was pioneered by the EC, which has established the first supranational competition regime. More recently, other regional groupings, including developing country groupings, have instituted common competition practices and institutions, though none has, as yet, developed a fully supranational system such as that of the EC. Secondly, provisions in international agreements can introduce a measure of substantive harmonization into the national competition policies of the member parties to an agreement.

Section II
Stocktaking and Analysis

As noted in the Introduction, competition issues are usually dealt with in a specialized instrument rather than a general IIA. At the multilateral level, the only instrument that covers all aspects of competition regulation is the 1980 United Nations Set.[5] Indeed, the United Nations Set is the only major international instrument that makes a significant link between the economic policy concerns of developing countries and the control of anticompetitive practices. Competition provisions can also be found in a number of international agreements, including regional agreements, free trade agreements and specialized cooperation agreements in the field of competition. Their provisions are analysed below in the context of the main issues identified in the previous section.

A. Determining what amounts to a restrictive business practice

1. Determining the subjects of competition provisions

In national laws, the usual subjects of competition rules are the market actors themselves. In international agreements, the most comprehensive approach to this matter is found in Articles 81 and 82 of the EC Treaty (box II.1).

Box II.1. Articles 81 and 82 of the EC Treaty

According to article 81(1) of the EC Treaty:
"The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market […]."

According to Article 82 of the EC Treaty:
"Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. […]"

Source: EC, The Treaty Establishing the European Community, http://europa.eu.int/eur-lex/en/treaties/dat/C_2002325EN.003301.html

These two provisions indicate that the anti-competitive practices they seek to regulate are those committed by "undertakings", "associations of undertakings" or by "one or more undertakings", as the case may be, a phrase that has been broadly interpreted in EC law. Formulations other than the term "undertaking" have been used in other agreements, though to a similarly broad effect. Thus, the Protocol for the Protection of Competition in the Common Market of the Southern Cone (MERCOSUR), adopted by Decision 17/96 on 17 December 1996 (MERCOSUR Protocol), makes clear, in Article 2, that the rules contained in the instrument "apply to actions taken by natural and legal persons under public and private law, and other entities whose purpose is to influence or to bring influence to bear upon competition in the framework of the MERCOSUR and consequently to influence trade between the States Parties". This provision goes on to assert that undertakings exercising a State monopoly are within the definition of juridical persons.

By contrast, the United Nations Set speaks of "enterprises" as the main concern of its provisions. This term is defined as meaning "firms, partnerships, corporations, companies, other associations, natural or juridical persons, or any combination thereof, irrespective of the mode of creation or control or ownership, private or State, which are engaged in commercial activities, and includes their branches, subsidiaries, affiliates, or other entities directly or indirectly controlled by them" (section B(i)(3)). Again this is a wide approach, allowing for any type of commercial entity to be included. It is notable that the United Nations Set also expressly refers to TNCs as a separate type of entity, distinct from "other enterprises", whose RBPs are to be controlled.[6] No doubt this reflects the special concerns of the drafters of the United Nations Set as to the potential effects on development of anti-competitive practices carried out by TNCs in particular, given their often dominant position in the economies of developing host countries. Section B(ii)(4) of the United Nations Set states that, "[t]he Set of Principles and Rules applies to restrictive business practices, including those of transnational corporations, adversely affecting international trade, particularly that of developing countries and the economic development of these countries. It applies irrespective of whether such practices involve enterprises in one or more countries." Of particular importance to TNCs are the contents of section D, entitled "Principles and Rules for Enterprises, including transnational corporations". Section D begins by exhorting enterprises to conform to the RBP laws of States in which they operate, and to consult and co-operate with the competent authorities of countries whose interests are adversely affected by RBPs (section D(1) and (2)).

The Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises also speak of "enterprises" as the addressees of the guideline on Competition. "Enterprises" is a term not specifically defined in the Guidelines. However, it is possible to infer from the introductory section on "Concepts and Principles" that it includes transnational (called "multinational" in the Guidelines), domestic, small and medium-sized enterprises. Again the coverage is broad.

As noted in section I, a specific issue that is of central concern is determining when a TNC should be treated as an undertaking to which the competition provisions in the agreement apply. Under EC law, a group is treated as a single entity where the undertakings belonging to it "form an economic unit within which the subsidiary has no real freedom to determine its course of action on the market, and if the agreements or practices are concerned merely with the internal allocation of tasks as between the undertakings".[7] This introduces a test of factual control as between the parent firm and affiliates. A similar approach has been adopted in the United Nations Set. Thus, section D(3) introduces an "economic entity" doctrine as a limitation on the applicability of RBP controls in the case of anti-competitive agreements or arrangements:

> "Enterprises, except when dealing with each other in the context of an economic entity wherein they are under common control, including through ownership, or otherwise not able to act independently of each other, engaged on the market in rival or potentially rival activities, should refrain from practices such as the following […]."

The main issue raised by such provisions is**:** what amounts to control? This may be an issue of fact in each case, though certain presumptions may be made. For example, where an affiliate is "wholly" or "majority owned" by its parent firm, it is safe to assume that the two undertakings comprise a single economic entity. On the other hand, minority control could pose difficult questions. When is it sufficient to exercise a decisive influence on the conduct of an

undertaking? Such issues are important given the value to the efficient organization of the supply side of the market of allowing commercial entities the free choice of means in determining their optimal industrial organization. One such choice is the group enterprise. Of itself, the creation of a group, even a large transnational group, is not an anti-competitive practice (Muchlinski, 1999a, pp. 386-387).

2. Defining restrictive business practices

Competition provisions in IIAs and other international instruments tend to follow one of two main approaches to defining RBPs: either they contain a general definition clause supplemented by specific clauses covering particular types of RBPs, or they only contain clauses defining particular RBPs. The main kinds of general clauses will be considered first, followed by clauses covering the four types of RBPs that have been identified in section I. In this section, the discussion of the first two types, horizontal and vertical arrangements, will be considered together, as most agreements deal with them in a single provision. This will then be followed by an analysis of clauses covering abuse of a dominant position and, finally, clauses covering M&As.

a. General clauses

This kind of clause has been used in the United Nations Set and regional competition arrangements. As defined in the United Nations Set, RBPs comprise:

> "acts or behaviour of enterprises which, through an abuse or acquisition and abuse of a dominant position of market power, limit access to markets or otherwise unduly restrain competition, having or being likely to have adverse effects on international trade, particularly that of developing countries, and on the economic development of these countries, or which through formal, informal, written or unwritten agreements or arrangements among enterprises have the same impact" (section B (i)(1)).

This provision should be read as stating that an offence exists when a practice abuses a dominant position in the ways listed and such a practice has an adverse effect on trade or development. It does not make the adverse effect on developing countries the sole test of a RBP. In section B (ii)(9) the United Nations Set makes clear that it does not apply to "intergovernmental agreements, nor to restrictive business practices directly caused by such agreements". This definition is the only general definition of RBPs used in a multilateral instrument. It is distinct from other provisions dealing with competition issues not only for this reason but also for its focus on competition and development. Equally, it is of significance that the United Nations Set stresses the need for a dominant market position as a pre-requisite for any anti-competitive effect. This follows the view that only the anticompetitive practices of undertakings with significant market power need to be regulated.

The 1996 MERCOSUR Protocol also contains a general definition clause. According to article 4 of the Protocol:

> "Acts, whether individual or concerted, whatever their form, whose object or effect is to limit, restrict, falsify or distort competition or market access or which constitute an abuse of a dominant position in the relevant market of goods or services within MERCOSUR and which affect trade between States Parties, shall, irrespective of fault, be violations of the Rules of this Protocol."

The terms of this clause cover the main types of RBPs, illustrative examples of which are then offered in article 6 of the MERCOSUR Protocol (box II.2). Of note are the references to "concerted acts", "object or effect" and "affect trade between States Parties". These phrases are also found in Articles 81 and 82 of the EC Treaty and they have particular implications for the scope of operation of international competition provisions. The first of these, "concerted acts" ("concerted practices" in article 81(1) of the EC treaty), makes clear that not only formal agreements, but also informal cooperative arrangements that have an anti-competitive effect are covered by the instrument.[8] This is important, as otherwise it would be easy for competitors to escape review of their anti-competitive cooperative practices on the ground that there was no formal agreement to act in such a prohibited manner. Equally, as there is rarely a concluded formal agreement in such cases, the only proof of collusion may be that which arises from informal arrangements.[9]

Box II.2. Article 6 of the MERCOSUR Protocol

"The following forms of conduct, inter alia, insofar as they embody the hypotheses advanced in article 4, constitute practices which limit competition:

I. to fix, impose or practice, directly or indirectly, in collaboration with competitors or individually, in any form, the prices and conditions of the purchase or sale of goods, the providing of services or production;
II. to procure or to contribute to the adoption of uniform business practices or concerted action by competitors;
III. to regulate goods or service markets, entering into agreements to limit or control research and technological development, the production of goods or the supply of services, or to hinder investments intended for the production of goods or services or their distribution;
IV. to divide up the markets of finished or semi-finished goods or services, or the supply source of raw materials and intermediate products;
V. to limit or prevent access of new enterprises to the market;
VI. to agree on prices or advantages which may affect competition in public bids;
VII. to adopt, with regard to third parties, unequal conditions for equivalent services, thus placing them at a competitive disadvantage;
VIII. to subordinate the sale of one good to the purchase of another good or to the use of a service, or to subordinate the supply of a service to the use of another or to the purchase of a good;
IX. to prevent the access of competitors to raw materials, investment goods or technologies, as well as to distribution channels;
X. to require or to grant exclusivity with respect to the dissemination of publicity in the communication media;
XI. to subordinate buying or selling to the condition of not using or acquiring, selling or supplying goods or services which are produced, processed, distributed or marketed by a third party;
XII. to sell merchandise, for reasons unfounded on business practices, at prices below the cost price;
XIII. to reject without good reason the sale of goods or the supply of services;
XIV. to interrupt or to reduce production on a large scale, without any justifiable cause;
XV. to destroy, render useless or accumulate raw materials, intermediate or finished goods, as well as to destroy, render useless or obstruct the functioning of equipment designed to produce, transport or distribute them;
XVI. to abandon, cause to be abandoned or destroy crops and plantations without just cause;
XVII. to manipulate the market in order to impose prices."

Source: UNCTAD, 2000a, vol. IV.

As to "object or effect", this brings an element of intent and causation into the provision. The term "object" may be of importance where concerted action is involved. Proof of an anti-competitive intent on the part of the undertakings involved in the action is of great significance in establishing that a violation has occurred. On the other hand, where, in terms of economic effect, a concerted practice can have foreseeable anti-competitive results, the issue of intent may not matter – the probable, or indeed actual, anti-competitive effect would be decisive proof of a violation. Thus intent may strengthen a case of violation but the crucial factor is whether, in objective terms, the action has a potential or actual anti-competitive effect.

As to the phrase "affects trade between States Parties" ("Member States" in the EC Treaty), this offers a jurisdictional limit to the competence of the international regulatory system in question. Thus a regional arrangement such as MERCOSUR or the EU will only apply to anti-competitive acts occurring within the territory of the regional grouping. This can raise issues as to extraterritorial application of the regime, which will be considered in more detail below.

A final feature of the MERCOSUR Protocol that is worthy of note is the exclusion, in article 5, from offences against competition of "[m]ere market conquest resulting from the natural process of the most efficient economic agent among competitors […]". This introduces a basic principle of competition law into the Protocol, namely, that a superior market position gained through greater productive efficiency is not in itself an anti-competitive act. This is important in relation to the operations of TNCs in developing countries covered by the Protocol, where domestic enterprises may in fact be in a relatively weaker market position. This situation of itself cannot give rise to regulation of a TNC's activities on competition grounds.

Article 30 of the Annex to the 1973 Treaty Establishing the Caribbean Community (CARICOM) on the Caribbean Common Market is devoted to RBPs. The article is drafted in fairly general terms, naming as incompatible with the Treaty "agreements between enterprises, decisions by associations of enterprises and concerted practices between enterprises which have as their object or result the prevention, restriction or distortion of competition within the Common Market" (article 30(1)(a)) and such "actions by which one or more enterprises take unfair

advantage of a dominant position within the Common Market or a substantial part of it" (article 30(1)(b)). This provision allows for the further development of competition policy within CARICOM in light of subsequent experience. A subsequent revision to this treaty including the CARICOM Single Market and Economy (CSME), opened for signature in 2000, contains competition provisions replacing *inter alia,* article 30 above. Chapter 8 (entitled "Competition Policy and Consumer Protection") of the revised treaty contains detailed provisions on anti-competitive business conduct, abuse of a dominant position and "any other like conduct by enterprises whose object or effect is to frustrate the benefits expected from the establishment of the CSME" (article 177(1)).

b. Horizontal and vertical arrangements

Under this heading, international agreements may deal with both types of arrangements in the same provision, or with horizontal arrangements only. The OECD Guidelines are an example of the latter. Thus, the guideline on Competition asserts that:

> "Enterprises should, within the framework of applicable laws and regulations, conduct their activities in a competitive manner. In particular, enterprises should:
> Refrain from entering into or carrying out anti-competitive agreements among competitors:
> a) To fix prices;
> b) To make rigged bids (collusive tenders);
> c) To establish output restrictions or quotas; or
> d) To share or divide markets by allocating customers, suppliers, territories or lines of commerce."

The reference to "competitors" suggests that only horizontal arrangements, that is, arrangements between competing firms on the same level of the market, are covered. On the other hand, the reference to applicable laws and regulations suggests a wider coverage. As the Commentary to the Guidelines states, competition laws and policies prohibit "(a) hard core cartels; (b) other agreements that are deemed to be anti-competitive; (c) conduct that exploits or extends market dominance or market power; and (d) anti-competitive mergers and acquisitions" (paragraph 56). As enterprises are expected to act within the framework of such laws and regulations, it can be inferred that the guideline on Competition implicitly extends to such other practices. Nonetheless, the express terms of this provision are clear so far as the content of the guideline is concerned. The current draft should be contrasted with the earlier version of 1991, which contained a specific provision on both vertical and horizontal arrangements.[10] This change may reflect a shift in priorities for competition regulators in the OECD countries, who, as noted in section I, may no longer view vertical co-operation as anti-competitive in the absence of significant market power and market concentration.

The concern of the OECD with horizontal agreements is further emphasized by the 1998 OECD Council Recommendation Concerning Effective Action Against Hard Core Cartels (OECD Recommendation on Hard Core Cartels). In that document "hard core cartels" are defined as follows:

> "For the purposes of this Recommendation:
> a) a 'hard core cartel' is an anticompetitive agreement, anticompetitive concerted practice, or anticompetitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markets by allocating customers, suppliers, territories, or lines of commerce."

This provision uses the same terms as the Competition guideline, emphasising that such anti-competitive action is of central concern to the OECD. The Recommendation goes on to recommend to member countries that they should ensure their competition laws effectively halt and deter such cartels through, in particular, effective national legal sanctions and enforcement procedures. The Recommendation also excludes certain agreements, concerted practices or arrangements from this policy, in particular those that "(i) are reasonably related to the lawful realisation of cost-reducing or output-enhancing efficiencies, (ii) are excluded directly or indirectly from the coverage of a Member country's own laws, or (iii) are authorised in accordance with those laws". However, member countries are required to ensure that all exclusions and authorizations of what would otherwise be hard core cartels are transparent and are reviewed periodically to assess whether they are both necessary and no broader than necessary to achieve their overriding policy objectives.

The principal provisions of the United Nations Set dealing with anti-competitive arrangements are contained in section D (3). It states in the relevant part as follows:

"Enterprises […] should refrain from practices such as the following when, through formal, informal, written or unwritten agreements or arrangements they limit access to markets or otherwise unduly restrain competition, having or being likely to have adverse effects on international trade, particularly that of developing countries, and on the economic development of these countries:

(a) Agreements fixing prices, including as to exports and imports;
(b) Collusive tendering;
(c) Market or customer allocation arrangements;
(d) Allocation by quota as to sales and production;
(e) Collective action to enforce arrangements, e.g. by concerted refusals to deal;
(f) Concerted refusal of supplies to potential importers;
(g) Collective denial of access to an arrangement, or association, which is crucial to competition."

The reference to enterprises that are engaged on the market in rival or potentially rival activities could be read to suggest that only horizontal arrangements are in fact covered. However, the list of covered practices is broad enough to include vertical arrangements, though the wording could be clearer in this regard.

Other international agreements in this area cover both horizontal and vertical arrangements. The longest established example is article 81(1) of the EC Treaty (box II.3).

In a similar vein, article 3 of the 1991 Andean Community Decision 285 on Rules and Regulations for Preventing or Correcting Distortions in Competition Caused by Practices that Restrict Free Competition refers to horizontal and vertical agreements entered into by related parties as an example of the types of RBPs covered by this instrument. Article 4 then enumerates examples of agreements, parallel behaviours or collusion that distort competition. These cover price fixing, production distribution or technical development controls, import or export controls, allocations of supplies, the imposition of unequal trading conditions on equivalent goods, or services tie-ins that are unrelated to the subject matter of the contract in question and "other cases with equivalent effects". Thus, the list is illustrative and not exhaustive of the types of restrictions that the instrument covers.

Box II.3. The EC regime

After the general description of the anti-competitive practices covered by this provision, article 81(1) goes on to list a number of illustrative practices prohibited by its terms. These include: directly or indirectly fixing purchase or selling prices or any other trading conditions; limiting or controlling production, markets, technical development or investment; sharing markets or sources of supply; applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and, making the conclusion of contracts subject to the acceptance by other parties of supplementary obligations which, by their nature or according to their commercial usage, have no connection with the subject matter of such contracts.

These examples are not exhaustive as to the coverage of article 81(1). Thus any type of practice that has the prohibited effect can be reviewed by the EC Commission to test its conformity with the competition rules contained in article 81(1). Article 81(2) makes clear that "(a)ny agreements or decisions prohibited pursuant to this article shall be automatically void." However, article 81(3) introduces certain exceptions to the applicability of article 81(1). In accordance with this provision, the provisions of paragraph 1 may be declared inapplicable in the case of any agreement or category of agreements between undertakings, any decision or category of decisions by associations of undertakings, or any concerted practice or category of concerted practices which contributes to improving the production or distribution of goods, or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not impose, on the undertakings concerned, restrictions that are not indispensable to the attainment of these objectives or afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question. This qualification of the prohibition in article 81(1) recognizes that not all types of collaboration between competing enterprises are necessarily harmful to competition. In particular, EC law has accepted that vertical agreements between undertakings at different levels of the market are unlikely to be anti-competitive unless the market is concentrated and the undertakings concerned have a large market share. Equally, joint ventures that seek to develop new products processes and technologies, through the pooling of expertise and know-how among competing firms, have been given approval. Indeed, the Commission regularly issues regulatory exemptions from article 81(1), based on the criteria in article 81(3), exempting certain types of restrictive agreements that are usually not anti-competitive from review under this provision. These are known as "block exemptions". Their main effect is to avoid unnecessary regulatory intervention by the EC Commission in the conclusion and operation of cooperative agreements or arrangements that are conducive to the enhancement of economic and technical efficiency and consumer benefit.

Source: UNCTAD.

c. Abuse of a dominant position

Article 82 of the EC Treaty offers a classic definition of this type of RBP. It provides that "[a]ny abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States". This general prohibition is then followed by illustrative examples of abuse. These include the direct or indirect imposition of unfair purchase or selling prices or other unfair trading conditions; the limitation of production, markets or technical development to the prejudice of consumers; the application of dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and making the conclusion of contracts subject to the acceptance of obligations with little or no connection to the subject matter of such contracts.

A more elaborate provision in this area can be found in the CARICOM Treaty, as revised in 2000. Chapter 8 sets down in some detail the steps to be taken by the regulatory authority to determine whether an abuse of a dominant position has occurred. As such it is a useful summary of the process of regulating such abuses (box II.4).

Box II.4. Articles 178 and 179 of the CARICOM Treaty

"Article 178: Determination of Dominant Position
For the purposes of this Chapter:
(a) an enterprise holds a dominant position in a market if by itself or together with an interconnected enterprise, it occupies such a position of economic strength as will enable it to operate in the market without effective constraints from its competitors or potential competitors;
(b) any two enterprises shall be treated as interconnected enterprises if one of them is a subsidiary of the other or both of them are subsidiaries of the same parent enterprise.

Article 179: Abuse of a Dominant Position
1. Subject to paragraph 2 of this Article, an enterprise abuses its dominant position in a market if it prevents, restricts or distorts competition in the market and, in particular but without prejudice to the generality of the foregoing, it:
   (a) restricts the entry of any enterprise into a market;
   (b) prevents or deters any enterprise from engaging in competition in a market;
   (c) eliminates or removes any enterprise from a market;

/…

Box II.4 (concluded)

   (d) directly or indirectly imposes unfair purchase or selling prices or other restrictive practices;
   (e) limits the production of goods or services for a market to the prejudice of consumers;
   (f) as a party to an agreement, makes the conclusion of such agreement subject to acceptance by another party of supplementary obligations, which, by their nature or according to commercial usage, have no connection with the subject of the agreement;
   (g) engages in any business conduct that results in the exploitation of its customers or suppliers, so as to frustrate the benefits expected from the establishment of the CSME.
2. In determining whether an enterprise has abused its dominant position, consideration shall be given to:
   (a) the relevant market defined in terms of the product and the geographic context;
   (b) the concentration level before and after the relevant activity of the enterprise measured in terms of annual sales volume, the value of assets and the value of the transaction;
   c) the level of competition among the participants in terms of number of competitors, production capacity and product demand;
   (d) the barriers to entry of competitors; and
   (e) the history of competition and rivalry between participants in the sector of activity.
3. An enterprise shall not be treated as abusing its dominant position if it establishes that:
   (a) its behaviour was directed exclusively to increasing efficiency in the production, provision or distribution of goods or services or to promoting technical or economic progress and that consumers were allowed a fair share of the resulting benefit;
   (b) it reasonably enforces or seeks to enforce a right under or existing by virtue of a copyright, patent, registered trade mark or design; or
   (c) the effect or likely effect of its behaviour on the market is the result of superior competitive performance of the enterprise concerned."

Source: UNCTAD, 2002a, Vol. VIII.

Section D(4) of the United Nations Set lists certain abuses of a dominant position committed by enterprises. It states:

> "Enterprises should refrain from the following acts or behaviour in a relevant market when through an abuse or acquisition and abuse of a dominant position of market power, they limit access to markets or otherwise unduly restrain competition, having or being likely to have adverse effects on international trade, particularly that of developing countries, and on the economic development of these countries:

(a) Predatory behaviour towards competitors, such as using below-cost pricing to eliminate competitors;
(b) Discriminatory (i.e. unjustifiably differentiated) pricing or terms and conditions in the supply and purchase of goods or services, including by means of the use of pricing policies in transactions between affiliated enterprises which overcharge or undercharge for goods or services purchased or supplied as compared with prices for similar or comparable transactions outside the affiliated enterprises;
(c) Mergers, takeovers, joint ventures or other acquisitions of control, whether of a horizontal, vertical or a conglomerate nature;
(d) Fixing the prices at which goods exported can be resold in importing countries;
(e) Restrictions on the importation of goods which have been legitimately marked abroad with a trademark identical with or similar to the trademark protected as to identical or similar goods in the importing country where the trademarks in question are of the same origin, i.e. belong to the same owner or are used by enterprises between which there is economic, organizational, managerial or legal interdependence and where the purpose of such restrictions is to maintain artificially high prices;
(f) When not ensuring the achievement of legitimate business purposes, such as quality, safety, adequate distribution or service:
    (i) Partial or complete refusals to deal on the enterprise's customary commercial terms;
    (ii) Making the supply of particular goods or services dependent upon the acceptance of restrictions on the distribution or manufacture of competing or other goods;
    (iii) Imposing restrictions concerning where, to whom, or in what form or quantities, goods supplied or other goods may be resold or exported;
    (iv) Making the supply of particular goods or services dependent upon the purchase of other goods or services from the supplier or his designee."[11]

Section D (4) contains a definition of "abuse" in a footnote that has implications for group enterprises. The footnote states that the determination of whether acts or behaviour are abusive should be examined "with reference to whether they limit access to markets or otherwise unduly restrain competition [...]" and to whether they are, *inter alia*, "[a]ppropriate in the light of the organizational, managerial and legal relationship among the enterprises concerned, such as the context of relations within an economic entity and not having restrictive effects outside the related enterprises; […]". Thus, acts engaged in by related enterprises that are inappropriate to their organizational arrangements, and which result in the limitation of access or other restraints of competition outside the related enterprises, are covered where the related enterprises are in a position of market dominance. This suggests that intra-firm practices in general are subject to review under the Set. It is not clear how the line between legitimate and anticompetitive intra-firm practices should be drawn (Muchlinski, 1999a, p. 407).

Finally, it should be noted that the current version of the OECD Guidelines does not contain any provision on abuse of a dominant position. Again the reference to "applicable laws and regulations" in the chapeau to the Competition guideline may suggest that this issue is now to be left to national regulation. By contrast, the previous version of 1991 did contain a specific provision on this issue.[12]

d. Mergers and acquisitions

As noted above, section D (4) (c) of the United Nations Set requests enterprises to refrain from mergers, takeovers, joint ventures or other acquisitions of control, whether of a horizontal, vertical or a conglomerate nature, when, through an abuse or acquisition and abuse of a dominant position of market power, they fall under the Set's definition of RBPs.[13] It is important to note here that the legitimacy of a merger is conditional on the parties not abusing – or acquiring and abusing – a dominant position. In this connection, the Set stipulates that: "Whether acts or behaviour are abusive or not should be examined in terms of their purpose and effects in the actual situation, in particular with reference to whether they limit access to markets or otherwise unduly restrain competition, having or being likely to have adverse effects on international trade, particularly that of developing countries, and on the economic

development of these countries […]" (see the footnote to section D(4) of the Set). Under this definition, the likelihood of adverse effects, in this case from a merger, constitutes an abusive act**.** More broadly, this definition suggests that adverse effects on the trade of developing countries should be made a test in determining whether any given M&A should be controlled.

Aside from the EC Merger Control Regulation (box II.5), in general IIAs and other instruments have not established specific regimes for the control of M&As. This issue has been more prominent in arrangements that seek to enhance co-operation between national competition authorities, as will be seen below.

Box II.5. The EC merger control regulation

The EC Merger Control Regulation is the most advanced international system of regulation in this area (EC Council, 1989; Whish, 2003, chapter 17). It is a highly complex instrument that has been revised since its entry into force in 1989 (EC Council, 1997, EC Council, 2004). Its principal features highlight what an international system for dealing with M&As requires. In particular it contains specific rules on:

- *Jurisdiction*, to determine which transactions come within the competence of the member states of the EU and which come under the review powers of the EC Commission. The key test is whether a proposed merger or acquisition amounts to a "concentration" having a "Community dimension" as defined in the Commission's Guidance Notices on these issues.
- *Procedures* to be followed by applicants seeking to contest a given transaction, by the Commission, in its investigation.
- *Substantive rules* by which a proposed merger or acquisition is to be reviewed. In this regard the main question is whether the transaction will create or further enhance a dominant position on the relevant market such that the risk of an abuse of a dominant position is increased.
- *Enforcement powers* to be exercised by the Commission. This includes a power to prohibit the transaction under review or to allow it subject to terms and conditions and periodic review of the competitive situation on the market in which the transaction takes place.

Source: UNCTAD.

3. The kinds of issues covered

Having considered how competition provisions in international agreements have sought to define the main types of RBPs, the next issue to be considered is their scope. Not all provisions cover the same types of RBPs. As already noted in section I and in the previous sub-section, EC competition rules on M&As did not come into force until 1989, given the politically sensitive nature of such controls for national industrial policy and the reluctance of EC member States to cede jurisdiction to the EC Commission over this field, while OECD practice has tended to emphasise controls over horizontal cartels rather than vertical arrangements. Equally, it was not until the 1990s that provisions relating to competition actually appeared in WTO Agreements. Thus future IIAs can choose which, if any, of the four main types of RBPs they wish to cover and may also change that coverage over time by agreement of the parties. In addition, existing agreements show that there may be further choices as to whether certain types of competition related issues that do not fall within the main definitions of RBPs should be covered as well. In particular, certain free trade agreements have restricted competition provisions to trade related RBPs only. Other issues concern specific clauses on state aids, state enterprises and monopolies, transfer pricing manipulations, and technology transfer. Finally, the issue of the development dimension and competition has been considered in the United Nations Set.

a. Trade-related restrictive business practices

In recent years, a trend has arisen in free trade agreements requiring parties to regulate anticompetitive practices that may interfere with the conduct of cross-border trade between the signatory States. Such provisions are a significant feature of EU Association, Europe and Euro-Mediterranean Agreements and other free trade agreements, trade agreements of the European Free Trade Association (EFTA) and Turkey with some countries in Central and Eastern Europe (CEE) and between some CEE countries.

In EU association agreements, including Europe and Euro-Mediterranean agreements, competition standards based on EU competition rules are applicable where trade between the EU and the other signatory party is adversely affected by the anti-competitive practices specified in the competition provision.[14] The Euro-Mediterranean Agreements carry similar obligations to those of the Association Agreements.[15]

On the other hand, EC Partnership and Cooperation Agreements with certain member countries of the Commonwealth of Independent States (CIS) do not have so specific a provision on

competition, as the aim is to foster closer economic cooperation with the non-EC party and not to bring competition rules into conformity with EC rules, in anticipation of that party's future integration into the EC.16 A further variation of EC practice is used in some agreements between the EC and non-European partners to trade, development and cooperation agreements.[17]

The Convention Establishing the EFTA (EFTA Convention) uses language based on EC provisions in its Chapter VI on "Rules of Competition" (article 18). EFTA free trade agreements (FTAs) typically use the same model text in their standard provision on rules of competition concerning undertakings. For example, following closely the language of Articles 81 and 82 of the EC Treaty, article 18 of the 1992 Agreement between EFTA and the Czech Republic states that, in so far as they affect trade between an EFTA State and the Czech Republic, all anti-competitive agreements, concerted practices and abuses of a dominant position are incompatible with the proper functioning of the Agreement.[18] Similar provisions can be found in other bilateral free trade agreements (FTAs) between certain CEE countries.[19]

The Turkish bilateral FTAs take two approaches to competition issues. The first follows closely the structure and content of the abovementioned EFTA provisions. This formulation is found, for example, in the 1999 FTA between Turkey and Poland, with the difference that public undertakings are subject to competition disciplines from the inception of the Agreement (article 20). Other free trade agreements contain a somewhat different provision that is more wide-ranging in scope in that it includes a prohibition on anti-competitive state aids but does not mention public undertakings.[20] The provision on such state aids is subjected to a transparency obligation in article 25(2) and to any applicable WTO disciplines. This has the effect of incorporating the WTO Agreement on Subsidies and Countervailing Measures into this Agreement. Article 25 also introduces a system for dealing with anti competitive practices not dealt with by its substantive provisions, but which, in the view of either party, are causing material injury to it.[21] Also, Free Trade Area Agreements concluded by Turkey contain such a provision with some particular variations.[22] Thus the 1996 Turkey-Israel Agreement also mentions an exemption of agricultural products from the prohibition of state aids (article 25(4)). The 1997 FTA between Turkey and Romania is distinctive in that it expressly refers to the competition provisions in the EC Treaty as the basis of assessing any anti-competitive practices prohibited under the Agreement (article 24(2)).

b. State aids

As noted in the previous section, certain FTAs that contain a competition provision may extend its coverage to the control of anti-competitive state aids from the inception of the agreement. Such aids were also covered from the inception of the EC Treaty.[23]

c. State enterprises and monopolies

A further issue that might be covered by a competition provision in an IIA concerns the extension of competition disciplines to state enterprises and to government monopolies. EFTA free trade agreements extend such disciplines to public undertakings after a transitional period, while those Turkish FTAs that cover public undertakings apply competition disciplines from the outset. These matters are also covered by other, more recent, agreements. For example, article 12.6 of the 2003 FTA between the Republic of Korea and Chile requires that the parties ensure that designated monopolies, in the fields of public telecommunications, transport networks or services, do not use their monopoly position to engage in anti-competitive conduct, whether directly or through affiliates, in such a manner as to affect adversely a person of the other party. Such conduct may include cross-subsidization, predatory conduct and discriminatory provision of access to the designated sectors. Similarly, by article 07-12 of the 2003 FTA between Singapore and Australia, parties agree to ensure that a service monopoly supplier does not abuse its monopoly position to act in a manner that is inconsistent with commitments as to market access and national treatment made by such party in the agreement. At the regional level, article 35a of the 1997 Protocol II Amending the CARICOM Treaty subjects government monopolies "to the agreed rules of competition established for Community economic enterprises" (section 2(a)).

At the multilateral level, article VIII of the General Agreement on Trade in Services (GATS) contains a provision regulating the provision of monopoly and exclusive service suppliers. It covers competition issues to the extent that, where

a member's monopoly supplier competes, either directly or through an affiliated company, in the supply of a service outside its monopoly rights and which is subject to that members specific commitments, "the Member shall ensure that such a supplier does not abuse its monopoly position to act in its territory in a manner inconsistent with such commitments" (article VIII:2). The Council for Trade in Services may request specific information on any operations that infringe this principle from the member in question. Members are obliged to notify the Council for Trade in Services of any new grants of monopoly rights that relate to the supply of a service covered by specific commitments. This provision has been influential in relation to similar provisions in some of the more recent bilateral FTAs, which closely follow its wording.[24]

d. Transfer pricing manipulations

Transfer pricing can be regarded as a TNC-related RBP. Indeed, the United Nations Set contemplates transfer pricing abuses by affiliated enterprises as a species of abuse of a dominant position. This was opposed in principle by some developed countries, which argued that such practices were better seen as taxation issues. However, these counties compromised on the basis that the then current version of the OECD Guidelines included, as an abuse of a dominant position, transfer pricing manipulations that adversely affected competition outside the affiliated enterprises.

e. Technology transfer

One area in which IIAs have addressed competition issues is that of technology transfer. Here, two main competition related matters have arisen: first the control of performance requirements connected with such transfer; and, second, the protection of intellectual property rights and technology transfer. These matters have been discussed in detail in chapter 23. For present purposes, it suffices to note that in relation to the first issue, certain bilateral investment treaties (BITs) entered into by the United States, and more recently by Canada, contain a general prohibition on the imposition of performance requirements relating to the transfer of technology but specifically permit technology transfer requirements that are imposed by the courts, administrative tribunals or competition authorities of the host country which aim to remedy an alleged violation of competition laws. This approach is also taken in article 1116 of the North-American Free Trade Agreement (NAFTA). This provision was also followed verbatim in the 1996 FTA between Canada and Chile (article G-06). Some more recent bilateral FTAs contain similar provisions.[25]

As regards the second issue, the 1985 Draft International Code of Conduct on the Transfer of Technology contained specific regulatory rules concerning the use of restrictive conditions in technology transfer transactions. The developing countries sought to prohibit such clauses, while the developed countries preferred a competition based approach which subjected such terms to a "rule of reason" analysis whereby a restrictive term would be acceptable provided it could be said to be reasonable given the interests of the transferor and transferee. More recently, the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) has reaffirmed a competition-based approach to this issue.[26] Thus by article 8(2) of the TRIPS Agreement, States may adopt such measures as may be needed "to prevent the abuse of intellectual property rights by right holders or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology", provided these are consistent with other provisions of the Agreement (such as the non-discrimination principle). This approach is further developed in article 40 of the TRIPS Agreement, which provides certain examples of practices that may be controlled, such as exclusive grant back conditions, conditions preventing challenges to the validity of intellectual property rights and coercive package licensing.

NAFTA takes a similar approach in article 1704, which allows the parties to specify in their domestic law licensing practices or conditions that may, in particular cases, constitute an anti-competitive abuse of intellectual property rights in the relevant market (NAFTA, 1993, p. 671).

f. The development dimension and competition

The only instrument that covers all aspects of competition regulation, including from the development perspective, is the 1980s United Nations Set. This instrument not only stresses the close relationship between the control of RBPs and development policies, but also makes a significant

link between the economic policy concerns of developing countries and the control of anticompetitive practices (UNCTAD, 1997a, pp. 229-233 and UNCTAD, 2003a, p. 135). It represents an acceptance of the view that the basic norms of competition law, which have long been in use in developed countries, should extend to the operations of enterprises, including TNCs, in developing countries. Thus, the section on "Objectives of the Set" emphasises that interests of developing countries in particular should be taken into account in the elimination of RBPs that may cause prejudice to international trade and development. Furthermore, the Objectives section sees the Set as an international contribution to a wider process of encouraging the adoption and strengthening of laws and policies in this area at the national and regional levels. This objective should be seen alongside UNCTAD's work on the formulation of a Model Law on RBPs.

The draft Model Law embodies the principles laid down in the Set and couples these with a scheme for a national competition authority. It is intended for developing counties that do not, as yet, have a domestic system of competition regulation. Finally, section C(iii)(7) of the Set lays down a principle of preferential treatment for developing countries as an aspect of the equitable application of the principles contained in the Set. Thus, States, in particular developed countries, are to take into account in the application of their RBP controls the "development, financial and trade needs of developing countries, in particular those of the least developed countries, for the purposes especially of developing countries in: (a) promoting the establishment or development of domestic industries and the economic development of other sectors of the economy, and (b) encouraging their economic development through regional or global arrangements among developing countries". Therefore, the Set envisages "infant industry" and regional economic integration exceptions to the application of competition controls to enterprises and other organizations from developing countries. This provision was accepted by the developed States in return for the developing countries' acceptance of the principle that "States, while bearing in mind the need to ensure the comprehensive application of the Set of Principles and Rules, should take due account of the extent to which the conduct of enterprises, whether or not created or controlled by States, is accepted under applicable legislation or regulations [...]". Thus the Set accepts that States cannot interfere with another State's decision to exempt certain activities from the operation of competition laws (see also UNCTAD, 1997a, p. 225).

B. Procedural issues

1. Extraterritoriality

The two single most significant causes of international conflict arising out of the operations of TNCs in the FDI/competition interface relate to merger control and its trans-border effects and trans-border evidence-gathering (foreign discovery orders) in litigating competition cases.

a. Responses to extraterritorial effects of merger control

One of the most significant attempts to deal with this area of potential conflict is the 1991 "Agreement between the United States and the EC regarding the Application of Their Competition Laws". It calls for enhanced cooperation and, "in appropriate cases", coordination in the application of the two parties' respective competition laws and in enforcement proceedings between the two parties in an effort to avoid conflicts stemming from the extraterritorial reach of competition/antitrust laws and policy from either party. Under the Agreement, the parties have committed "to promote cooperation and coordination and lessen the possibility or impact of differences between [them] in the application of their competition laws" (article I (1)). The parties further agree that, from the time the competition authorities of one party become aware that their enforcement activities may have an adverse impact or effect on "important interests" of the other, these interests should be taken into account at all stages of enforcement activities of the initiating party (article II (1) and article VI). In addition, the other party should be notified of reportable M&As – or other matters where there are "notifiable circumstances" – well enough in advance of a consent decree (United States) or a decision or settlement (EC), to allow that party's views to be taken into account (article II (3)(a)(iii), (3)(b)(iii), and (4)). Under the Agreement, each party agrees to enter into consultations at the request of the other party, in an effort expeditiously to reach "mutually satisfying conclusions" (article VII (1)).

This Agreement gave rise to a new notion referred to as "positive comity". In accordance with the concept of "positive comity", each country undertakes to rely on the other country's

local enforcement mechanisms, rather than resorting to the potentially controversial application of its own antitrust/competition law outside its borders. This is clearly distinguishable from the traditional concept of comity, in which moderation and restraint are exercised largely on the basis of balance of interests and broader foreign policy considerations (so called traditional or negative comity).

The effectiveness of positive comity has been questioned, partly because it is thought to be unrealistic to assume that any government will be willing to prosecute its nationals for the benefit of the interests of another sovereign.[27] It is nonetheless significant that the Agreement provides the first instance in which the notion of comity is codified in an international instrument relating to competition.

Though the 1991 Competition Cooperation Agreement between the United States and the EC is the most widely known bilateral co-operation agreement, it was not the first.[28] A myriad of similar bilateral cooperation agreements have since been concluded, involving many State parties, including developing countries. Initially, few of these cooperation agreements involved developing countries, with the exceptions of the 1991 Andean Common Market Commission Decision 285, the 1996 MERCOSUR Protocol and certain EU Association Agreements with various southern Mediterranean countries concluded since 1995. More recently, the 2000 "Partnership Agreement between the Members of the African, Caribbean and Pacific Group of States and the EC", signed at Cotonou (Cotonou Agreement), includes a commitment in article 45 to implement national competition rules in the developing country parties and to further cooperation in this field. These are further discussed below.

At the multilateral level, there is no mention of the issue of extraterritoriality in the United Nations Set. The only multilateral instrument that can be said to concern itself directly with issues of "extraterritorial" jurisdiction is the Conflicting Requirements instrument of the 1976 OECD "Declaration and Decisions on International Investment and Multinational Enterprises". This instrument calls on member countries to avoid or minimize conflicting requirements imposed on TNCs by governments of different countries. It provides for consultations with the Committee on International Investment and Multinational Enterprises (CIME), or other mutually acceptable arrangements, for member countries with any problems arising from the fact that TNCs are made subject to conflicting requirements. At the same time it is recognized that, "while bilateral and multilateral co-operation should be strengthened when multinational enterprises are made subject to conflicting requirements, effective co-operation on problems arising therefrom may best be pursued in most circumstances on a bilateral level, although there may be cases where the multilateral approach would be more effective" (preamble to the OEDC Guidelines: Second Revised Decision of the Council, as amended in 1991).

b. Cross-border evidence-gathering in competition cases

The 1970 "Convention on the Taking of Evidence Abroad in Civil or Commercial Matters" signed within the framework of the Hague Conference on Private International Law (Hague Evidence Convention)[29] is geared in part, to mitigate controversy over the extraterritorial reach of competition/antitrust laws as regards cross-border evidence gathering. This can arise in the course of competition cases involving complex transnational groups, where relevant information required for the purposes of the case in question is held by a TNC in a foreign jurisdiction. The Hague Evidence Convention provides that, in civil or commercial matters, the courts of one contracting State have a right, by Letter of Request via a designated Central Authority (or certain specified other competent authorities (articles 15-17)) to obtain evidence or perform some other judicial act through the courts of another contracting State, for use in judicial proceedings, commenced or contemplated (articles 1-2). The Convention allows certain derogations from its rules where bilateral or plurilateral agreements are already in force (article 28). The original intent of the Hague Evidence Convention was basically two-fold. One objective was to facilitate the obtaining of evidence abroad that would otherwise be unobtainable or fraught with foreign government opposition or obstruction. The other was to contain the extraterritorial reach and scope of foreign parties in pre-trial discovery proceedings – so-called "fishing expeditions", which have proved to be a particular problem in United States litigation which allows for a far broader range of pre-trial discovery than other legal systems.

The United Nations Set also covers the issue of information gathering outside the

regulating jurisdiction. According to the Set's provisions addressed to enterprises, specifically including TNCs, disclosure of information located abroad to be made by enterprises to their national authorities is to be subject to "applicable law or established public policy" in the target State, as well as to "safeguards normally applicable in this field" (section D (2)). Under the provisions addressed to States, the Set recommends that, where a State obtains such information from enterprises acting upon this directive which contain legitimate business secrets, that State equally "should accord such information reasonable safeguards normally applicable in this field, particularly to protect its confidentiality" (section E (5)). In either of these cases, the Set is not addressing litigation-related disclosure or "discovery". The Set goes on to exhort States to improve or institute procedures for procuring information from enterprises, expressly including TNCs (section E (6)). Here again, and throughout section E, individual States are directed to take national (or regional or sub-regional) measures to implement the international guidelines.

The 1995 OECD "Revised Recommendation of the Council Concerning Co-operation Between Member Countries on Anticompetitive Practices Affecting International Trade" (OECD Recommendation) also stresses the necessity of conformity with international law and due regard for international comity when developing any laws aimed at facilitating extraterritorial investigation and disclosure. It further emphasizes the importance of regard for the law and established policies and national interests of the country in which the documents are situated. It promotes the notion that moderation and restraint should be used by member States in the extraterritorial application of their competition laws. The OECD Recommendation appears generally to have provided a useful multilateral instrument; it was referred to by the European Court of Justice (ECJ) in the landmark *Wood Pulp* case, which established the right of the EC Commission to seek jurisdiction, in competition investigations, over any undertaking that had an active presence on the EC internal market whether through contractual links with customers or more substantial forms of business presence.[30]

In addition, operating under the OECD Recommendation, the United States has concluded a number of cooperative bilateral mutual legal assistance treaties. These have received statutory support through such legislation as the 1994 United States International Antitrust Enforcement Assistance Act (IAEAA),[31] and are considered to be playing a not insignificant role in policies of convergence. The Act gives the relevant authorities the power to enter into agreements with foreign competition authorities for the exchange of evidence located abroad, in the pursuit of antitrust investigations, on a reciprocal basis. This includes confidential information. Furthermore, United States Federal competition authorities are authorized to employ compulsory processes to acquire information at the request of a foreign competition authority whose important national interests are affected by anti-competitive behaviour organized in the United States, even if such behaviour is not illegal under United States law. The only agreement concluded so far on this basis is the 1999 "Agreement between the United States and Australia on Mutual Antitrust Enforcement Assistance" (UNCTAD, 2003b, p. 9).

In the absence of international legal standards specifically developed to provide for a comprehensive and consistent approach to the cross-border exchange of confidential information, competition authorities will continue to have limited access to requested documents and will be obliged to proceed on a case-by-case basis, relying on company waivers, relevant provisions of bilateral treaties, positive comity principles and, in criminal investigations, the provisions of mutual legal assistance treaties (UNCTAD, 2003b, p. 9). Indeed, bilateral agreements may continue to be the most effective interim solution, pending a broader international consensus.

2. International cooperation in procedural matters

Apart from issues of extraterritoriality, international cooperation also extends to the activities of information exchange, notification, consultations and mutual enforcement assistance. Such cooperation has been envisaged for some time in international instruments. The 1960 GATT Council "Decision on Arrangements for Consultations on Restrictive Business Practices" contained a recommendation that, at the request of any contracting party, bilateral consultations should be held on RBPs considered to be harmful to international trade (GATT, 1961, pp. 28-29). Equally, the OECD has been concerned with the question of international cooperation for a considerable time (BNA, 1994). The 1995 OECD Recommendation, referred to above, which

replaces the earlier instruments, provides for notification, consultations, the exchange of information, the coordination of investigations, investigatory assistance, traditional and positive comity, consultations and a conciliation mechanism to resolve disputes (UNCTAD, 2003b, p. 17).

In more recent years, an increasing number of bilateral and regional cooperation agreements in the field of competition policy have been concluded. Bilateral agreements tend to deal solely with competition issues while regional agreements deal with cooperation in competition matters as one part of a wider agreement. Also of note is the fact that the concentration of cooperation agreements among OECD countries is not quite as heavy as before, with more countries outside this grouping undertaking agreements in the field (UNCTAD, 2003b, p. 7).

a. Bilateral cooperation agreements

Such agreements have been entered into mainly by the United States and the EU. Typical provisions of many of these agreements include: notification of enforcement activities affecting the other party's important interests; taking into account the other party's significant interests when applying remedies against RBPs (traditional or negative comity); consultations to resolve conflicting legal requirements, coordinated action against RBPs occurring on the territory of both parties; requests for assistance in investigations by one party concerning RBPs occurring on the territory of the other party that affect the requesting party's vital interests; requests for assistance in the enforcement of orders made by one party on the territory of the other party; and commitments to give serious consideration to such requests for investigatory assistance, including providing non-confidential information and confidential information subject to safeguards (UNCTAD, 2003b, p. 8).

The signing of the 1998 Agreement between the EC and the United States on the "Application of Positive Comity Principles in the Enforcement of their Competition Laws" (also known as the "Positive Comity Agreement") reconfirmed and reinforced cooperation between the European Commission and the relevant United States agencies. Article III of the Agreement encourages the use of positive comity in the enforcement of the two parties' competition/antitrust laws,[32] while article IV requires that, when the authority deemed to be better placed to investigate the conduct at issue agrees to do so, the other party will normally defer or suspend its own enforcement procedures. This later agreement does not endow the relevant authorities with any powers additional to those conferred by the 1991 Agreement, mentioned in the previous sub-section.

The bilateral agreements specific to mutual cooperation in antitrust matters concluded by the United States with Germany and with Canada as well as the agreement between France and Germany33 and the 1995 OECD Recommendation on which these are essentially based, are less detailed and, with the notable exception of that between the United States and Canada, less "engaged" than the United States-EC Agreement. The first of these, the 1976 United States-Germany Agreement, for example, calls for the regularization of cooperation between their antitrust authorities in connection with antitrust investigations, competition policy studies and possible changes in antitrust laws as well as information exchange, in connection with competition issues (article 2). The 1999 Agreement between the EC and Canada regarding the Application of Their Competition Laws follows closely the formula of the United States-Canada and the United States-EC Agreements. The major difference between the EU-Canada Agreement and the United States-EC Agreement is the more detailed provision regarding confidentiality (article X).

The EU has also concluded cooperation agreements with other countries that cover cooperation in the field of competition. For example, such agreements have been concluded with Mexico and with South Africa. The 1997 Economic Partnership, Political Coordination and Cooperation Agreement between the EC and Mexico calls for the establishment of mechanisms of cooperation and coordination in the mutual enforcement of the two parties' competition rules, including mutual legal assistance, notification, consultation and exchange of information, towards more transparency in bilateral enforcement assistance (article 11(1)). The 1999 Agreement on Trade, Development and Cooperation between the EC and South Africa also contains similar cooperation provisions. Other lower-intensity cooperation agreements have been concluded between the EC and a number of Central and South American countries. Among the cooperation provisions, the parties typically commit, *inter alia*,

to hold an ongoing dialogue on the monitoring of RBPs (UNCTAD, 2003b, p. 13).

Another model is furnished by European association and partnership agreements mentioned above. EC association agreements, including Europe and Euro-Mediterranean agreements, contain mutual notification requirements of anticipated action, particularly where a case falling under the exclusive competence of one party could affect the "important interests" of the other. Consultations are also required before action can be taken against a practice, not deemed to have been dealt with adequately by the other party. Requests may also be made to the other party to take remedial action against RBPs having harmful cross-border effects. It is important to note that these agreements make no provision for supranational competition authorities.

In the practice of EFTA, cooperation provisions generally follow the EU model. Indeed, under the Agreement of the European Economic Area (EEA), concluded by the EU with most countries of EFTA, all practices liable to impinge on trade and competition among the EEA members are subject to rules that are almost identical to EC competition law. The European Commission or the EFTA Surveillance Authority has the authority over such practices, and the Agreement has provisions for the exchange of information, consultations, coordinated enforcement and dispute settlement. However, the accession of many former EFTA members to the EU has now reduced the practical scope of this agreement (UNCTAD, 2003b, p. 11). As regards agreements between EFTA and non-European countries, the 2000 FTA between the EFTA States and Mexico extends to specific provisions on co-operation (article 52) and consultations (article 55). The parties agree to adopt or maintain (national) measures to proscribe anticompetitive business conduct (article 51(1)) and undertake to "apply their respective competition laws so as to avoid that the benefits of this Agreement may be undermined or nullified by anticompetitive business conduct ... [giving] particular attention to anticompetitive agreements, abuse of market power and anticompetitive mergers and acquisitions in accordance with their respective competition laws" (article 51(2)). By contrast article 50 of the 2002 FTA between EFTA and Singapore provides only for a consultation mechanism in cases in which anti-competitive agreements, concerted practices or abuse of a dominant position may restrict trade between the parties. It specifically excludes the arbitration provisions of the agreement from competition matters.

Turning to the approach taken by certain Asian countries, the 2002 Agreement between Singapore and Japan for a New-Age Economic Partnership contains a simple, general provision on cooperation in controlling anti-competitive activities. It states, "[t]he Parties shall, in accordance with their respective laws and regulations, cooperate in the field of controlling anti-competitive activities subject to their available resources", leaving the details and procedures of cooperation in the field of competition, with special reference to information exchange, to be specified in an Implementing Agreement (article 104). The Agreement's competition rules guide each party to refer to its applicable national laws and regulations in taking appropriate measures against anti-competitive practices "in order to facilitate trade and investment flows between the Parties and the efficient functioning of its markets" (article 103). Of particular interest here is a direct reference to investment as well as trade, which is more common.

The 1999 "Agreement between the United States and Japan Concerning Cooperation on Anticompetitive Activities" similarly gives great deference to the laws and regulations of the respective State parties (article III(1) and (2)) and urges the respective competition authorities to "consider" coordinating their enforcement activities when pursuing enforcement activities with regard to related matters (article IV(1)). The purpose of the United States-Japan Agreement is summed up in article I as being "to contribute to the effective enforcement of the competition laws of each country through the development of cooperative relationships between the competition authorities of each Party... [which] shall, in accordance with the provisions of this Agreement, cooperate with and provide assistance to each other in their enforcement activities, to the extent compatible with the respective Party's important interests." There is provision for one party to request that the competition authority of the other party initiate appropriate enforcement activities (article V(1)), while giving "careful consideration to the important interests of the other Party" (article VI(1)). The overall emphasis of the Agreement, however, is on notification (article II) (for example, of M&As and enforcement activities); mutual assistance (article III); enforcement coordination (articles IV-VI); consultations (articles VII-VIII); and (carefully

guarded) information exchange (articles VIII-X). As with the 2002 Japan-Singapore Agreement, the enforcement assistance to be rendered to the other party's competition authorities is engaged only "to the extent consistent with the laws and regulations of the country of the assisting Party and the important interests of the assisting Party, and within its reasonably available resources" (article III(1)). There is a provision that "either Party may, at any time, limit or terminate the coordination of enforcement activities and pursue their enforcement activities independently" (article IV(5)).

Finally, it should be noted that there are a few bilateral agreements that organize technical assistance on competition law as part of a wider commitment to cooperation over technical assistance on different forms of economic regulation. For example, under the 1992 Technical Cooperation Agreement between the French Direction-Générale de la Consommation et de la Repression des Fraudes and the Direction-Générale de la Consommation of Gabon, the two authorities undertook to cooperate in such areas as competition policy, consumer protection, unfair competition, product quality and safety and price control. In fulfilment of the terms of this agreement, the French authority sent personnel to Gabon to undertake short-term and long-term training in competition law. There is a similar agreement between France and the Russian Federation (UNCTAD, 2003b, p. 10).

b. Regional and inter-regional cooperation agreements

At the regional level, cooperation has tended to take place among developed countries, though it has also become more common among developing countries. The major examples come from North America and Latin America. Thus, Chapter Fifteen of NAFTA furnishes an example of competition provisions calling mainly for consultation and mutual assistance, along with information exchange (box II.6). It provides for the establishment of a Working Group on Trade and Competition, comprising representatives from each of the three parties to the Agreement, whose task is to report and make recommendations to the Commission on further work, "as appropriate", within five years of the date of entry into force of the Agreement (article 1504).[34] There is a Negotiating Group on Competition Policy of the Free Trade Area of the Americas, which has elaborated a draft chapter on competition policy (UNCTAD, 2003b, p. 15).

The 1991 Andean Community Decision 285 allows member countries, or those countries' enterprises having a legitimate interest, to request the Andean Group Board to apply measures to prevent or rectify damage to production or exports caused by business practices that restrict free competition in the region. The 1991 Decision specifies those types of business practices that fall under this rubric and enumerates the procedures to be followed to deal with them or their effects. Within the Andean Pact, it has been suggested that the requirements for proving RBPs as defined by Decision 285, coupled with the absence of enforcement powers on the part of the Andean Board, account for the failure of Andean Pact competition legislation and case law to develop as quickly as that of its member countries (Ciuffetelli, 1998, p. 522). An amendment to this Decision is under consideration, with the objective of establishing new Rules for the Promotion and Protection of Competition (UNCTAD, 2003b, p. 26).

Box II.6. NAFTA: chapter fifteen

"Article 1501: Competition Law

1. Each Party shall adopt or maintain measures to proscribe anticompetitive business conduct and take appropriate action with respect thereto, recognizing that such measures will enhance the fulfilment of the objectives of this Agreement.
2. Each Party recognizes the importance of cooperation and coordination among their authorities to further effective competition law enforcement in the free trade area. The Parties shall cooperate on issues of competition law enforcement policy, including mutual legal assistance, notification, consultation and exchange of information relating to the enforcement of competition laws and policies in the free trade area."

Source: http://www.sice.org/trade/nafta/naftatce.asp.

The 1996 MERCOSUR Protocol has provisions on enforcement procedures, cooperation and dispute settlement. In order to promote cooperation in the area of competition policy, article 30 of the Protocol requires the parties to adopt national measures establishing mechanisms for cooperation that include information exchange, training of experts, the collection of legal decisions related to the defence of competition and joint investigation of anti-competitive practices. This is

to be supplemented by a common regulatory mechanism to be discussed below.

Outside the Western Hemisphere, the most significant cooperation mechanism involving both developed and developing countries can be found in the 2000 Cotonou Agreement. Under article 45 of that Agreement, the parties agree to reinforce cooperation for introducing and implementing "effective and sound" competition policies with the relevant national competition authorities for the purpose of progressively ensuring effective enforcement towards the goal of "sustainable industrialization" and "transparency in the access to markets", and to "secure an investment friendly climate" (article 45(1)). This cooperation includes commitments to implement national or regional rules and policies "with due consideration to the different levels of development and economic needs of each ACP country", as well as to eliminate practices that lead to the prevention, restriction or distortion of competition (article 45(2)), including the abuse of a dominant position. The Agreement promotes cooperation in formulating and supporting effective competition enforcement policies at the national level, including assistance in developing appropriate legal frameworks, and in supporting actual enforcement activities, with special reference to the least developed countries (article 45(3)).

At the inter-regional level, there are few agreements that deal with competition issues. However, article 6 of the Energy Charter Treaty obliges each contracting party "to work to alleviate market distortions and barriers to competition" and "to ensure that within its jurisdiction it has and enforces such laws as are necessary and appropriate to address unilateral and concerted anti-competitive conduct in economic activity in the energy sector" (paragraphs 1 and 2). The competition provisions that follow mainly deal with providing technical assistance in developing and implementing competition rules to contracting parties less experienced in these issues (article 6(3)), consulting and exchanging information (article 6(4)), and notifying counterpart authorities or other contracting parties of anti-competitive activities where enforcement assistance is needed by those authorities to combat such activities, with an emphasis on information and cooperation (article 6(5)). Although article 6(5) uses a mixture of "may" and "shall" language, the provisions in article 6(1-4) are binding ("shall").

In addition, the cooperation provisions of the 1998 OECD Recommendation on Hard Core Cartels require that all members control hard core cartels through the application of positive comity principles and the sharing of relevant information, subject to commercial confidentiality requirements.

c. Multilateral cooperation agreements

Multilateral cooperation is primarily addressed in the 1980 United Nations Set which links economic policy concerns of developing countries and the control of anti-competitive practices.[35] When calling for mutually reinforcing actions at the national, regional and international levels and intergovernmental collaboration and consultation (in section C(i)(1)), the Set also envisages that States with greater experience in the operation of systems of RBP control should share that experience with, or otherwise render technical assistance to, other States wishing to develop or improve such systems.

At the same time, the Set preserves the primacy of national laws ("[t]he provisions of the Set of Principles and Rules should not be construed as justifying conduct by enterprises which is unlawful under applicable national or regional legislation" (section C(i)(5)), and lays down only a minimum definition of offences, leaving it to individual States to expand this at the national level.

On the other hand, it provides some guidance as to acceptable behaviour on the part of States when controlling RBPs. In section E ("Principles and rules for States at national, regional and subregional levels"), States are called on to "[ensure] in their control of restrictive business practices, […] treatment of enterprises which is fair, equitable, on the same basis to all enterprises, and in accordance with established procedures of law. The laws and regulations should be publicly and readily available" (paragraph 3). Furthermore, States should protect the confidentiality of sensitive business information received from enterprises on the basis of reasonable safeguards normally applicable in this field.

The Set also includes a section on international measures to be taken under the auspices of UNCTAD for the control of RBPs, and establishes an institutional structure for the development of the Set by means of an Intergovernmental Group of Experts acting as a Committee of UNCTAD. This Intergovernmental Working Group provides a forum for multilateral consultations, discussions and exchanges of views

by States on the Set; undertakes studies and research on RBPs; invites studies by other UN organizations in this field; studies matters arising under the Set and collects and disseminates information on such matters; makes appropriate reports and recommendations to States on matters within its competence, including the application and implementation of the Set; and, finally, submits an annual report.

Section G(ii)(4) of the Set makes clear, however, that "neither the Intergovernmental Group nor its subsidiary organs shall act like a tribunal or otherwise pass judgment on the activities or conduct of individual Governments or of individual enterprises in connection with a specific business transaction", and that "[t]he Intergovernmental Group or its subsidiary organs should avoid becoming involved when enterprises to a specific business transaction are in dispute". Thus, the institutional machinery set up under the auspices of UNCTAD cannot act in an investigative or adjudicatory capacity. In this the Intergovernmental Group is unlike bodies such as the EC Commission's Competition Directorate, which enjoys the abovementioned powers.

In addition to the Set, a further multilateral cooperation provision can be found in article IX of the GATS. By this provision:

> "1. Members recognise that certain business practices of service suppliers, other than those falling under Article VIII [Monopolies and Exclusive Service Suppliers], may restrain competition and thereby restrict trade in services.
>
> 2. Each Member shall, at the request of any other Member, enter into consultations with a view to eliminating practices referred to in paragraph 1. The Member addressed shall accord full and sympathetic consideration to such a request and shall cooperate through the supply of publicly available non-confidential information of relevance to the matter in question. The Member addressed shall also provide other information available to the requesting Member, subject to its domestic law and to the conclusion of satisfactory agreement concerning the safeguarding of its confidentiality by the requesting Member."

This provision introduces a mechanism for dealing informally with alleged abuses of competition rules by service suppliers. However, there is no indication as to what types of RBPs are covered, apart from the exclusion of monopolies, which are subject to the regime in article VIII. Presumably any practice, apart from monopolies, deemed to restrain competition and thereby to restrict trade in services is covered. This requires a causal element to be shown in that the mere existence of a restrictive practice is insufficient to bring the consultation process into operation. The requesting member must also show that the practice in question in fact, restricts trade in services.

3. Harmonization measures

Such measures can take either of two main forms: first harmonization effected through common institutional arrangements between the contracting parties**;** secondly, harmonization of substantive national competition rules through international provisions.

a. Harmonization through common institutions

A recent, though as yet gradual, trend in international agreements has been the adoption, by regional economic integration organizations, of competition policies administered by a common competition authority or through closer common cooperation. Examples include MERCOSUR and the Caribbean Community.

As to the MERCOSUR initiative, the 1996 Protocol provides for substantive harmonization, within a two year term, of "common norms for the control of acts and contracts, of any kind which may limit or in any other way prejudice free competition or result in the domination of the relevant regional market of goods and services, including those resulting in economic concentration, with a view to preventing their possible anti-competitive effects in the context of MERCOSUR" (article 7). In addition, the Protocol introduces a "Committee for the Defence of Competition". This body is primarily responsible for the application of the Protocol being integrated with the national organs for the application of the Protocol in each State Party (article 8). This body can hear complaints initiated by national organs *ex officio* or on the basis of a reasoned representation by a party with a legitimate interest (article 10). The Committee will then carry out an investigation, issue a decision and order sanctions in accordance with the procedural provisions of the Protocol Chapter V. Proceedings can at any stage be settled by cessation of the practice under investigation under authority of the Commission in

accordance with the procedures laid down in Chapter VI. Otherwise the Committee can order sanctions by way of penalty fines, or prohibitions on participation in government purchases, or public financial institutions in accordance with article 28 of the Protocol.

Chapter VIII of the 2001 Revised CARICOM Treaty provides that the Community shall establish appropriate norms and institutional arrangements to prohibit and penalise anti-competitive business conduct (article 170(1)(a)(i)). Article 170(1)(b) directs member States to enact local competition legislation and to establish local enforcement institutions and procedures, as well as to ensure access to enforcement authorities by nationals of other member States. In the case of cross-border anti-competitive business transactions of a regional dimension, competence resides in a Competition Commission which steps in to apply regional competition rules; promote competition within the Community; and to coordinate the implementation of CARICOM competition policy which calls for collaboration on enforcement among national competition authorities (articles 170-171).

b. Substantive harmonization through treaty provisions

EU Association Agreements require that the non-EU contracting party bring its national laws into conformity with those of the EU. Under the Europe Agreements between the EU and the majority of central and eastern European and Baltic countries respectively, competition standards based on EU competition rules are applicable where trade between the EU and the other signatory party is affected. In addition, the other parties are bound to ensure the approximation of their existing and future cooperation legislation with EU competition law. Such is not required under the Euro-Mediterranean Agreements or the Partnership and Cooperation Agreements concluded with the countries of the Commonwealth or Independent States (UNCTAD, 2003b, p. 12).

The establishment of common competition rules modelled on the 1957 Treaty of Rome has been addressed by regional organizations in Africa and through specialized intergovernmental agreements. Thus, the 1994 Treaty Establishing the Economic and Monetary Community of Central Africa (CEMAC) which, when in force, will replace the 1964 Treaty Establishing the Central African Economic and Customs Union (UDEAC), provides for the establishment of common competition rules to control RBPs and governmental activity; two draft regulations on these subjects are being formulated. Under the 1993 Treaty Establishing the Common Market for Eastern and Southern Africa (COMESA), the parties agree to control RBPs along the lines of article 81 of the EC Treaty with provision for the COMESA Council to grant exemptions. The Council is also to elaborate competition rules for adoption within the member States. A regional competition policy will be formulated harmonizing national competition rules. The South African Development Community (SADC) has agreed that member States shall implement measures within the Community that prohibit unfair business practices and promote competition. The 1993 Treaty on the Harmonisation of Business Law in Africa[36] proposes to elaborate and adopt a common competition act, which would have direct effect within the territory of the 16 signatory States from West and Central Africa (UNCTAD, 2003b, p. 14).

Section III Interaction with other Issues and Concepts

Given the relatively self-contained nature of competition issues in the context of IIAs, this subject has few significant interactions with other issues and concepts found in such agreements. However, certain potential interactions are worthy of note (table III.1).

In particular, the application of competition laws by host countries can have significant effects on the operation of any obligations in IIAs dealing with entry and establishment of foreign investors, their treatment at the point of entry and after entry as well as on the operation of certain economic policy tools, such as taxation provisions, state aids, technology transfer provisions, incentives and performance requirements that may affect the rights of foreign investors, as determined in the provisions of IIAs to which the country in question is a party. Equally, certain procedural requirements might arise out of the provisions of IIAs, of which due process and transparency are of some importance.

- **Admission and establishment.** There is an interface of competition with admission and establishment issues, especially in relation to market entry by means of cross-border M&As. Of the many applications of competition or

Table III.1. Interaction across issues and concepts

Issue	Competition
Admission and establishment	++
Dispute settlement: investor-State	+
Dispute settlement: State-State	+
Employment	0
Environment	+
Fair and equitable treatment	++
Home country measures	+
Host country operational measures	++
Illicit payment	0
Incentives	++
Investment-related trade measures	+
MFN treatment	++
National treatment	++
Scope and definition	+
Social responsibility	+
State contracts	0
Taking of property	0
Taxation	0
Transfer of funds	0
Transfer of technology	++
Transfer pricing	++
Transparency	++

Source: UNCTAD.
Key: 0 = negligible or no interaction.
+ = moderate interaction.
++ = extensive interaction.

antitrust law, that pertaining to transnational M&As is susceptible to utilization as a mechanism for screening FDI on the basis of its impact upon the domestic market, thereby potentially affecting on market entry for TNCs. Where an IIA covers the pre-entry treatment of investors and investments, then the application of competition law at the point of entry is subject to compliance with the relevant standards of treatment contained in the agreement. If the IIA covers post-entry treatment only, then the host country is free to act as it sees fit in relation to the competition implications of a proposed investment at the point of entry. It need only observe the treatment standards in the IIA in the course of the subsequent application of competition laws after entry. On the other hand, an effective competition policy applied at the point of entry can ensure that only efficient investors and investments enter the host country. This can contribute to the enhancement of national economic development policy by protecting the competitive situation of domestic firms that might otherwise be "crowded out" of the local market by more dominant foreign firms. However, an ineffective application of competition law at this stage could undermine the benefits of increased market access in a liberalizing policy environment, as where this results in the protection of inefficient domestic firms against foreign competition or in the admission of foreign investment that tends to dominate the market and leads to abuses of a dominant position.

- **Fair and equitable treatment.** The fair and equitable treatment standard introduces certain basic notions of good governance to the treatment of foreign investors and their investments. In relation to competition policy, certain notions of good governance have been identified as core principles. Thus the 2001 Doha Declaration includes "procedural fairness" among these core principles. The WTO Working Group on Trade and Competition Policy has since discussed the meaning of this phrase. In the course of these discussions the view has been expressed that competition policy had to be applied in the light of certain standards of procedural fairness, such as notice of charges, fair and equitable administrative proceedings and an appeal process, so as to provide assurances to parties affected by competition investigations that proper procedures were followed to protect their rights and interests (WTO, 2003, p. 9). On the other hand, procedural fairness is a matter that has many national variations, and so may not be easy to deal with in an international instrument. In particular, the level of development of a host country could affect the meaning and content of procedural fairness. Accordingly, dealing with this aspect of competition policy in an international instrument would require that some sort of balance be struck between the differing national approaches to fairness and the need for agreed international standards that are both general and, at the same time, specific enough to act as a practical guide to competition authorities (WTO, 2003, p. 10).
- **Host country operational measures.** Where a host country introduces certain operational measures as a condition of entry for a foreign investor, this may become a competition related matter should no such requirements be placed upon other foreign or domestic investors. This may have a market distorting effect that cannot be accepted on a competition

based analysis. It may require the use of special exemptions or exceptions based on national industrial policy. On the other hand, such measures may be applied to TNCs to counteract any potentially anti-competitive effects that their entry into the host country market might have. For example, technology transfer requirements may be placed on an investing firm to ensure that its domestic competitors can benefit from exposure to that investor's technical know-how. In addition, restrictions might be placed upon an investor against imposing restrictive covenants on former employees that might prevent them from working for local competitors, allowing the latter to benefit from that employee's exposure to the foreign investors know-how and business practices.

- **Incentives.** As noted in section II, certain agreements contain provisions dealing with the use of state aids or other types of incentives, as a means of offering a competitive advantage to certain enterprises. Where such an advantage is not offered to all enterprises in the same or like position, not only could this amount to a breach of the non-discrimination principle, but also to an infringement of competition related provisions covering the anti-competitive use of such industrial policy devices. Equally, incentives may have such an effect, *de facto*, as where they are offered to all investors in like circumstances but in fact the conditions attached to them may be met only by a certain category of investors.
- **National treatment and most-favoured-nation treatment.** National treatment and most-favoured-nation (MFN) treatment are significant concerns related to competition issues. BITs and competition cooperation agreements typically have national treatment provisions. Virtually all IIAs relating to FDI guarantee national treatment and MFN once a foreign affiliate is established in the host country, and some instruments also extend non-discrimination to the pre-entry stage. As noted in discussions before the WTO Working Group on the Relationship between Trade and Competition, the principle of non-discrimination is a core value of the multilateral trading system and is also vital to the credibility and effectiveness of competition policy (WTO, 2003, p. 7). Each aspect of the non-discrimination principle raises specific concerns. Thus, the MFN principle may give rise to issues concerning the interaction of different agreements. If not subjected to qualifications and exceptions, MFN could lead to the extension of wider provisions in certain agreements to agreements covering a narrower range of issues, based on preferential treatment for investors from certain countries. Thus, where MFN is to be included in agreements covering competition issues it may have to be subjected to exemptions based on national policy so as to avoid distortions of coverage between agreements (WTO, 2003, p. 8). This issue can also arise in relation to national treatment, where differences in treatment on competition matters arise between national and foreign investors on the basis of national policy concerns, including development concerns. One example could be a regime of preference in industrial policy for domestic small and medium-sized national firms based on sales thresholds (WTO, 2003, p. 8). In addition, if national treatment were to be applied without exceptions it could lead to the risk of "crowding out" of less competitive smaller national firms at the hands of TNCs.
- **Transfer of technology.** As noted in section II, transfer of technology has a strong interface with competition. The primary emphasis of this interface is in relation to the control of RBPs in licensing agreements. While licensing agreements may not be directly related to FDI, as normally defined, the subject was given much attention in the draft International Code of Conduct on the Transfer of Technology, negotiated under the auspices of UNCTAD between 1976 and 1985. The developing countries were of the view that the clauses in licensing technology agreements could thwart their development objectives and exploit their weaker bargaining position relative to that of technologically advanced foreign TNCs. The negotiations on the Code broke down essentially over the inability to reconcile this position with that of the industrialized countries, which favoured the regulation only of those licensing agreement clauses that could be regarded as unreasonable restrictions on the freedom of the recipient firm to compete with the foreign enterprise, or which placed unreasonable restraints on the competitive freedom of third parties (see chapter 23). As noted in section II above, the TRIPS Agreement introduced general rules

that follow the competition-oriented model of technology transfer regulation.

- **Transfer pricing.** Transfer pricing interfaces with competition when intra-enterprise transfer prices are manipulated, thus becoming a restrictive business practice – i.e. anti-competitive – potentially shifting the revenue base to a tax-preferred territory and away from the true base of operations. This can be particularly burdensome to developing countries that may be depending on the tax revenues as a needed infusion of foreign capital. In addition, when transfer pricing (neutral in itself) is not abused, the domestic counterpart may still be put at a competitive disadvantage *vis-à-vis* the TNC if it is not equally in a position to enjoy tax savings through legitimate transfers among affiliates. Certain IIA provisions relating to transfer pricing as a RBP have been covered in section II above.
- **Transparency**. "Transparency" is mentioned as another "core principle" of competition policy in the 2001 Doha Declaration. Accordingly, where an IIA contains a transparency provision in its competition clause or as a general clause, competition authorities can be expected to conduct their activities in accordance with this requirement. In the absence of such special provisions it is possible that transparency in the conduct of competition policy may be seen as a part of the general obligation of fair and equitable treatment. On the other hand, a commitment to transparency does raise certain questions in relation to developing countries. For countries that already have competition laws it could lead to pressures for change in these laws, including the scope of exemptions from competition regulation. In countries where such laws do not yet exist it is not clear how transparency commitments could be met (WTO, 2003, p. 7). Another issue raised in this context concerns the extent to which competition authorities can be expected to disclose information that they acquire in the course of investigations. Here the usual practice would be to allow for transparency of all non-confidential information, but to introduce safeguards over the disclosure of confidential and/or commercially sensitive information.

Conclusion: Economic and Development Implications and Policy Options

The control of restrictive practices is a major issue for developing countries particularly because restrictive arrangements by TNCs can limit the positive developmental impact of FDI — say by reducing exports or limiting the use of technology.[37] This can happen if a parent company limits the external markets of its individual affiliates (Puri and Brusick, 1989; Correa and Kumar, 2003). A possible abuse of dominant positions can occur as a result of large cross-border M&As. Indeed, the main interface between competition law and FDI occurs when foreign affiliates are established by significant M&As.[38]

When foreign entry is accomplished by cross-border M&As, the probability of an anticompetitive impact increases for two reasons: first, because the number of competitors may be reduced; second, because cross-border M&As do not necessarily add new capacities. So countries tend to screen those transactions and often regulate them both at the entry and post-entry phases. Regulation at entry considers the potential market effects of an acquisition of a local enterprise by a foreign investor on competition in the host country industry, where the foreign investor might acquire sufficient market dominance to warrant such review. The control of potential post-entry anticompetitive behaviour by TNCs may be necessary to deal with the conflicting objectives of effective competition and local capacity building. Such action may be particularly needed for a host developing country in which the free play of market forces does not always bring the desired development results (UNCTAD, 1997a, pp. 229–231). Of particular concern in the case of developing countries is that the market power of a foreign enterprise is often buttressed by the latest technology and procedures which, while welcomed for their input into the local economy through technology transfer, import substitution, and other benefits of foreign capital and know-how, may at the same time appear to threaten competing local firms endowed with less advanced technology.

In addition, the effect on developing countries of the most egregious form of RBPs, hard-core cartels, may be severe. Such cartels can raise prices and restrict the supply of essential

goods and services (including industrial inputs) that make these unavailable to some users and unnecessarily expensive to others. Furthermore, such cartels can reduce the participating enterprises' incentives for cost control and the propensity to innovate and could, as a result, impede the transfer of technology to developing countries. On the other hand, hard-core cartels could be seen as a predominantly developed country problem, given the preponderance of such cases in those countries, giving rise to the possibility that developing countries might not see the regulation of such anti-competitive activities as a major priority. However, cartels can be a major issue for certain developing countries and they may wish to take action against them. There is a need here to clarify the precise effects of hard-core cartels on the development objectives of developing countries (WTO, 2003, pp. 11-13). Other types of cartels that may have implications for developing country competition policies are export cartels, which have a demonstrable anti-competitive effect on the developing country market and government sponsored arrangements. The latter tend to be excluded from competition policy as emphasised by the United Nations Set in section B(9).

Current models of competition law and policy do not distinguish firms by their nationality, only their impact on competition matters. Moreover, they assume that maintaining and strengthening competition would lead to more development. Indeed, a shielding from market forces may become counter-productive in the longer term if it prevents enterprises from responding positively to market stimuli; brings about a loss of productive efficiency and innovation; or allows collaborative research and development activity that is a front for anticompetitive collusion between enterprises.

A host country can limit the application of its competition policy when the expected benefits outweigh the welfare loss due to anticompetitive effects--say, for nurturing particular enterprises or new and innovative research and development -- by providing temporary protection and exclusivity. The aim behind such an exception is to reduce the risk to infant enterprises — and to the undertaking of innovative research that may not be easily undertaken in full competitive conditions, or which requires a degree of inter-firm cooperation that might be otherwise incompatible with rules against anticompetitive collaboration between enterprises. Other reasons for limiting the application of competition policy — typically arising from competing objectives — include ensuring the provision of basic services, reducing foreign exchange shortages, safeguarding national security and culture and avoiding negative externalities through tightly regulating pollution, to mention a few (UNCTAD, 1997a, pp. 229–233). Exceptions need to be treated with care, so that an exception unwarranted by market conditions is not permitted to continue indefinitely.

As regards international approaches to competition/antitrust standards, if these are to be development-friendly, they will have to focus on those international dimensions that are currently or prospectively most detrimental to developing countries and take into consideration the costs and capacity constraints, as well as differing national priorities, prevailing across the spectrum of this category of countries. A major consideration is enforcement capacity. Although developing countries are in increasing numbers introducing competition/antitrust regimes, the means to enforce the rules may, in some cases, be inadequate.[39] Having a competition law and authority does not necessarily mean effective action by governments (UNCTAD, 2003a, p.135). Indeed, developing countries have not thus far participated to any great extent in intensive case-specific enforcement cooperation (UNCTAD, 2003b, p. 24-25). However, this may be in the process of changing, as more developing countries adopt, or are in the process of adopting or drafting, competition laws. Indeed, the effective future enforcement of such laws may require increased cooperation, which may be achieved through cooperation agreements. In addition, even those countries with limited (or no) competition regimes may benefit to some extent from acquiring a degree of control over RBPs through international arrangements. This was the case, for example, with the member States of the EU, as not all of them had national competition laws in place upon becoming parties to the Treaty of Rome. Furthermore, international arrangements can help further technical assistance for developing countries seeking to establish, or evolve, their competition policies. Thus there may be certain development advantages arising out of international provisions in this field, given the value of competition policy to the development process, and the capacity of such arrangements to enhance that value.

Moreover, it is essential not to loose sight of the difficulties that developing countries may particularly experience through their participation

in international agreements containing competition related provisions. Developing countries will find themselves in an asymmetrical relationship with developed country parties to such agreements. First, a relative lack of resources and experience on the part of the developing country party places greater emphasis on the developed country party to bear the brunt of any cooperative activity. Secondly, trade and investment flows are more likely to pass from developed to developing countries, creating an asymmetrical market structure between them. As a result, the problems of cooperation take on a different perspective from those arising between developed countries among themselves, where reciprocal cross-border flows of trade and investment may offer a higher level of mutual market integration, giving greater impetus to cooperation in the competition field. By contrast, there may be less of an incentive for a developed country to act in the case of relations with a developing country where the activity of undertakings on the market of the latter may have few effects on the market of the developed country party.

Agreements between developing countries themselves may also raise special problems. These may diminish the capacity for effective cooperation. The problem of limited resources and experience remains, and will be without the possible counterbalance of the resources and experience that a developed country party might bring, unless one or more of the developing country parties already has some experience in competition law investigation and enforcement that it can pass to the other parties. Furthermore, the actual cooperation mechanisms in place under the agreement might be unsuitable for fully developed cooperation to take place. Moreover, it is possible that trade and investment between developing country parties is limited, or the actual incidence of covered RBPs is rare, and so there are few occasions for cooperation to take place (UNCTAD, 2003b, p. 26).

In light of the preceding analysis, a number of policy options arise in IIAs in the area of competition/antitrust policies having an international dimension.

A. Policy option 1: no competition provisions

The first option is to continue the prevailing practice in current IIAs and exclude competition provisions. The advantage of this option is that countries are free to fashion competition policies according to their own local conditions and national objectives, unrestricted by the imposition of specialized international requirements. For instance, competition policy and its application remain subject to the general standards of treatment contained in IIAs for the protection of investors and their investments. Thus, competition rules may be subjected in particular to requirements of non-discrimination and fair and equitable treatment, whether at the post-entry stage or at pre-and post-entry stage, given the scope of the IIA in question.

The disadvantage of this approach might lie in the possibility of discouraging inward FDI if the locally adopted rules are not transparent or do not conform with some degree of consistency to other regimes. In addition, the exclusion of this important issue will also exclude the possibility of cooperation in the application of competition policy and of technical assistance in competition matters.

B. Policy option 2: the inclusion of competition provisions

Where an agreement does include competition provisions, these can be organized around a number of further options that vary according to the degree of legal obligation required of the parties and of the scope of substantive and procedural issues that they cover.

1. The extent of legal obligation

a. Non-binding "best efforts" approach

The least demanding competition clause is non-binding "best efforts" provision that urges the commitment of the signatory parties to adopt effective domestic competition laws and enforcement mechanisms and/or to strengthen enforcement and/or notification/consultation features of existing competition/antitrust laws. Such an approach could be attractive to countries that seek to place competition issues on their cooperation agenda, but do not wish to apply extensive efforts or resources to this task. It may be particularly useful in cases in which a developing country party is yet to adopt, or to develop the application of competition laws, but is interested in doing so, and in which developed country parties are willing to enter into a low level commitment to assist in this process, but do not wish to be

encumbered by positive legal duties in this regard. The major disadvantage of this approach is that in the absence of positive action, it may be ineffective in furthering any progress on the development of national competition policy, or of international cooperation, on the part of the signatories.

b. Minimal binding obligations

Where the contracting parties to an IIA wish to include competition issues, they may seek a minimal approach that establishes binding obligations only in the most general terms. Such an approach is served through the use of a general definitional clause, covering only a minimal number of RBPs as selected by the parties, and offering no cooperation mechanism or a minimal mechanism based on consultations and voluntary exchange of non-confidential information. Such an approach may be useful in partnership and cooperation agreements that seek to improve the overall climate for trade and/or investment between the parties, but which does not aim at the development of a process of close procedural cooperation, or of substantive convergence, in competition matters. This approach is evident in bilateral agreements between countries within a region that has little or no experience of cross-border competition regulation or between parties from different regions in the global economy, where there is little need for close cooperation, but a desire to improve the mutual understanding of competition policy concerns between the parties. It is an approach that may also be attractive to a regional grouping that is as yet not ready to undertake a major commitment towards a supranational competition policy, but wishes to lay down some basic common policy standards and goals in the field.

c. Comprehensive legal obligations

The most developed form of competition provisions would entail the adoption of comprehensive binding legal obligations by the signatories. These could be focused on procedural cooperation alone, in the case of parties that already have established competition law and policy regimes under national laws; they could allow for cooperation in procedural matters and also introduce an element of substantive harmonization in the content of national competition laws and policies; or they could establish a common regime of cooperation in regulation, investigation and standard setting. As examined in section II, the various binding bilateral cooperation treaties are examples of the first approach, the EU Association Agreements are examples of the second, while MERCOSUR and COMESA regimes are examples of the third.

The second and third approaches could be used both by countries with established national competition law and policy regimes or by countries seeking to establish and/or further develop their national policies in an international cooperative setting. A fourth possible alternative is the establishment of a supranational regime modelled on the EC example. This may be a swift and effective way towards the adoption of a comprehensive competition law and policy system in countries that do not currently have one, as was the case in the EU. Equally, where the agreement involves smaller countries with limited regulatory capacities, a supranational approach could allow for more effective investigation and enforcement by allowing the burden of such regulation to be shared by all contracting parties. This was the experience of the smaller EU members in this field. The unilateral adoption of national competition laws based on existing national models, or upon the UNCTAD Model Law is a further possible alternative. Indeed, it is possible for a combined national and supranational approach to be taken to the development of competition law and policy.

2. The scope of competition provisions

Notwithstanding the particular choice made by parties to IIAs as to the legal force of competition provisions in the agreement in question, the second area of choice lies with the substantive and procedural scope of these provisions.

a. Substantive scope

Following the pattern of issues set down in section I, if the competition provisions of an IIA are to deal with substantive competition issues, they will have to define who the addressees of any substantive obligations should be; the approach to and content of definitional clauses; and the range of RBPs and related competition matters that the agreement should cover.

- ***Addressees of obligations.*** The provision may impose obligations on private actors to act in accordance with the substantive requirements of the provision and to refrain from engaging

in RBPs and other competition related actions covered by the agreement, as the case may be. Here, the provision could be wide and extend to all commercial actors in the market or only to some. Thus the provision may refer to “undertakings” in general or to particular categories of market actors such as “competitors” at the same level of the market or to “enterprises” excluding for example non-business entities. In addition, certain express exemptions or exclusions could be added as for trades unions, charitable bodies or governmental organisations.

- ***The definition of RBPs.*** As noted in section II, the competition provisions of an IIA could have a general definitional clause only, a general clause coupled with more specific clauses defining particular RBPs or only specific clauses defining particular RBPs. Each type of clause could also have an illustrative list of RBPs covered by its terms, though in the second approach such a list is most likely to appear in the specific definitional clauses only. Most such clauses cover the four main types of RBPs: horizontal and vertical agreements or concerted practices, abuse of a dominant position and mergers and acquisitions.
- ***The range of RBPs covered.*** The third element of substantive scope concerns which RBPs and related competition issues the competition provisions of the IIA should cover. This is an issue of policy in each case and no hard and fast principles apply. However, the provision can cover any one or more of the four main RBPs and/or the specialized issue areas identified in section II above, namely, restriction to trade-related RBPs only, inclusion of specific provisions on state aids and other incentives, government sanctioned monopolies/state enterprises, anti-competitive taxation practices such as transfer pricing, technology transfer and related IPR issues, and performance requirement issues. Anti-dumping issues can also be included, though these can be seen as a specialized field of regulation that go beyond the main subject-matter of competition law and policy. The link between competition and anti-dumping is made in some agreements notably in the Revised CARICOM Treaty (chapter VIII). Development related provisions could also be included. These are discussed in more detail under the issue of special and differential treatment below.

b. Scope of procedural provisions

The procedural aspects of competition provisions in IIAs can cover any one or more of the matters discussed in section II. The range of coverage again depends on the policy goals of the contracting parties. Thus an agreement may cover any one or more of the following:

- control of extraterritorial conflicts in the investigation and enforcement of competition laws and policies;
- information exchange, which may be limited to non-confidential information but could be widened to cover confidential information subject to any applicable safeguards for confidential governmental or commercial information;
- cooperation in the investigation of alleged anti-competitive activities by one party through traditional and/or positive comity;
- cooperation in the joint investigation of alleged anti-competitive activities;
- cooperation in the enforcement of national decisions and remedies taken by one party on the territory of another;
- the establishment and use of common investigation and enforcement mechanisms at the supranational level;
- the adoption of transparency and due process obligations in the conduct of competition investigations.

The development implications of these types of provisions are hard to determine. However, the general points made in sub-section A as to the special problems that developing countries may have in their participation in international cooperative arrangements should be borne in mind.

c. Dispute settlement

A remaining question that arises in this field is whether there should be provision for dispute settlement in relation to competition issues. The predominant practice at present is to exclude dispute settlement provisions from competition issues unless an agreement seeks to establish a fully functioning supranational system of competition law and policy, as is the case with the EU, where the ECJ and the Court of First Instance can hear competition cases arising out of the

competition provisions of the Treaty of Rome. Other agreements include less elaborate methods for dealing with possible issues or disagreements between the parties such as consultations. Provision is made for such an approach in, for example, the EC Association Agreements, EFTA Agreements and other cooperation agreements discussed in section II above.

d. Special and differential treatment for developing countries

As shown by the example of the United Nations Set, it is possible to take a flexible approach to the development implications of international competition arrangements and to introduce specialized, development-friendly provisions that may include an element of special and differential treatment for developing and least developed country parties. In particular, cooperative mechanisms for the further development of competition policy awareness could be included in IIAs. For example, the Asia-Pacific Economic Cooperation Forum (APEC) members have undertaken, in the non-binding 1999 APEC Principles to Enhance Competition Policy and Regulatory Reform,[40] to introduce and maintain effective, adequate and transparent competition policies or laws and enforcement, to promote competition among APEC economies and to take action in the area of de-regulation. An APEC-OECD cooperative initiative aims to support regulatory reform adopted by both organizations, as does an APEC training programme on competition policy, which aims, in particular, at supporting the implementation of those Principles as they focus on competition policy (UNCTAD, 2003b, p. 16). In addition, specific technical assistance provisions requiring cooperation between competition authorities in developed and developing countries could be concluded. Other provisions could take into account the practical difficulties that developing countries may face in cooperation over information exchange, investigation or enforcement and allow for greater obligations in this regard for developed country parties. Such obligations could help to fill the regulatory gap that the lower resources and experience of developing country parties might leave in relation to the control of anti-competitive practices that are harmful to the markets and undertakings of those developing country parties.

* * *

The issue of competition is undoubtedly gaining importance in the context of an increasingly integrated global economy in which governments are frequently pursuing greater FDI policy liberalization. The resulting openness may create greater opportunities for inward FDI but also certain risks, including the risk of weakening the competitive environment of host countries. Given this possibility, competition related provisions in IIAs may permit the evolution of a development-friendly balance between FDI openness and host country regulation of RBPs that can undermine the benefits of FDI. How far countries should go in developing international rules on competition matters is an issue of policy discretion. They may choose between relatively limited or highly developed commitments aimed at realizing the range of policy options outlined above. Whatever the outcome of this choice, it is clear that competition questions will play a significant role in the future evolution of FDI policies for development.

Notes

1 UNCTAD, 1996c; Boner and Krueger, 1991.

2 For a full discussion of the basic economic principles underlying competition policy and its main aims and mechanisms, see Whish, 2003; Scherer and Ross, 1990.

3 Here the dominant firm (or firms) can use its (their) market power to trade at a loss for a period of time sufficient to drive less dominant competitors, who cannot sustain such prices for their products, from the market.

4 For example, the EC Commission has issued guidance on how such an analysis is to be undertaken, based on the extensive jurisprudence of the European Court of Justice in this area and on Commission practice. See EC, 1997.

5 Updated information is available from: www.unctad.org/en/subsites/cpolicy/docs/CPSet/cpset.htm. Unless otherwise noted, all instruments cited herein may be found in UNCTAD, 1996a, 2000a, 2001a, 2002a and 2004a.

6 Thus section A (4) of the United Nations Set states that among the objectives of this instrument is the elimination of "the disadvantages to trade and development which may result from the restrictive business practices of transnational corporations or other enterprises […]."

7 Case 30/87, *Corinne Bodson v SA Pompes Funèbres des Régions Libérées* [1988] ECR 2479, paragraph 4.

8 An alternative approach to this issue is seen in article 3 of the Andean Community 1991 Decision 285 on Rules and Regulations for Preventing or

Correcting Distortions in Competition Caused by Practices that Restrict Free Competition which states: “Practices restricting free competition are understood to mean agreements, parallel behaviours or collusion between enterprises that restrict, impede or distort competition or that could do so. […]”. The reference to parallel behaviour connotes the fact that enterprises in a concentrated market can follow closely, and match, the commercial decisions of other competitors without necessarily being in collusion with them. It is only where such behaviour is collusive and actually distorts competition that it becomes a legitimate object of regulation. The distinction between innocent parallel behaviour and anti-competitive collusion evidenced by parallel behaviour is one of the most difficult issues in the regulation of such arrangements.

[9] This is particularly true of illegal horizontal arrangements, which may carry criminal penalties in some jurisdictions.

[10] Paragraphs 2 and 3 stated: “2. Allow purchasers, distributors and licensees freedom to resell, export, purchase and develop their operations consistent with law, trade conditions, the need for specialisation and sound commercial practice; 3. Refrain from participating in or otherwise purposely strengthening the restrictive effects of international or domestic cartels or restrictive agreements which adversely affect or eliminate competition and which are not generally or specifically accepted under applicable national or international legislation; […].”

[11] It should be noted that according to section B (i) (2) of the Set: “ ‘Dominant position of market power’ refers to a situation where an enterprise, either by itself or acting together with a few other enterprises, is in a position to control the relevant market for a particular good or service or group of goods or services.”

[12] Article 1 of the section on Competition of the 1991 version reads as follows: “Enterprises should, while conforming to official competition rules and established policies of the countries in which they operate: 1. Refrain from actions which would adversely affect competition in the relevant market by abusing a dominant position of market power, by means of, for example:

a) Anti-competitive acquisitions;
b) Predatory behaviour toward competitors;
c) Unreasonable refusal to deal;
d) Anti-competitive abuse of industrial property rights;
e) Discriminatory (i.e. unreasonably differentiated) pricing and using such pricing transactions between affiliated enterprises as a means of affecting adversely competition outside these enterprises; […]”.

[13] Horizontal mergers are mergers between firms dealing in the same products in the same markets; vertical mergers are mergers between firms which supply goods or services or parts in the same production line in the same market; conglomerate mergers are mergers between companies with different product lines, either indirectly related or totally non-related, in either the same or in different markets.

[14] See for example the 1991 EC-Poland Agreement (article 63); the 1991 EC-Hungary Agreement (article 62); the 1993 EC-Czech Republic Agreement (article 64); the 1993 EC-Romania Agreement (article 64); the 1991 EC-Slovakia Agreement (article 64); the 1993 EC-Bulgaria Agreement (article 64); the 1995 EC-Lithuania Agreement (article 64); and the 1996 EC-Slovenia Agreement (article 65). The 1997 Interim Agreement on Trade Related Matters between the EC and Macedonia contains a similar provision in article 33 even though it is not a full Association Agreement.

[15] See for example the 1995 EC-Tunisia Agreement (article 36). See too the 1995 EC-Israel Agreement (article 36); the 1996 EC-Morocco Agreement (article 36); the 2001 EC-Egypt Agreement (article 34); and the 1997 EC-the PLO Agreement (article 30). By contrast the 2002 EC-Algeria Agreement only covers anti-competitive agreements and concerted practices between undertakings, decisions of associations of undertakings and abuse of a dominant position by one or more undertakings (article 41). The issue of special or exclusive rights granted to public enterprises is left for future decision (article 43). The same approach is followed by the 2002 EC-Lebanon Agreement (articles 35 and 37).

[16] See for example the 1994 EC-Moldova Partnership and Cooperation Agreement (article 48). Similar provisions can be found in the 1994 EC-Russia Agreement (article 53) and 1994 EC-Ukraine Agreement (article 49). However some Partnership and Cooperation Agreements have provisions concerning competition under the “legislative cooperation” title: see for example the 1995 EC-Kyrgyz Republic Agreement; the 1996 EC-Armenia Agreement; the 1996 EC-Georgia Agreement; the 1995 EC-Kazakhstan Agreement; and the 1996 EC-Uzbekistan Agreement.

[17] See for example, article 35 of the 1999 EC-South Africa Agreement on Trade, Development and Cooperation and article 11 of the 1997 EC-Mexico Partnership and Cooperation Agreement.

[18] Similar provisions, with minor changes of wording, can be found in the EFTA Agreements with Israel (article 17); the Slovak Republic (article 18); Poland (article 18); Romania (article 18); Estonia (article 16); Slovenia (article 17); Latvia (article 16); Morocco (article 17); Macedonia (article17); Croatia (article 19); Jordan (article 18); and the PLO (article 16).

[19] See, for examples, the 2001 FTA between Croatia and Hungary (article 20); the 2001 FTA between Slovenia and Bosnia and Herzegovina (article 17); the 1996 FTA between Latvia and Slovenia (article 16); and the 1997 FTA between Slovenia and Lithuania (article 22). See the examples in UNCTAD, 2003b, p. 13.

[20] See, for example, article 25 of the 1998 FTA between Turkey and Latvia.

[21] Similar provisions can be found in other bilateral FTAs concluded by Turkey. See, for example, the 1998 FTAs with Macedonia (article 24) and Slovenia (article 27).

[22] See the Free Trade Area Agreements concluded by Turkey with Lithuania in 1996 (article 25) and Estonia in 1997 (article 24).

[23] See articles 87-89 EC Treaty (UNCTAD, 1996a, vol. III).

[24] See, for example, the 1999 FTA between Singapore and Australia (article 07-12).

[25] See the 2003 FTA between the United States and Chile (article 10.5(1)(f) and 3(b), the 2003 FTA between the United States and Singapore (article 15.8(1)(f) and (3)(b)(ii) and the 2003 FTA between the Republic of Korea and Chile (article 10.7(1)(f).

[26] The TRIPS Agreement also contains provisions on compulsory licensing of intellectual property rights, which contain a competition element (article 31). See too the 2000 Andean Common Market Decision 486. For further discussion see chapter 23.

[27] Positive comity procedures have only been formally activated once when the United States Department of Justice requested the European Commission to investigate allegations that a computerized reservation system (CRS) set up by four European airlines provided more favourable treatment to those airlines at the expense of their American competitors who used an American based reservation system. This led the Commission to investigate one of the airlines against whom some evidence was found, but the case was dropped after the airline agreed to give equal treatment to the American based reservation system (UNCTAD, 2003b, p. 21).

[28] See too the 1976 "Agreement between the United States and the Federal Republic of Germany Relating to Mutual Cooperation Regarding Restrictive Business Practices" / *Abkommen zwischen der Regierung der Bundesrepublik Deutschland und der Regierung der Vereinigten Staaten von Amerika über die Zusammenarbeit in bezug auf restriktive Geschäftspraktiken* (UNCTAD, 2000a (Vol.V); the 1995 "Agreement Between the United States and Canada regarding the Application of their Competition and Deceptive Marketing Practices Laws" (UNCTAD, 2000a (Vol.V); and the 1984 Memorandum of Understanding between the United States and Canada as to "Notification, Consultation, and Cooperation with Respect to the Application of National Antitrust Laws", 23 I.L.M. 275 (1984).

[29] For the full text of the Convention see http://www.hcch.net/e/conventions/ text20e.html.

[30] Joined Cases C-89/85, C-104/85, C-114/85, C-116 and 117/85, C-125-129/85, *A. Ahlström Osakeyhtiö and others v. Commission* [1988] ECR 5193, paragraphs 499-500. For a fuller discussion of the *Wood Pulp* case and the issue of "effects" and "implementation", see Wallace, 2002, pp. 755-763.

[31] International Antitrust Enforcement Assistance Act (IAEAA) of 1994, Pub. L. No. 103-438, 108 Stat. 4597 (1994), (*codified at* 15 U.S.C., ss. 6201 *et seq.*), *reprinted in* 67 Antitrust & Trade Reg. Rep. (BNA) No. 1683 (October 6, 1994), p. 417. This law authorizes the United States Department of Justice and the Federal Reserve Commission to enter into mutual legal assistance treaties.

[32] Article III of this agreement states: "The competition authorities of a Requesting Party may request the competition authorities of a Requested Party to investigate and, if warranted, to remedy anti-competitive activities in accordance with the Requested Party's competition laws. Such a request may be made regardless of whether the activities also violate the Requesting Party's competition laws, and regardless of whether the competition authorities of the Requesting Party have commenced or contemplate taking enforcement activities under their own competition laws."

[33] See Abkommen zwischen der Regierung der Bundesrepublik Deutschland und der Regierung der Französischen Republik über die Zusammenarbeit in bezug auf wettbewerbsbeschränkende Praktiken, 1984 BGBl II S. 758; Accord entre le Gouvernement de la République française et le Gouvernement de la République fédérale d'allemagne sur la coopération relative aux pratiques restrictives de la concurrence, [1984] JO 3460.

[34] For the full text of the NAFTA see http://www.sice.org/trade/nafta/naftatce.asp. Similar provisions are contained in the 1996 FTA between Canada and Chile, with the exception of the establishment of the working group. There are also competition chapters in the 2001 FTA between Canada and Israel and the 1996 FTA between Canada and Costa Rica. Chile has also signed FTAs with Mexico (1998) and some Central American countries (1999), containing chapters on competition policy, including RBPs and the control of State monopolies.

[35] The following paragraphs are based on Muchlinski, 1999a, pp. 407-411.

[36] For the full text of the Treaty see http://www.ohada.com.

[37] These paragraphs are based on UNCTAD, 2003a, pp. 134-135.

[38] For an extensive discussion of this issue, see UNCTAD, 1997.

[39] Hoekman and Mavroidis, 2003, pp. 22-23.

[40] For the full text see http://www.apecsec.org.sg/ apec/leaders_ declarations/1999/attachment_-_apec.html.

Chapter 25. Investment-related Trade Measures*

Executive summary

Investment-related trade measures (IRTMs) are a diverse array of trade policy instruments that influence the volume, sectoral composition and geographic distribution of foreign direct investment (FDI). Some trade measures classified as IRTMs (such as tariffs, quotas, and export financing programmes) are not principally designed to influence FDI flows but nevertheless can have major consequences on the decisions of international investors. Other devices (such as export processing zones, and co-production or buy-back trade arrangements) are designed with FDI effects more clearly in mind. In either case, whether the FDI consequence is intended or not, the resultant impact on production location decisions and intra-company trade flows exerts an influence on world commerce. IRTMs help, therefore, to shape how international business activities affect both global welfare and the relative distribution of benefits among national economies through their impact on FDI flows. IRTMs are thus relevant to international investment agreements.

The interaction between trade and FDI policies becomes a matter of concern for national governments as FDI assumes an increasingly important role in the global economy. Numerous international negotiations and agreements have historically addressed international trade issues compared to the attention given to FDI. International trade negotiations recently incorporated the impact of FDI policies on trade flows (trade-related investment measures, or TRIMs), but there has been less recognition of the converse effects that trade policies can have on FDI decisions. An examination of IRTMs provides a way to understand some of these effects so that they can be assessed and, if appropriate, addressed in international discussions on trade and FDI policies.

For developing countries, it is important to assess accurately the interactive link between trade and FDI in order to understand the effects of changes in national policy regimes as well as the potential consequences of international investment agreements. For example, the use of import substitution in development policies relies on trade restrictions to encourage local production and thus often attracts FDI. Regional trade agreements that stimulate or induce FDI within member countries, as well as administrative devices such as rules of origin, anti-dumping regulations, safety and health standards, and national security controls can have significant impacts on FDI patterns through their effects on prospective trade flows. These FDI undertakings may also produce impacts on later trade flows, particularly through the coordination of intra-firm trade among the affiliated units of transnational corporations (TNCs). Understanding the effects that trade policies can have on FDI decisions is therefore important to assessing and enhancing the development dimension of national and international economic policies.

Introduction

IRTMs, as a concept, suggests a shift away from traditionally trade-centered perspectives towards a greater recognition of the importance of investment decisions in shaping international economic relations, including related trade flows. As a category of policies, IRTMs encompass a range of trade policy instruments that, intentionally or not, have a significant influence on FDI flows.[1] When these policies are being used or their principles negotiated, both the immediate trade *and* second-stage FDI impacts should be considered and evaluated, along with longer-term, third-stage trade effects that may emerge from FDI locational decisions.

Investment-related trade measures are the reverse of the trade-dominated perspective represented by the concept of TRIMs. TRIMs emerged from the Uruguay Round of trade negotiations. They address national investment policies that could distort international trade flows.

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TRIMs incorporate investment incentives or trade requirements attached to an FDI project, generally as part of the investment approval process. They include, for instance, domestic content and trade balancing requirements.

By contrast, compared to TRIMs, IRTMs are more general trade measures that are usually not tied to a specific trade or FDI transaction. These trade measures have first-stage effects on immediate trade flows; but as IRTMs, they also influence the decision-making calculus of prospective investors in ways that may have second-stage effects on subsequent FDI flows. IRTMs help shape, positively or negatively, the attractiveness of the investment climate by altering trade conditions associated with a given country or region. Hence, IRTMs can change the distributional pattern of FDI flows compared to what would have emerged otherwise if directed by market forces, absent government policy interventions. It is worth noting that such FDI pattern changes may also have important subsequent third-stage effects on future related trade flows. These types of impacts can be identified, evaluated and addressed in relation to national trade and FDI policy regimes; they can also be assessed in the context of international investment agreements.

Section I
Explanation of the Issue

Various types of trade policy measures can be identified as IRTMs and examined to demonstrate the nature and scope of this issue. Most IRTMs primarily affect market access, serving to *attract* FDI inside markets where trade measures disadvantage imports. In some cases, these IRTMs may also act to *retain* FDI by discouraging outflows of capital to countries whose comparative advantages otherwise might attract export-oriented FDI designed to serve home country markets. The effectiveness of preferential trade policies designed to favour developing country exports can also be influenced by market access IRTMs. Other types of IRTMs affect FDI flows by promoting or supporting exports, or, conversely, by restricting exports for reasons associated with national security controls.

For the purpose of this analysis, the following broad categories of IRTMs have been identified: market access restrictions, market access development preferences, export promotion devices and export restrictions (table 1). These categories of IRTMs are examined throughout the chapter in terms of their relative importance, frequency of use and impact on national and international trade and investment outcomes.

Table 1. IRTMs

Market access restrictions
Tariffs and quantitative restrictions on imports; sectorally-managed trade arrangements (including voluntary export restraints); regional free trade agreements; rules of origin; anti-dumping regulations; national standards (e.g. safety; health; environment; privacy); non-monetary trade arrangements.
Market access development preferences
Generalized System of Preferences (GSP); Caribbean Basin Initiative (CBI); Lomé; etc.
Export promotion devices
Export processing zones; export financing; taxation measures.
Export restrictions
Export controls.

Source: UNCTAD.

An illustrative example of IRTMs is found in the sectoral trade policy effect of the North American Free Trade Agreement (NAFTA),[2] which exhibits the three-stage effects of the IRTMs concept. Prior to NAFTA, no projection television tubes were being manufactured in North America. NAFTA affected trade at a first stage by offering an opportunity for firms to qualify for NAFTA trade benefits if they could meet rule-of-origin requirements that the major value-added component of colour televisions, the television tube, be produced in North America. Over the next few years, stage two FDI effects were observable as five North American factories were planned or established by firms that included Hitachi, Mitsubishi, Sony and Samsung. This new FDI-based production led to third-stage effects when these foreign affiliates began United States export sales of television tubes, not only to Mexico (within the NAFTA) but also to Asia (Jensen-Moran, 1996a).

This example indicates how governmental trade policies can influence business strategy decisions, with corresponding impacts on FDI and subsequent related trade flows. Trade and FDI considerations become interwoven as elements of TNC decision-making. The TRIMs concept, introduced during the Uruguay Round of Multilateral Trade Negotiations, drew attention to

one dimension of these interactive impacts. Increasing discussions about international investment agreements present an opportunity to explore the concept of IRTMs as the converse dimension of this relationship. In fact, examining these interactive effects from an investment perspective is becoming essential to understand fully the growing impact of FDI on world trade.[2]

The influence of FDI derives not only from its relatively faster growth compared to international trade but also from its interactive effects, as FDI increasingly structures the direction and volume of related trade flows. This influence arises from the fact that trade occurs as individual, discrete transactions (i.e. there is no continuing "stock" measure for trade), whereas individual FDI decisions have produced a cumulative stock of in-place investments that influence where future production and related trade flows will occur. Approximately one-third of global trade is now intra firm trade, meaning that it occurs within a TNC's affiliated network. Another one-third involves a TNC trading with unrelated foreign enterprises (UNCTAD, 1995a). In other words, approximately two-thirds of global trade is influenced in terms of its direction and distribution by the location of TNC facilities established by past FDI decisions. This effect represents the third-stage impact that can arise from IRTMs which affect first trade, then FDI, and finally FDI-related trade flows.

Section II
Stocktaking and Analysis

A wide array of trade measures (table 1) can impact FDI decisions. This section examines these measures more closely, using specific examples to help define their nature and illustrate their relative importance with relation to interactive trade and FDI effects. These IRTMs extend over national, regional and multilateral policies and programmes. For some measures, the FDI impact is direct and intentional whereas for others it can appear as an unintended or even unrecognized side-effect. The effectiveness and relative importance of IRTMs also vary greatly.

Market access restrictions comprise the broadest and most numerous category of IRTMs. These measures generally restrict or otherwise disadvantage import competition, thereby increasing the attractiveness of gaining market access through FDI. Some measures may operate in conjunction with each other, for example when rules-of-origin policies are used to enforce product content requirements to qualify for regional trade agreement preferences. A separate IRTM category is reserved for *market access development preferences* which represent a distinctive application of trade measures, granting privileged access to otherwise restricted markets. In these cases, the FDI effect can favour investment in the countries benefiting from the trade preference, but the preference's relative importance can again be affected by measures such as rules-of-origin definitions on qualifying products. *Export promotion devices* are less frequently associated with FDI effects, although export processing zones constitute one of the most direct and intentional uses of a trade measure to affect FDI by attracting foreign enterprises to invest in the zone. *Export restrictions* are another type of IRTM, but they are relatively infrequent compared with other types of IRTMs.

A. Market access restrictions

1. Tariffs and quantitative restrictions on imports

Trade measures that impose restrictive tariffs or quotas on imported products are among the most common types of IRTMs. Tariffs and quotas protect domestic products from foreign competition. Many countries pursued such policies as part of an import-substitution development strategy that sought to increase the amount of domestic value-added production taking place within their borders. The protected producers could be national firms or, if FDI was permitted, approved foreign investors. The classification of "tariff-jumping FDI" captures the investment impact of these trade measures because the principal motivation for the FDI comes from a desire to gain access to trade-protected markets by producing within the tariff or quota walls. Successive rounds of the General Agreement on Tariffs and Trade (GATT) tariff cuts and restrictions on quantitative measures have reduced the historical importance of these IRTMs, but their incidence in particular industries can still be significant.

2. Sectorally-managed trade arrangements

Sectorally-managed trade arrangements have sometimes evolved to replace or evade the use of

trade quotas that are specifically prohibited by multilateral trade rules. Steel, textiles, automobiles, semiconductors, aerospace and construction are some of the industries in which managed trade arrangements have been employed (UN-TCMD, 1992). These IRTMs can have a three-fold impact on FDI: keeping investment (*retention*) in the countries whose trade position is enhanced; drawing FDI (*attraction*) from other countries to the advantaged country(ies); and effectively excluding non-capital-exporting countries lying outside the pact from potential participation in affected sectoral transactions.

The WTO Agreement on Textiles and Clothing (ATC) (WTO, 1995) shows how such a trade measure can influence FDI decisions when enterprises establish operations in countries primarily to take advantage of their unmet textile export quota allocations. Some investors move out of countries with better factor endowments because those countries' export quota ceilings have already been reached. Of course, enterprises may also seek to circumvent the quota system through a trans-shipment of goods without establishing significant FDI operations in other countries. Authorities in the ultimate importing country attempt to guard against this manoeuvre, however, and the intermediary country also has an interest in encouraging maximum value-added production within its borders. Although the ATC is a transitional agreement that phases out textile quotas by 1 January 2005, it serves as an example of how such managed trade quota restrictions not only distort free market trade flows but influence FDI location decisions as well.[3]

Other forms of sectorally-managed trade, sometimes referred to as "voluntary export restraints", are often more bilateral in nature. The United States' use of voluntary export restraints against Japanese auto imports in the early 1980s is another example of an IRTM where a trade restriction, imposed primarily to offer the domestic industry temporary protection from auto imports, produced a second stage effect of increasing FDI flows into the domestic automotive industry. Use of this managed trade measure is now recognized as providing the primary stimulus to Japanese FDI in the United States automotive industry in order to reduce United States protests over the bilateral trade deficit and secure market access against further possible trade restrictions (Graham and Krugman, 1995; Reich, 1992).

Sectoral restrictions imposed by certain European countries on auto imports from Japan also affected FDI decisions. Initially, some countries discouraged FDI, preferring to protect their domestic industry from both trade and investment competition. However, Japanese enterprises established operations in the United Kingdom and other countries whose membership in the European Community (EC) would permit market access to other EC members. This development prompted a debate about what constitutes a Japanese automobile and how auto exports from a Japanese company located in the United Kingdom would be counted in terms of national restrictions on Japanese auto imports into a country such as France.[4] The controversy was resolved through the incorporation of national restrictions into an EC-wide system of temporary sectoral trade restraints, but the FDI impact remained, prompting increased Japanese automotive investment throughout Europe.[5]

The automotive industry in a number of developing countries, such as Mexico and Brazil, offers an evolving hybrid of the IRTM effect. Initially, both countries used trade restrictions on auto imports to encourage foreign enterprises to invest and produce within their countries, seeking to build a domestic automotive industry by progressively adjusting trade restrictions to prohibit the importation of higher value-added components. In these cases, the IRTMs were specifically linked to a policy of attracting FDI to establish a local automotive industry, as opposed to the United States and EC examples, where protection of an existing industry was the objective. Of course, depending on how tightly the trade and FDI regulations are drawn, enterprises comprising a new infant auto industry may also expect protection from competing imports even after they become established.

More recently, in the case of Mexico and Brazil automotive industry policies have evolved due primarily to their incorporation in the North American Free Trade Agreement (NAFTA) and the Southern Common Market (MERCOSUR), respectively. Auto trade within the regions was a significant component of the economic rationale for the agreements, which contain integrally linked trade and investment policy measures to manage the industry's development. A regional free trade agreement itself serves as an IRTM by granting favourable market access to internally invested firms, creating an incentive for FDI within the region. Specific auto industry provisions determine the height of the trade restrictions by using rules of origin to define the regional content required for a

product to benefit from the free trade agreement. In NAFTA's case, the trade agreement denies benefits not only to automobile imports but also to automobiles partially produced or assembled locally if they fail to meet a relatively high standard of 62.5 per cent NAFTA content (Lipsey et al., 1994).

3. Regional free trade agreements

Regional free trade agreements constitute perhaps the most significant type of IRTMs, with an influence that extends far beyond their impact on FDI in the automotive industry. These trade agreements essentially allow member States to construct and implement non-most favoured nation (MFN) trade measures advantageous to enterprises operating within the region (and hence discriminatory against imports from firms located outside the region). In order to be sanctioned by the WTO, these agreements should be structured to meet certain conditions regarding the eventual reduction of trade barriers with non-member countries. However, their IRTM effect is often immediate, sometimes even occurring in anticipation of the actual approval and implementation of an agreement. The impact arises because regional free trade arrangements tend to attract FDI from enterprises based in non-member countries, affecting first those enterprises whose current exports will lose competitiveness to local producers that will benefit from the agreement. These foreign firms may undertake FDI in order to gain a "level playing field" within the regional trade area. Other firms may be drawn to invest by the factors associated with the increased attractiveness of market integration and greater economies of scale (UNCTAD, 1998b).

This generalized influence of the formation and/or expansion of regional trade agreements on FDI is most evident in the case of Europe's movement from a sectoral Iron and Steel Community to a broader Common Market, then to the European Economic Community and now the European Union. The imposition of a common external tariff created FDI impacts similar to the tariff-jumping motivations induced by a single country's use of tariffs to protect an attractive domestic market, only larger due to the larger internal market. Announcement of the EC 1992 reform programme prompted firms from EC member countries such as France and Germany to expand intra-EC FDI flows, positioning themselves to take advantage of the new market integration opportunities (UN-TCMD, 1992; UNCTAD, 1993a). Enterprises based outside the EC also increased their FDI within the region, responding partly to the same market integration opportunities but also seeking to protect against competitive exclusion fromthe enhanced market, i.e. reflecting concerns (whether or not justified) about a "Fortress Europe" (Wallace and Kline, 1992).

The trade walls established by NAFTA and MERCOSUR create analogous conditions for potential FDI effects. In these cases, however, the regional accords more explicitly recognize the investment dimension, incorporating FDI-related provisions as part of the NAFTA agreement and, in MERCOSUR's case, in a companion accord, the Colonia Protocol. Some FDI impacts are internal to the region although they may differ depending on the region: for example, United States enterprises increasing their investment in Mexico or Brazil, and Argentina's cross-investment in MERCOSUR. The number of Brazilian firms investing in Argentina jumped from 20 to over 400 after the customs union was formed (UNCTAD, 1997a and 1997b).[6] Other FDI impacts arise when enterprises external to the region invest within the free trade area, either substituting for previous imports and/or to take better advantage of expected market growth.[7]

The proliferation of regional trade agreements around the world enlarges the potential FDI impact of these IRTMs. For example, the common external tariff of the Treaty Establishing the Caribbean Community (CARICOM) was not put into effect until 1991. Since that time, FDI flows in the CARICOM subregion have increased at an annual rate of 20 per cent, growing from $412 million in 1991 to $900 million in 1995 (UNCTAD, 1997b). Many regional agreements are now being negotiated or revised with a more explicit recognition and assessment of how the incorporated trade measures will affect FDI decisions relative to market access considerations and the attractiveness of the internal investment climate. For example, a protocol has been signed for FDI promotion and protection as part of the effort to create an Association of South East Asian Nations (ASEAN) Investment Area (UNCTAD, 1998b, ch. III). Cooperative schemes among ASEAN members already have achieved some integration in automobile manufacturing, where auto parts production and assembly in different countries benefit from a preferential duty arrangement (UNCTAD, 1997b). The specific importance of FDI to a regional trade agreement

depends, of course, on many factors, including a region's internal investment endowment and its stage of economic development.

4. Rules of origin

With respect to regional trade agreements, rules of origin set the standard for determining the level of regional content that must be embodied in a product to qualify for the trade benefits granted under an agreement. In other cases, rules of origin are used to determine the country of origin for an imported product. This determination is essential to implement restrictive trade devices as well as to grant preferential trade status to selected countries.

Depending on the definitional methods chosen to administer a rules-of-origin policy, this type of IRTM can be more or less protectionist, with a concomitant impact on FDI flows. The easiest method would rely on a change in a product's classification in the tariff schedule to determine when (and thereby where) a substantial transformation on a good took place. However, the change of classification in the tariff schedule does not necessarily demonstrate the substantiality of transformation occurred in the good, since the tariff schedule is originally established for the purpose other than origin determination. In addition, countries discovered possible national advantages to designing rules of origin in ways that encouraged greater local value-added production. Hence, rule-of-origin methods may also use specified percentages of local content and/or certain stages of production to designate the point at which a product's country of origin changes in terms of the application of particular trade measures.

An illustration of how rules of origin, used in conjunction with regional trade agreements, influence FDI flows is the European Union's 1989 decision to require that the wafer fabrication stage of semiconductor production be performed in the European Union to avoid a 14 per cent tariff. The measure was a significant factor in the jump in FDI in European semiconductor fabrication facilities, which rose 20 per cent between 1987 and 1990, despite higher production costs relative to the United States or Asia. For example, Intel's decision to expand FDI in Europe was influenced by the need to meet this new standard (Jensen-Moran, 1996a).

NAFTA rules of origin in high technology products had similar FDI impacts, particularly affecting both existing and prospective investment decisions regarding production in Asia. ATT shifted production of telecommunications equipment from Asia to Mexico due to a requirement that at least nine of ten printed circuit boards (the key component of office switching equipment) be packaged within NAFTA to qualify for its trade benefits. Canon reportedly invested over $100 million in a new United States copier facility, rather than building the plant in (lower-cost) China or Malaysia, because a special NAFTA rule of origin for copying machines required the equivalent of 80 per cent local value added (Jensen-Moran, 1996b).

Even where FDI is placed outside the member countries of a regional trade agreement, investment patterns can still be influenced by the region's rules of origin. For example, General Motors invested in an engine plant in Hungary but needed to use German steel rather than lower cost alternatives from Hungary or other non-European Union member countries in order to meet the 60 per cent sectoral domestic content requirement contained in the European Union's association agreements with Central and Eastern European countries (Moran, 1998). This outcome can affect investment patterns in those countries. German and other European Union steel makers would be less likely to relocate outside the European Union, while TNCs from other countries would also have reduced interest in using FDI to build new facilities or undertake joint ventures to improve steel plants in association countries. In this case, the rule-of-origin requirements function as an IRTM that limits the benefits of a European Union trade policy aimed at granting preferential treatment to imports from Central and Eastern European countries.

The actual impact of rules of origin depends, of course, on their specific definition and applications. For example, using rules of origin for imported products from developing countries that receive preferential tariff treatment is one way to try to ensure that the economic benefit of the trade preference actually accrues to developing countries. In such cases, the effect of a relatively high domestic content rule of origin may depend on the ability of a developing country to meet the required standard. If it has, or can attract, the necessary level of local production capacity, the rule could benefit its value-added production and perhaps even serve as leverage to attract more FDI seeking to qualify for the trade preference. On the other hand, an unrealistically high rule-of-origin standard might preclude a developing country from

benefiting from a trade preference if local productive capacity proved inadequate without the use of significant imported components that would mean exceeding the foreign value-added limit.

In either case, rules of origin influence FDI flows. Even where a particular developing country benefits from more FDI due to the particular rules of origin employed in a trade preference scheme, that gain may come at the expense of other countries (developing or developed) excluded from that particular preference arrangement. The principal point is that rules of origin as trade measures will impact investment flows, distorting their direction and location compared to FDI decisions taken in the absence of such IRTMs.

5. Anti-dumping regulations

Anti-dumping regulations are a trade measure that can be used to prevent predatory pricing practices by importers seeking to gain future monopolistic advantages by driving competitor firms out of a market. Historically, anti-dumping actions relied on an international price discrimination test. If imports were sold at prices below those charged in the producing firm's home market, the pricing differential was taken as evidence that the firm benefited from trade protection at home that subsidized its pricing strategy in foreign markets. (If the home market were not protected, the products could simply be re-exported and sold at the higher price charged in the home market.) More recently, the definitional methods used to determine anti-dumping actions have been changing in ways that can disadvantage actual low-cost foreign production sites.

In recent years, the United States and the European Union have increasingly been using a "fair cost of production" standard rather than price discrimination to administer anti-dumping regulations. Their methodology relies on average total cost plus a markup for profit and overhead to determine a "fair price".[8] The use of average total cost as a measurement penalizes importers which, for competitive reasons, often price according to marginal cost or average variable cost rather than average total cost. Discrimination against imports occurs because domestic enterprises may price near marginal cost without being penalized by government regulations while foreign firms can fall victim to the imposition of anti-dumping duties for similar pricing methods. An Organisation for Economic Co-operation and Development (OECD) study of anti-dumping actions in the United States, the European Union, Canada and Australia concluded that 90 per cent of imports found to be unfairly priced under anti-dumping regulations would have been deemed fairly priced under comparable domestic competition standards (Moran, 1998).

If the import discrimination under anti-dumping regulations is significant enough, it could lead a foreign firm to invest in the protected market to avoid the dumping penalties. However, an equally if not more significant FDI impact in developed countries could be to discourage enterprises from engaging in FDI. By restricting or causing increased concern about the access of imports to a market, anti-dumping regulations can exert an indirect influence on prospective FDI decisions and to keep investors at home rather than establishing operations abroad at lower-cost production sites. The domestic producer may not want to risk FDI, even though it could lead to competitive efficiencies in serving the home market, if anti-dumping measures raise substantial doubts about whether the foreign-produced goods would be subject to punitive anti-dumping duties upon importation.

These IRTM effects from the application of anti-dumping regulations may be increasing in significance. The WTO reported nearly 1,600 anti-dumping investigations between 1985 and 1994, with the United States and Australia each accounting for over one-fourth of the total and the remainder divided nearly equally between the European Union, Canada and other countries together. While the initiation of anti-dumping investigations in developed countries remains high (although below rates recorded in the early 1990s), developing countries registered a significant expansion in their own use of anti-dumping regulations, with investigation rates rising from 31 to 118 to 246 in three-year increments between 1988 and 1996 (Moran, 1998).

6. National standards

A range of national regulatory standards that may (or at least appear to) be based on legitimate domestic policy concerns can effectively raise non-tariff barriers to imports. When such measures impair market access, they function as possible IRTMs by encouraging FDI necessary to meet the national standards requirements and thereby compete for sales in that market. For example, if plant visits are required by national government inspectors to certify compliance with

product health or safety standards, foreign producers are effectively disadvantaged, if not excluded from that national market, unless the inspectors travel to the other country (unlikely) or an intergovernmental agreement exists to accept the other country's inspection certification (infrequent). Faced with such national standards barriers, FDI may be the only alternative for a foreign producer to compete in the market, resulting in local production that would substitute for potential (and perhaps more competitively efficient) production in other countries.

The scope of national standards that may function as IRTMs is broad, and it is often difficult to establish clearly the extent to which a standard intentionally or unintentionally impedes imports. There is also wide variation in how well such standards are addressed by various intergovernmental agreements. For instance, environmental standards are subject to WTO and/or regional trade agreement discipline when they unfairly discriminate against imported products or services. However, this area is quite new and the rules, their interpretation and application, and the effectiveness of possible remedies are yet to be confirmed by substantial experience and practice. National cultural standards have proven especially controversial, precluding widespread agreement on whether or how to subject these measures to intergovernmental discipline. Even differing national standards regarding the protection of personal privacy raised issues of trade discrimination that had direct and indirect impacts on FDI decisions, resulting in negotiations in the Council of Europe and the OECD to achieve agreements to ameliorate the resulting market distortions (Kline, 1985).

7. Non-monetary trade arrangements

Often grouped under the general term "countertrade", certain non-monetary trade arrangements function as IRTMs by structuring trade contracts in ways that result in FDI flows that would not otherwise have occurred. These mechanisms increased in frequency during the debt crisis of the early 1980s when many countries lacked sufficient hard currency to finance normal import flows. Non-monetary trade also takes place most often in certain industries, such as aerospace and electronics, and is most likely to occur in highly competitive industries, especially in major transactions that may involve governmental funding.

Co-production requirements are probably the most common and significant IRTM in this category. Rather than importing a finished product through a monetary transaction, a co-production arrangement will require that a substantial part of the production take place locally, often to reduce the drain on scarce foreign exchange. The result is a shift in the location of value-added production from a foreign site to the purchasing country, often involving FDI by a foreign enterprise to provide necessary capital, technology or quality control processes. Once in place, such an investment could also influence the geographical distribution of future production as the enterprise utilizes the new facilities to provide follow-on local sales, or possibly as a base for exports to additional countries.

Other forms of non-monetary trade could also influence FDI decisions. Buy-back arrangements may involve FDI when foreign exchange restrictions preclude the purchase of imported consumer products. A foreign enterprise may establish operations to serve the local market, arranging to repatriate profits in the form of exported production destined for its home market, or elsewhere, rather than as monetary transfers. Bilateral arrangements that designate a portion of a country's available hard currency reserves to promote trade with another specific country for foreign policy or other reasons can also cause TNCs to shift the production of an item to the country favoured by the bilateral arrangement because exporting from an established third-country site is not an option if foreign exchange is not available for such trade (Yoffie, 1984).

Non-monetary trade arrangements may be trade distorting or trade enhancing, depending on whether the transactions could have taken place without the arrangement. In cases in which severe foreign exchange problems legitimately preclude trade on a monetary basis, non-monetary exchanges may be the only option. However, questions about the severity of the shortage and the priority designations for available funds can raise issues similar to the debate over national standards. As IRTMs, non-monetary measures can be used as barriers against imports in order to increase local value-added production, in many cases drawing in FDI as an alternative to the precluded imports.

B. Market access development preferences

A special category of IRTMs emerges when the trade policy measures discussed above are modified to provide preferential market access for developing countries. These preferences, permissible under multilateral trade rules upon fulfillment of certain criteria, are granted by countries or regional groupings to other countries or regional groupings on terms and conditions that vary with specific cases. Although generally discussed and implemented as trade policy preferences, these measures also result in distinctive FDI impacts that are becoming more explicitly recognized, acknowledged and intentionally exploited. These IRTMs usually serve to attract export-oriented FDI to the developing countries favoured by the preferences.

The Generalized System of Preferences (GSP) is an example of this kind of policy instrument. In the case of the United States, for example, the GSP now provides preferential duty-free entry for approximately 4,500 imported products from over 140 beneficiary countries and territories (Robinson, 1998). The designated products and countries change periodically, sometimes after mandated reviews of United States legislated criteria. Regulations also require direct shipment of the imported goods with a minimum 35 per cent local content in order to control transshipment problems while ensuring substantial value-added local production in the developing country. The FDI impact of this trade preference arises from the increased attractiveness of GSP-designated countries as production sites for eligible goods destined for the United States market, giving these locales an advantage over countries whose exports face United States tariffs. Duty-free treatment of imports may also influence decisions by United States firms contemplating FDI as a response to competitive cost-reduction pressures.

The United States Caribbean Basin Initiative (CBI) is a more region-specific development preference begun in 1984 that uses trade incentives and economic aid to promote both trade and FDI. The goal of increasing FDI is explicit in the programme as a way to encourage economic diversification and increased export earnings for the eligible developing countries. Rule-of-origin regulations vary somewhat from the GSP standard, specifying that United States-origin materials may constitute 15 per cent of the minimum 35 per cent local value-added content in a CBI country (CBI, 1998). Overall, the trade and aid benefits can provide allocation for FDI-based, export-oriented production that is even more advantageous for gaining preferential access to the United States market than sites available in non-CBI GSP-eligible countries.

The European Union also provides market access trade preferences through various association agreements with countries in Central and Eastern Europe, as well as for certain developing countries through its GSP scheme and the Lomé trade regime. Begun in 1975 as an arrangement between nine EC member States and 46 countries in the Africa-Caribbean-Pacific (ACP) group, the periodically revised Lomé Conventions now link the 15 European Union members with 71 ACP countries. This preferential arrangement received a waiver from GATT MFN rules in 1994.

The Lomé arrangements grant duty-free access to the European Union market for all industrial and fish products and nearly 80 per cent of agricultural products, with the latter governed by certain exceptions and quota controls. Under this preferential status, nearly one-half of ACP agricultural exports gain a significant advantage over exports from countries with simple (non-preferential) MFN status which face an average tariff of about 23 per cent. For industrial products, the preference is less significant, with only about 16 per cent of ACP exports receiving duty-free entry that is unavailable to non-preferential MFN trading partners, whose comparable products face an average duty of 8 per cent (European Commission, 1998). The Lomé Conventions also have an important financial assistance component. Although the goals are not so specifically targeted as the CBI at promoting economic development through private business opportunities (including FDI), the assistance may nonetheless enhance the developing countries' investment climate, especially through projects to improve physical infrastructure, education and fiscal management.

An example of FDI impact related to these development preferences arose during a controversy over the European Union's application of tariff and quota preferences to bananas exported from ACP countries. The preference scheme disadvantaged banana exports from some Latin American countries, which protested to the WTO.[9] United States TNCs, which had concentrated FDI in Latin America, faced a decision about whether to invest within ACP countries and the European Union in order to compete for the preferentially protected market in bananas. Two of the three

principal United States firms did choose this FDI route and gained additional market share. The firm that chose to expand FDI in Latin America instead lost market share in the European Union (Southey, 1995).

C. Export promotion devices

1. Export processing zones

Export processing zones (EPZs) function directly as IRTMs because the free trade benefits granted within the zone are designed specifically to attract (domestic and) foreign investment. Developing countries often use an EPZ's trade incentives explicitly with the intention of attracting FDI resources that are unavailable domestically in order to create local employment, facilitate technology transfer and generate export sales. These zones (also known by names such as foreign trade zones, special economic zones and free economic zones) operate under very liberal trade rules designed to promote business activity free from normal customs restrictions and import duties.[10] In this way, a zone can promote export growth while maintaining a country's general regulations governing access to the domestic market. Although the main objective is to promote exports competitive on the world market, many zones also permit input warehousing or local value-added processing for products later offered for domestic sale.

Areas designated as EPZs allow the tariff-free import of raw materials, components, machinery, equipment and supplies used to produce manufactured goods for export. They induce investment by providing low-cost processing, rapid duty-free entry and tax-free exit. In addition, products entering the domestic market from an EPZ are not charged duty on the value-added in the zone. EPZs also offer other indirect benefits. Firms may save on transport costs by moving larger shipments without having to pay duty upon arrival. Storage of the product in the final country thus shortens response time between orders and distribution. Spare parts may be held in a zone without duty payment, and no customs duties are paid if merchandise is returned to a zone. In some cases, if part of the merchandise is processed in the zone, it may not be subject to any quota.

There has been much growth in EPZs. In early 1989, some 200 zones employed 1.5 million workers and accounted for exports of $15 billion (UN-TCMD, 1992). By 1996, at least 840 such zones existed (UNCTAD, 1998b, p. 59). In the United States alone, the number of foreign trade zones increased by over 50 per cent between 1988 and 1994. More than 300,000 United States jobs were created by FDI in these zones, with twice as many jobs attributable to related services outside the zones (Burns, 1995). But, overall, approximately 90 per cent of production in current EPZs is located in developing countries (Burns, 1995). For example, Viet Nam had 18 EPZs in 1997, attracting 264 FDI projects worth $2.54 billion; the government hopes that these EPZs could bring as many as 2,400 projects worth $20 billion to Viet Nam in the future.[11]

In order to facilitate the movement and production of goods, EPZs have sparked investment not only in processing, but also in EPZ infrastructure, communications and financial services. Foreign investors build and operate some EPZs primarily to coordinate their own international trade and processing needs. For example, Japan's Sumitomo Corporation has developed fourteen EPZs in countries throughout Asia in order to provide the necessary infrastructure to manufacture and distribute its products (WEPZA, 1998). The company can then link up related processes among the EPZs in order to maximize tariff-free production.

In regional trade areas such as NAFTA and the European Union, EPZs can heighten the investment attraction already provided by a regional trade agreement, combining duty-free production with preferential access to the regional market. For instance, the creation of NAFTA led to the establishment of 30 general purpose United States zones directly related to trade with Mexico. Under NAFTA, goods made in a United States free trade zone are considered manufactured in the United States; yet because the zone is not within the United States customs territory, foreign-sourced materials may be admitted free of duty. Moreover, goods may be shipped among free trade zones in NAFTA countries without paying duties until the article is completed; then, only duty on those components shipped from abroad is paid. The rule-of-origin requirements in NAFTA will reduce this incentive by 2001, however, when the duty-free factories (*maquiladoras*) that exist in Mexico's "free perimeter" EPZ along the Mexico-United States border will require at least 60 per cent North American content to enjoy duty-free status (Burns, 1995). Most pre-NAFTA *maquiladora* plants were also linked to an IRTM,

with United States tariff provisions (schedule 806/807) imposing duty only on the value-added portion of goods reimported after assembly by lower-cost labour in facilities located in Mexico.

2. Export financing

Competitive export financing programmes can function as IRTMs by attracting new or expanded export-oriented FDI to the country providing the greatest subsidization and/or retaining FDI by offsetting economic advantages that might lead a TNC to source an export sale abroad. Historically, national governments have competed for export sales through the use of government-backed credits offering favourable interest rates and repayment terms and/ or the use of "tied" aid packages where development assistance is linked to the purchase of goods from the grantor country. Differentials in the export financing support available in various countries can affect FDI through corporate decisions on where to source an export sale. For example, the type of large export orders typically supported by public export credit agencies may lead to the expansion of a TNC's plant and equipment in the sourcing country.

Market distortions arising from competition in export financing were significant enough to lead most OECD members in 1978 to approve an *Arrangement on Guidelines for Officially Supported Export Credits*. Although negotiated and administered within the framework of the OECD, this "gentlemen's agreement" is not a formal, legal OECD instrument. The terms have been adopted into European Union law for member States, but other countries are officially bound only by so-called "soft law" commitments. The arrangement covers interest rates, cash-down payments, repayment periods, concessional financing levels and, most recently, minimum premium rates for country and sovereign risk (OECD, 1998a and 1998b). The objective is to prevent an export credit race where subsidized trade financing terms, rather than product and service quality and pricing, determine the source country for the export sale (and its potentially related FDI impact).

The arrangement on export credits has a development dimension in that the agreed financing terms vary, depending on the development category of the importing country. The World Bank's graduation threshold is used to classify countries regarding some export credit terms while gross national product (GNP) per capita income criteria determine eligibility for tied aid. The United Nation's distinction between developing and least developed countries is utilized to set minimum concessionality levels for countries eligible for tied aid credits and grants (OECD, 1998b). Although limitations on export credit subsidies for developing countries may enhance the role of product quality and price factors in trade transactions, the overall direct cost to the developing country may be increased by the arrangement's restrictions. The effect on the tied aid components is more problematic; it depends on whether the arrangement's limitations result in a greater loss in concessional aid compared to economic efficiency gains realized through a broader choice of sourcing locations for products and services purchased with the aid funds.

3. Taxation measures

Multilateral trade system rules governing tax rebates on exports affect FDI both directly and indirectly. Original GATT rules were established to prohibit rebates on direct (income) taxes as illegal export subsidies while rebates on indirect (sales or value-added) taxes were permissible. The effect of this trade policy decision is to favour exports from countries that rely more heavily on value-added taxes compared to countries with high direct income taxes. Consequently, companies choosing a new international location for an export-oriented investment may consider this tax-related trade measure among the factors that influence their selection of an FDI site.

An instance where such a trade policy measure directly affected FDI emerged from the GATT debate over the United States Domestic International Sales Corporation (DISC). Faced with a GATT panel decision ruling that the DISC constituted an illegal export subsidy through its deferral of direct taxes on export income, the United States replaced the DISC with Foreign Sales Corporations (FSC). Under this new programme, United States firms could gain tax advantages by establishing a foreign-based entity through which exports could be channeled. Because the FSC's export income from a sale is foreign-source income, its taxation is not covered by GATT trade rules (Hill, 1986). Hence, this United States trade measure provided an incentive for United States firms to engage in FDI, at least to the extent of establishing a foreign-based facility to manage export trade. These United States tax-

related trade measures aimed at the retention of investment at home (assuming that the GATT rules might induce firms to move export operations abroad) by equalizing taxation effects on exports, either through a deferral of direct taxes on export income or favourable treatment for related foreign-source income.

D. Export restrictions

An atypical and somewhat narrow category of IRTMs consists of export restrictions that can influence FDI decisions through a corporate desire to escape or minimize such controls. Export restrictions are often imposed for military security or other foreign policy purposes, either to prevent militarily sensitive products from reaching potential adversaries or to deny otherwise beneficial goods and services to political opponents. At times these trade policies may be coordinated internationally, but more often their imposition is either unilateral or else broad compliance differences exist among cooperating countries.

When internationally-agreed trade controls are not achievable or effective and extraterritorial enforcement is impractical or too politically costly, the evasion of national export controls through FDI becomes a viable business option. Enterprises facing export restrictions in one country may seek to invest or expand operations in non-controlled countries in order to conduct business more freely. In such cases, the initial trade controls encourage FDI, which in turn sets new trading patterns from the FDI base. Conversely potential foreign investors may also hesitate to place or expand FDI in countries employing export controls, particularly in sensitive industries.

The end of the Cold War might appear to lessen the military context for export controls, but in reality the scope of such controls could widen as they are applied across a broader range of products for a variety of reasons. Militarily, more countries may focus on lower-level threats, with greater diversity in their evaluations of particular situations. Questions surrounding dual-use technologies complicate this issue, particularly as concerns increase over the spread of chemical or biological weapons capabilities. In addition there is an increasing temptation and opportunity to invoke export controls to serve economic objectives, particularly to restrict transfers of technology that might threaten current or future domestic employment. Hence, differing national trade control policies and priorities could expand the potential for FDI diversion that responds to these differences.

Section III
Interaction with other Issues and Concepts

The concept of IRTMs is, by its very nature, interactive across many traditionally segregated investment issues. Interactive effects are particularly important in the areas indicated in table 2.

Table 2. Interactions across issues and concepts

Issue	IRTMs
Admission and establishment	+
Competition	+
Dispute settlement (investor-State)	+
Dispute settlement (State-State)	+
Employment	+
Environment	+
Fair and equitable treatment	+
Home country measures	+
Host country operational measures	++
Illicit payments	0
Incentives	+
Most-favoured-nation treatment	+
National treatment	+
Scope and definition	+
Social responsibility	+
State contracts	0
Taking of property	0
Taxation	++
Transfer of funds	+
Transfer of technology	+
Transfer pricing	++
Transparency	+

Source: UNCTAD.
Key: 0 = negligible or no interaction.
\+ = moderate interaction.
++ = extensive interaction.

- **Taxation and transfer pricing.** Multilateral trading rules aim to prevent the use of tax regulations to subsidize exports and, thereby distort trade patterns. However, differential treatment of rebates on direct and indirect taxation can influence FDI decisions for export-related production, which in turn will also be assessed in terms of how overall taxation policies affect FDI profitability, including the treatment of foreign source income and the applicability and effectiveness of bilateral tax treaties. In the DISC/FSC

example discussed earlier, United States regulations governing foreign source income were specifically modified to favour FDI operations related to United States exports.

Transfer pricing policies may also interact with IRTM issues, particularly as they link international trade and FDI decisions through corporate calculations regarding intrafirm trade. International standards and national regulations governing the pricing of goods and services traded between affiliated enterprises in different countries influence intrafirm transactions, which comprise one-third or more of global trade. If transfer pricing practices embody an "arm's-length" standard that reflects transactions between unaffiliated enterprises, these policies do not distort international trade or FDI flows compared to their free market patterns. However, to the extent that a firm manipulates intrafirm transfer prices to escape national taxation or evade foreign exchange controls, there are trade-FDI interactive effects. The dispersion of a firm's FDI relative to differences in national taxation or exchange regulations would certainly help determine both whether and how transfer pricing might be used to shift trade flow measures and hence the taxable profits associated with them.

- **Host country operational measures**. Among these types of measures, sourcing and local content requirements are particularly relevant, even though some of them may derive from trade policy decisions or depend on measures such as rule-of-origin regulations for their implementation. Regional and/or global products mandates also interact with trade policy to the extent that national or FDI-specific standards affect trade flows. Restrictions on imported goods or manufacturing inputs needed for FDI-based operations rely on administrative trade measures and may arise from trade policy decisions that neglected the policy's ramifications for FDI operations.

Conclusion: Economic and Development Implications and Policy Options

Trade measures affecting market access (to imports) or trade competitiveness (for exports) can influence FDI decisions where trade is an option to FDI or where trade is a related follow-on effect of an investment. A country's degree of trade policy liberalization or export support can affect potential FDI decisions which, once made, can structure longer-term trade flows as well. Measuring the potential impact of trade policy instruments only on the basis of their most obvious short-term trade results may therefore yield an incomplete and potentially distorted assessment. Similarly, making trade policy decisions without carefully weighing their impact on FDI flows could yield unforeseen and potentially counter-productive results, including distorted longer-term trade flows.

Historically, most developing and developed countries have used trade measures as part of their economic development policies. For example, tariffs and/or quotas were used in import substitution policies to encourage local production, stimulate the spillover benefits of new industrial activity and promote infant industries and enterprises. These policies often induced "tariff-jumping" FDI that sometimes proved questionable for long-term development purposes because it was motivated primarily by protective IRTMs. However, in many instances it also proved effective in overcoming market failures involved in learning more complex technologies and capturing widespread externalities. In those cases in which protected operations did not raise their technical efficiency, however, continued protection was needed for their survival, imposing costs on the economies concerned.

The use of IRTMs, especially by developed countries, can also yield FDI impacts that affect the goals and potential outcomes of economic development policies in other countries. Regional trade agreements among developed countries, or between certain developed and developing countries, shape the relative attractiveness of member and non-member countries as future investment sites. Specific rules-of-origin policies can operate to increase the disadvantage of locating outside a trade agreement area, even where non-member countries may offer comparative economic advantages for production. For example, regional market access restrictions can shift traditional patterns of import or component supplier relationships for firms within a trade zone. In fact, traditional foreign suppliers may feel impelled to invest within the regional market in order to remain competitive, shifting the resulting distribution of trade and other economic benefits among countries. Unless the FDI impact of both the larger trade area and its specific trade policy implementation measures (such as rules of

origin) are explicitly recognized and evaluated, projected outcomes from a regional trade agreement may well be inaccurately perceived and measured.

Programmes granting preferential market access for developing countries to developed countries and regional free trade areas constitute a special category of market access IRTMs that can shift FDI in ways similar to the impact of regional trade agreements themselves. Rather than attracting FDI into the consuming market, however, programmes such as the United States CBI or the European Union's Lomé arrangements have the effect of encouraging FDI in the developing countries benefiting from the grants of preferential access. Rules-of-origin measures are often applied by these programmes, with the rules' relative restrictiveness affecting how attractive a developing country site becomes to different value-added stages of the production process.

Modern EPZs integrate trade and FDI objectives even more closely by using liberal trade rules and other incentives to attract investment for local export-oriented production or assembly. A scarcity of domestic investment and technological capabilities often leads developing countries to design these zones expressly for FDI. For countries that are in the process of liberalizing their economies, EPZs can serve as an interim measure to provide a free trade environment while gradually restructuring their economies.

For countries with liberal trade regimes, such as the United States, EPZs are a means of reaping economies of scale and scope in providing inputs, infrastructure and administrative services. By adopting a viewpoint that specifically evaluates and incorporates the projected FDI impact of this export promotion measure, a country essentially recognizes and manages this trade mechanism from the perspective of an IRTM.

Variability exists both in the frequency and the relative importance of the market-access types of IRTMs. The growth of regional free trade agreements has expanded the influence of IRTMs on FDI at the same time as rules-of-origin measures have increased their impact, both as a part of regional market regulations and as programmatic devices associated with national initiatives such as development preferences and EPZs, which themselves have proliferated. By contrast, traditional national tariff and quota restrictions have been progressively reduced or prohibited through successive rounds of multilateral trade negotiations. During the past decade, a number of sectorally managed trade restraints have also been phased out or brought under stricter multilateral discipline.

These market access IRTMs and some export promotion programmes function largely in relation to the tariff levels that surround a country's market, either by defining the market's enclosed boundaries or by granting special reduced or duty-free preferences to imports from certain external producers. This tariff-based link means that the effects of these IRTMs will vary in proportion to the level of the tariff involved. A general lowering of tariff levels serves to moderate the importance of market access IRTMs where the benefits accruing to related FDI is based on the avoidance or reduction of the tariff. For example, the growth in regional trade agreements increases their overall impact on FDI, but the actual height of the tariff barrier to imports from non-member States has decreased as trade negotiations have lowered overall tariff levels. The barrier to market access that can motivate FDI within a region therefore declines in importance as the height of the tariff is reduced. Similarly, rules of origin linked to regional market access or development preferences based on duty-free entry of imports both become relatively less important as the size of the tariff barrier is lowered. In somewhat parallel fashion, the benefit derived from duty-free treatment in EPZs is proportional to the tariff being avoided, although other EPZ advantages, such as faster and less burdensome customs procedures, would still prove to be influential in FDI decisions.

Other categories of IRTMs are not so directly linked to tariff-based market access barriers. Differing national standards can operate as barriers to a market, at times perhaps serving as intentional replacements for the reduced effectiveness of tariff-based barriers. These measures display much variety and a strong connection to domestic policy that poses complex issues for multilateral negotiations. Nevertheless, the increasing importance of national standards and their effect on trade flows has been recognized, prompting efforts in several multilateral organizations to address their possible distortionary trade impacts. However, the potential second-stage influence that trade-distorting national measures can have on FDI has been less well recognized or evaluated.

The increasing frequency of anti-dumping actions in both developed and developing countries also suggests the need for greater attention to the potential for this device to function as an IRTM in

influencing FDI flows. Anti-dumping measures may be even more problematic than some other categories of IRTMs because they operate with more administrative discretion in individual cases compared to the type of generalized market access restrictions promulgated by most other IRTMs. The use of discriminatory anti-dumping measures in developed countries can affect development goals and the distribution of economic results by discouraging the outflow of FDI to developing country locations where comparative economic advantages might otherwise attract foreign investors in the absence of a home government's policy intervention. Aggressive anti-dumping policies may dissuade firms from moving to foreign locations, even where comparative advantages make production less costly, by increasing the risk and uncertainty regarding importation of the resulting output. This potential retention impact on FDI may become increasingly tempting for developed countries that have begun to worry more about domestic job dislocations and the loss of traditional areas of manufacturing strength.

These diverse economic consequences of IRTMs suggest the importance of taking them into account when considering ways to enhance the development dimension in international investment agreements. An analysis of IRTMs can help inform and guide trade policy choices in ways that enhance development objectives. A first step is to adopt a perspective that expressly considers how trade policies may impact FDI. Both the decision to invest in a particular location and the qualitative nature and market orientation of a given FDI project are affected by national and international trade policies. With expanding FDI, foreign production and intrafirm trade increasingly shape global trade patterns. Initial trade policy decisions that influence second-stage FDI decisions can thereby subsequently affect third-stage trade flows as well. These impacts should be considered when evaluating IRTMs that relate to national and regional trade policies as well as discussions of international investment agreements.

Some categories of IRTMs relate principally to national or regional market policies where some fundamental differences continue to exist over the priority goals and relative effectiveness of development policies. In these areas, proposals and programme options should realistically assess the interrelated trade and FDI effects on development objectives. Although the historical use of high tariffs in import substitution programmes has declined, other trade policy tools can serve a similar function, whether deployed as sectorally managed trade restraints, coproduction requirements, anti-dumping actions or non-tariff barriers such as national standards. These import substitution policies tend to encourage barrier-jumping FDI in relation to the attractiveness of the national market. These policies simultaneously impede beneficial linkages between a new facility and its global affiliates while at the same time protecting the operation's inefficiencies from the discipline of international competition. However, there may be legitimate grounds for temporary protection and the promotion of local content where these support valid infant industry and externality benefits, and these have to be carefully balanced against the potentially harmful effects of excessive and prolonged protection. The new international rules of the game increasingly constrain the use of trade interventions in any case, and this has to be taken into account in assessing IRTMs. The evaluation of IRTMs relative to markets created by regional trade agreements encompasses similar concerns, with the added importance of how rules-of-origin policies are defined and implemented.

Rules of origin have an additional developmental impact because they may define the nature and composition of products that can benefit from preferential trade policies, such as the Lomé trade regime or the United States GSP programme. The effect of these IRTMs helps shape the characteristics and location of investments (including FDI) undertaken in response to development programmes. From a developing country's standpoint, the programmes' rules of origin should be drafted to fit the characteristics of the developing country. If the rules require a higher local value-added content than can be supported by a particular developing country's endowments, even with some increase in FDI, then the country is unlikely to realize substantial benefits from the programme. Rules that specify particular stages of product manufacture or assembly that match a country's endowment potential might be the most likely to attract productive FDI designed to take advantage of the preferential export opportunity.

A developmental irony of tariff-based IRTMs is that, as international trade negotiations have progressively lowered tariff levels, the relative export benefit (and related FDI attraction) derived from many preferential trade policies has been simultaneously reduced. Tariff-free entry is advantageous to the degree that the relevant tariff

being avoided is high. Similarly, the tariff-jumping impact of free trade agreements corresponds to the height of the common external tariff established for a regional market. Of course, non-tariff market access barriers such as national standards are not similarly affected. Even the relative incentives offered by EPZs relate to the level of duty being avoided or delayed, although expedited customs treatment provides an additional benefit for zone-based activities.

Trade policy decisions related to IRTMs in capital exporting countries may also have a developmental impact. Protective measures that restrict imports may discourage outward FDI flows by enterprises that might have established export-oriented production in lower-cost developing countries aimed at serving the investor's home country market. As more developed countries encounter unemployment or other labour adjustment problems related to an integrated global economy, domestic political pressures may lead to an increased use of IRTMs that intentionally act to retain investment at home as well as potentially attract FDI from abroad. Rules of origin and anti-dumping regulations are particularly susceptible to being employed in this fashion.

The increased use of anti-dumping actions in some developing countries could serve to validate the expanded use of this IRTM in some other countries. Such an effect would be unfortunate for developing countries whose internal markets are not attractive enough to benefit from the FDI as well as the trade effects of such policies. On the other hand, for developing countries with large and attractive home markets, increased use of discriminatory anti-dumping methodologies could actually promote inward FDI and discourage outward FDI, while disadvantaging other country locations (including other developing countries) that may offer more economically efficient, lower-cost production sites. Placing greater international constraints on the administration of discriminatory anti-dumping actions could have a differential impact that tended to favour the least developed countries with small internal markets but potentially low-cost export production sites.

Trade promotional IRTMs such as export financing programmes also impact trade flow patterns and FDI decisions of TNCs able to source global sales among a number of national locations. On its face, the developed countries' decision to constrain competitive export financing programmes through an OECD-based "gentlemen's agreement" may initially reduce the benefits that importing developing countries might enjoy from a competition on export financing rates and terms. Restrictions on "tied" aid components will likely benefit developing countries except to the extent that overall development assistance levels are concomitantly reduced. The FDI impact of export financing programmes falls primarily on the distribution of sourcing among developed country locations, however, without much related impact on FDI in developing countries or other development-related objectives.

The recognition and evaluation of IRTM effects is important to assessing the developmental impact of international economic agreements more generally. The existing international framework for trade relations only recently recognized the need to consider investment-related issues but, in focusing only on the unidirectional influence of TRIMs, generally overlooked the counterpart effects of how IRTMs influence FDI decisions and outcomes. The practical interrelationship of trade and FDI decisions at the operational level of enterprise decision-making suggests that these concepts should be assessed as interactive elements when policies are evaluated.

Notes

[1] For a first discussion of IRTMs, see UN-TCMD, 1992, ch. XI. The relevance of IRTMs has been recognized by the World Trade Organization (WTO) Working Group on the Relationship between Trade and Investment which included in its work programme "the economic relationship between trade and investment; the impact of trade policies and measures on investment flows, including effects of the growing number of bilateral and regional arrangements". (See the "Checklist of issues suggested for study. Non-paper by the Chair", 4 June 1997.)

[2] Unless otherwise noted, all instruments cited herein may be found in UNCTAD (1996a).

[3] Before the ATC took effect on 1 January 1995, bilateral negotiations had established textile quotas, governed by the Multifibre Arrangement. This system departs from basic GATT non-discrimination principles. The ATC will terminate by integrating the sector fully into normal WTO trade rules.

[4] A similar debate arose over whether exports of Honda automobiles from Marysville, Ohio, in the United States should be considered United States or Japanese autos. This issue also relates to the discussion of regional trade arrangements and rules-of-origin policies.

[5] In a recent development, Toyota announced plans for a new automobile plant in France, which that

country now welcomes, in part as a way to encourage more employment-generating FDI.

[6] The FDI amounts involved are, however, still modest; see UNCTAD, 1998b.

[7] This discussion of regional free trade agreements (FTAs), similar to the NAFTA illustration used in section I of this chapter, focuses on how such trade measures can induce FDI flows. A related concern, particularly for developing countries considering membership in an FTA, is where the FDI would locate among member countries. For an examination of the various economic, policy and business facilitation determinants affecting FDI location, including among common FTA members, see UNCTAD, 1998b, chapter IV.

[8] Countries in transition from former centrally planned economies can be particularly vulnerable to anti-dumping pricing methodologies. When market forces in these economies do not provide enough accurate information on average production costs, the importing government may choose "surrogate" countries and simulate "constructed costs" based on input prices in those economies. The choice of "surrogates" can be quite arbitrary, however, leading to significant anti-dumping penalties against imports from the transitional economies. See Moran, 1998, pp. 110-111.

[9] See WTO dispute panel ruling on this matter (Reports: WT/DS 27/R/ECU WT/DS 27/R/GTM-WT/DS 27/R/HND, WT/DS 27/R/MEX and WT/DS 27/R/ USA) as modified by an Appellate Body ruling (Report: WT/DS 27/AB/R) and adopted by the Dispute Settlement Body on 25 September 1997.

[10] For a recent critical review of EPZs, see ILO (1998).

[11] "Vietnam: US$ 2.5 billion flows into EPZ", *The Saigon Times Daily*, 14 May 1997.

Chapter 26. Lessons from the MAI*

Executive summary

This chapter considers the factors that contributed to the decision of the members of the Organisation for Economic Co-operation and Development (OECD) to discontinue the negotiations on the Multilateral Agreement on Investment (MAI), and draws lessons that could be of use for future negotiations of international investment agreements (IIAs). The MAI negotiations, especially in the latter stages, attracted considerable attention in the public and private sectors, as well as civil society. These discussions are likely to have an effect on future negotiations of IIAs. Therefore, this chapter aims to enhance the understanding of the issues involved in, and the lessons from, the MAI negotiations.

The MAI negotiations set out to provide high standards for the liberalization of investment regimes and investment protection between the OECD member countries and, eventually, other interested non-member States. While the detailed and extensive exchange of views that took place in the negotiations pointed to a convergence of views on a number of substantive areas, various outstanding issues remained at the time the negotiations were suspended.

The main outstanding issues related to the topics of definition of investment, exceptions to national and most-favoured-nation treatment, intellectual property, cultural exception, performance requirements, labour and environmental issues, regulatory takings, and settlement of disputes. These issues are likely to be difficult issues in any other future negotiations, be it at the bilateral, regional or multilateral levels.

In addition to these outstanding issues, an inquiry into the broader political context within which the MAI negotiations took place provides a more complete perspective on the factors that contributed to their suspension and eventual discontinuation. Broader systemic factors included firstly, opposition of non-governmental organizations (NGOs) to the underlying philosophy, objectives and some of the substantive provisions under discussion, as well as the process of negotiations, which in their view was too closed and opaque. Secondly, the initial strong support of the business community for the MAI negotiations waned, after it became clear that no significant liberalization was to ensue, and that the issue of taxation would be excluded from the ambit of the rules. Thirdly, the aftermath of the election of centre/left governments in a number of OECD countries ushered in new political priorities which, given that no compelling problems of investment protection existed in the OECD area, left little incentive for political leaders to push the negotiations forward. Thus, the opposition of NGOs, the limited interest of the business community, and the negative outcome of an overall political cost-benefit analysis combined with the outstanding substantive issues to seal the fate of the MAI negotiations.

The MAI was only one initiative amongst many bilateral, regional and plurilateral instruments related to foreign direct investment (FDI). The context in which IIAs are negotiated is increasingly being shaped by the process of economic globalization and the current policies of governments to attract FDI. These factors make IIAs instruments that contribute towards a predictable environment for the promotion, protection and treatment of FDI. At the same time, the same factors cast domestic policy matters onto the international level, such that the substantive discussions in negotiation of IIAs increasingly reflect the internationalization of the domestic policy agenda. The implications of this and the lessons to be drawn are firstly, that given the nature of the substantive issues involved in the negotiation of IIAs, they have become subject to particular scrutiny; therefore, transparency in the conduct of negotiations and the involvement and input of all stakeholders, including civil society, could facilitate securing the necessary support and legitimacy for IIAs. Secondly, as the negotiating

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arena moves from the bilateral to regional and from regional to multilateral levels, the complexity of negotiations increases and, thus, it maybe advisable to pursue modest and incremental approaches to setting the agenda for the negotiation of IIAs. The existence of a network of bilateral investment treaties (BITs) containing similar provisions by and between the negotiating parties does not necessarily indicate the readiness to proceed to another level of international commitments of amore extensive legislative character. Thirdly, while commitments undertaken in IIAs, by definition, contain obligations that limit to some extent the autonomy of the participating States, the willingness to provide for a certain degree of flexibility to allow countries to pursue their development objectives in light of their specific needs and circumstances could enhance the desirability and acceptability of international rule-making in the area of FDI.

Introduction

The 1990s have witnessed a dramatic increase in negotiating activity related to international investment instruments, mainly at the bilateral, regional and interregional levels. This responds to a need felt by Governments to strengthen intergovernmental cooperation on FDI, in recognition of the role that such investment plays in an increasingly globalizing world economy.

None of these efforts have attracted more attention than the MAI that the members of the Organisation for Economic Co-operation and Development (OECD) sought to negotiate, until the decision in December 1998 to discontinue the endeavour. This decision was preceded by a six-month period of assessment to reflect and consult with civil society (OECD, 1998c; UNCTAD, 1998b), after it became clear during the OECD Council meeting at ministerial level on 28 April 1998 that the MAI negotiations, which had been scheduled to be concluded on that occasion (a year later than originally planned),[1] were encountering significant difficulties, and after France announced that it would no longer send its delegation to participate in the negotiations.[2] The following is a brief discussion of what caused the MAI to fail.

Section I
Objectives of the MAI

Originally, the stated main purposes[3] of the MAI negotiations were to consolidate what the OECD had achieved so far on investment rules[4] in a single instrument, to allow for a more structured dynamic for the liberalization process, to make some of these rules legally binding (e.g. the national treatment instrument) and to make the legally-binding nature of the rules clear by adding provisions for the settlement of investment disputes arising out of the agreement.[5] The negotiations were preceeded by several years of preparations in the Committee on International Investment and Multinational Enterprises (CIME) and the Committee on Capital Movements and Invisible Transactions (CMIT). This allowed member countries to agree on the main elements that should feature in the negotiations (box 1). In May 1995, the OECD Council at the ministerial level announced "the immediate start of negotiations in the OECD aimed at reaching a Multilateral Agreement on Investment by the Ministerial meeting of 1997" (OECD, 1995b, p. 3). According to the mandate for the negotiations the MAI was to:

- "Provide a broad multilateral framework for international investment with high standards for the liberalization of investment regimes and investment protection and with effective dispute settlement procedures;
- Be a free-standing international treaty open to all OECD members and the European Communities, and to accession by non-OECD member countries, which will be consulted as the negotiations progress" (OECD, 1995b, p. 3).

As indicated in box 1, the MAI draft consisted of 12 major sections, including issues that are generally covered in BITs, as well as new issues. The technical work undertaken during the negotiations produced a number of important results. The evolution of the negotiations points towards a meeting of the minds among the delegations in various substantive areas, especially on those issues that were the traditional subjects of BIT negotiations.

At the same time, when the negotiations were suspended and, eventually, discontinued, a number of substantive issues remained to be

resolved; these are discussed in section II.[6] The reasons for the discontinuation of the negotiations also had much to do with the broader political context; these are discussed in section III.

Box 1. Structure of the MAI

The MAI Negotiating Text as of 24 April 1998 was structured as follows:

I. General Provisions
 Preamble

II. Scope and Application
 Definitions
  Investor
  Investment
 Geographical Scope of Application
 Application to Overseas Territories

III. Treatment of Investors and Investments
 National Treatment and Most-Favoured-Nation Treatment
 Transparency
 Temporary Entry, Stay and Work of Investors and Key Personnel
 Nationality Requirements for Executives, Managers and Members of Boards of Directors
 Employment Requirements
 Performance Requirements
 Privatization
 Monopolies/ State Enterprises/ Concessions
 Entities with Delegated Governmental Authority
 Investment Incentives
 Recognition Arrangements
 Authorization Procedures
 Membership of Self-Regulatory Bodies
 Intellectual Property
 Public Debt
 Corporate Practices
 Technology R & D
 Not Lowering Standards
 Additional Clause on Labour and Environment

IV. Investment Protection
 General Treatment
 Expropriation and Compensation
 Protection from Strife
 Transfers
 Information Transfer and Data Processing
 Subrogation
 Protecting Existing Investments

V. Dispute Settlement
 State-State Procedures
 Investor-State Procedures

VI. Exceptions and Safeguards
 General Exceptions
 Transactions in Pursuit of Monetary and Exchange Rate Policies
 Temporary Safeguards

VII. Financial Services
 Prudential Measures
 Recognition Arrangements

/…

Box 1 (concluded)

 Authorization Procedures
 Transparency
 Information Transfer and Data Processsing
 Membership of Self-regulatory Bodies and Associations
 Payments and Clearing Systems/ Lender of Last Resort
 Dispute Settlement
 Definition of Financial Services

VIII. Taxation

IX. Country-Specific Exceptions
 Lodging of Country-Specific Exceptions

X. Relationship to Other International Agreements
 Obligations under the Articles of Agreement of the International Monetary Fund
 The OECD Guidelines for Multinational Enterprises

XI. Implementation and Operation
 The Preparatory Group
 The Parties Group

XII. Final Provisions
 Signature
 Acceptance and Entry into Force
 Accession
 Non-Applicability
 Review
 Amendment
 Revisions to the OECD Guidelines for Multinational Enterprises
 Withdrawal
 Depositary
 Status of Annexes
 Authentic Texts
 Denial of Benefits

Source: UNCTAD, 2000a.

Section II Main Outstanding Substantive Issues[7]

A. Definition of investment

The MAI Negotiating Text envisaged an asset-based broad and open-ended definition of investment covering every kind of asset. The definition included an illustrative list of assets covered.

Although there was broad support for an asset-based definition of investment, a few delegations argued for the exclusion of portfolio investment from the MAI coverage and a few others found it difficult to accept an open definition. To deal with such difficulties, it was generally agreed that a broad definition called for appropriate safeguard

provisions (e.g. a balance-of-payments derogation). Moreover, a number of issues were identified whose appropriate treatment in the MAI needed further consideration, namely, indirect investment, intellectual property, concessions, public debt and real estate. With respect to the inclusion of intellectual property rights, the prevailing view was that the provisions of the MAI should not interfere with the provisions of the relevant WIPO Agreements (see below).

B. National and most-favoured-nation treatment

The MAI Negotiating Text provided for rights of entry and establishment on the basis of national and most-favoured-nation (MFN) treatment. These standards would apply also to all aspects of the operation of an investment after entry in a host country.

The contracting parties were allowed to lodge country-specific exceptions to the application of national treatment, MFN and other provisions of the MAI to be determined. List A was intended to include any existing non-conforming measures that a country would wish to maintain and any amendments thereto, provided these did not increase the restrictive nature of the measure. The MAI Negotiating Text did not impose rollback obligations, although future rounds of negotiations on liberalization were envisaged.

A provision in brackets contemplated the inclusion of a second list of country-specific exceptions (list B) which would include a number of limited but as yet unspecified matters (among those being discussed were, for example, the question of preferential economic policies for aboriginal peoples and minorities, culture and incentives) to be excepted from the application of national and MFN treatment.

The formulation of the standards of national and MFN treatment covering pre- and post-establishment were agreed upon, except for a few aspects. The negative list approach to exceptions on these standards and other provisions of the MAI was not controversial per se. But one delegation insisted that the schedules of country exceptions that parties would wish to file should be discussed and negotiated before the completion of the Agreement. Its position was that "up-front liberalization" would offer greater opportunities for increased investment flows than an as yet unspecified rollback mechanism. Most other delegations were skeptical about negotiating away proposed exceptions before an agreement on the text would have been reached. But they agreed to a proposal by the Chairperson in early 1997 to table their exceptions. This produced a considerable number of exceptions, with the quantity and the character of the exceptions varying greatly between countries, raising the question of the balance of commitments. A number of them may have been of a tactical nature, i.e. they were meant to be removed in exchange for concessions. Other exceptions were added for prudential reasons, reflecting uncertainty as to the actual effect of some of the agreed provisions. More generally, agreeing on a common methodology for scheduling negative lists remained an open question until the end. The wide differences in the character of the exceptions listed made it difficult to compare them and raised questions of legal certainty.

The fact that even otherwise liberal countries had tabled many exceptions to liberalization commitments suggested the possibility that the liberalization process under MAI would not go beyond what had already been achieved through the OECD Liberalisation Codes; for delegations seeking better market access, this was discouraging. Others found the current level of liberalization under the OECD Codes sufficient, since they sought to establish a framework within which further liberalization could be achieved progressively.

Another outstanding matter related to the inclusion of a list B of exceptions. There were different views with respect to this draft article, which would allow new non-conforming measures to be introduced after the Agreement came into force. One view was that the unspecified and potentially open-ended nature of the exceptions allowed in such a provision might undermine the MAI disciplines. Another view was that such a provision would allow for flexibility and thus make it easier to preserve the high standards in the Agreement.

During the last stages of the negotiations before they were suspended, several proposals were made with a view to easing the strict application of the standstill principle while maintaining the overall level of liberalization. One such proposal called for the imposition of compensatory adjustments on an MFN basis with respect to non-conforming measures.

C. Subnational authorities

Regarding the question of the application of the MAI to subnational authorities, the lists of exceptions tabled by one delegation appeared to exclude subnational authorities in practice from many MAI obligations. Another delegation made the question of binding subnational authorities conditional upon a satisfactory balance of rights and obligations. A potential solution of this matter lay along the GATT lines, which impose an obligation upon federal States to take all reasonable measures to ensure compliance with its terms by subnational authorities.

Moreover, the application of the MAI to subnational authorities raised the question of whether the standard would be met if the investor were accorded "in state" treatment, or whether it would be sufficient to apply the treatment accorded to investors in any other state or province. A proposal was made that foreign investors should be accorded "in state" treatment.

D. The REIO clause

A regional economic integration organization exception (REIO clause), as proposed by the European Union, would have provided for the possibility of granting preferential treatment to some partners without having to extend it to all the parties to the MAI. It would apply to measures taken in the context of such regional economic integration organizations.

Some delegations argued that the REIO clause ran counter to some of the main objectives of the MAI, which were to achieve non-discriminatory market access and post-entry treatment within the MAI area. Indeed, one of their main negotiating purposes was to ensure for their investors market access to regional economic integration organizations on a par with access by investors of these organizations to their countries. In defence of their proposed REIO clause, the European Union argued, however, that the treatment extended by members of an integration group to each other depended on their acceptance of far-reaching decision-making mechanisms, including majority voting, which other countries had not accepted. In addition, the mutually accorded treatment within the REIO extended to fields not covered by the MAI non-discrimination clauses, such as the mutual recognition of diplomas or standards, or positive discrimination (i.e. the better treatment of other member States operators compared with a member State's own investors). According the benefits of such regional integration schemes fully and automatically to countries not committed to those principles of integration would be very difficult.

A compromise on this matter was explored in keeping with the approach taken in other agreements, notably GATT Article XXIV/GATS article V.[8] However, the divergence of views remained to the end, in particular over how broad or narrow a REIO clause, if at all acceptable, should be. The broader such a clause, the more it was perceived as upsetting the balance of obligations.

E. Intellectual property[9]

At the time of the discontinuation of the negotiations, the status of the discussions on intellectual property were that the MAI would include a separate provision on this subject which would explicitly exclude the application of national and MFN treatment obligations in this area beyond those in existing intellectual property agreements, notably the Paris Convention and the WTO TRIPS Agreement.

F. Cultural exception

A general cultural exception clause proposed by one delegation stated that "nothing in this agreement shall be construed to prevent any Contracting Party to take any measure to regulate investment of foreign companies and the conditions of activity of these companies, in the framework of policies designed to preserve and promote cultural and linguistic diversity."

Several delegations proposed from the outset that cultural industries should be exempted from the MAI coverage. The above-mentioned general exception clause was not discussed because the concept of a general cultural clause was not acceptable to some delegations. One possible solution might have been the inclusion of carefully defined cultural exceptions in the List B of exceptions; another might have been to adopt a bottom-up approach instead of a top-down one to cultural industries by including specific obligations for culture that the parties would accept in a separate schedule, subject to transparency commitments.[10]

G. Performance requirements

The MAI would have prohibited the imposition of a number of performance requirements, namely, a) trade-related: ratio of exports to total sales, domestic content, local purchases, ratio of local sales to exports; b) transfer of technology; c)location of headquarters; d) research and development; e) employment of nationals; and f) minimum and maximum level of equity participation. Trade-related investment measures listed under a) were prohibited whether mandatory or linked to incentives. All other requirements were allowed if voluntary and linked to advantages. The list was closed.

Although the issue of performance requirements was not a major controversial one for most OECD countries, its negotiation took more time than expected, mainly because negotiators realized the complexity of the obligations imposed. In particular, the fact that the MAI provision on performance requirements imposed absolute obligations, as opposed to relative obligations of national and MFN treatment, caused some delegations to take a cautious approach. Moreover, it was one of the issues NGOs identified in the MAI as having the effect of potentially eroding the regulatory capacity of host countries, and thus contributed to the public debate.

Delegations had agreed to consider a proposal that the provision on performance requirements was without prejudice to the rights and obligations of contracting parties under the WTO rules. Exceptions to protect the environment and to ensure that the parties' regional and small and medium-sized enterprises (SME) policies would not be undermined were also being considered.

H. Incentives

The MAI addressed incentives indirectly as part of provisions on national and MFN treatment, performance requirements and transparency. There was a preliminary understanding to include this matter in the built-in agenda of the MAI after its adoption.

After some initial discussions on whether or not incentives should be addressed explicitly in the MAI, it was decided to postpone negotiations on further disciplines on incentives aimed at avoiding excessive incentive competition. Such disciplines would have encountered opposition by subnational authorities with constitutional powers on foreign investment matters, as they continued to rely on incentives as an instrument to attract foreign investment away from other regions. Indeed, the provisions on national treatment were seen by some subnational authorities as a threat to their authority to formulate inward investment policy (see above). Some delegations argued that incentives were best dealt with on a regional or worldwide basis.

I. Labour and environmental issues

A labour and environmental package was proposed by the Chairperson which commanded considerable support: the preamble would make express reference to the parties' commitment to the relevant labour and environmental instruments such as the Rio and Copenhagen Declarations; in addition, the MAI would include a provision to prevent the lowering of labour, environmental or health standards as incentives in relation to a particular inward investment project.[11] *It was also agreed towards the end of the negotiations that the OECD Guidelines for Multinational Enterprises would be annexed to the MAI.*

There were early discussions among delegations on including a reference in the Preamble of the MAI to sustainable development and the relevant conventions on labour and the environment, and annexing the (non-binding) OECD Guidelines to the MAI in some way, as well as including provisions on labour and the environment. The idea of including provisions on not lowering labour and environmental standards developed later in the negotiations, in response to concerns for social and environmental impact raised by NGOs and trade unions. The issue remained controversial, with some countries opposing any reference to lowering standards. Negotiations also focused on whether the commitment not to lower standards would be binding on Governments or remain a hortatory statement. This issue remained unresolved. The above-mentioned compromise package by the Chairperson, which included legally binding language on not lowering standards (with the possibility that this clause might be submitted only to State-to-State settlement of disputes), was proposed towards the end of the negotiations.

J. Right to regulate vs. regulatory takings

The provision of the MAI on expropriation covered not only direct but also indirect takings. Accordingly, any measures taken by a host country having an effect equivalent to expropriation might need to be accompanied by prompt, adequate and effective compensation.

The coverage of indirect takings under expropriation provisions had been consistently followed in BITs and other international investment agreements, and it was thought to be a rather innocuous matter. However, it faced strong opposition in the MAI negotiations, especially after some cases raised under the investor-State provisions of NAFTA in the United States and Canada (e.g. the Ethyl case)[12] led NGOs to think that property rights of individuals could be given precedence over the right of society to regulate for environmental purposes.[13] More generally, NGOs argued that this provision could be interpreted to mean that any regulation that had the effect of limiting the profit-making capacity of an investment could be challenged as an act of indirect expropriation. NGOs argued that such an interpretation would effectively nullify many regulatory acts of Governments. As a result, this issue provoked much debate.

A proposal was made by the Chairperson to resolve this question, as part of his package of proposals on environment and related matters and on labour.[14] It suggested the inclusion of an interpretative note for the expropriation and general treatment articles. The proposal was in response to an agreement reached among delegations that the note should make it clear that the MAI would not inhibit the exercise of normal regulatory powers of governments and that the exercise of such powers would not amount to expropriation.

K. Settlement of disputes

The MAI Negotiating Text included clauses on the settlement of investment disputes that provided for consultations, conciliation and State-State and investor-State means of dispute resolution, the latter allowing for the possibility that such disputes could be submitted to third-party international arbitration.

The main issue was the settlement of investor-to-State disputes through third-party international arbitration. This means of resolving such disputes was not a traditional feature of customary international law, but it has become a standard feature in international investment agreements, notably in BITs,[15] NAFTA,[16] MERCOSUR and the Energy Charter Treaty. Therefore, objections to this clause came as a surprise in the MAI negotiations. One delegation objected to the clause as a matter of principle, as it would give foreign investors special privileges, not available to domestic investors, to challenge host country decisions regarding compliance with the MAI outside the relevant country's jurisdiction. Moreover, the argument was taken up by some NGOs as one of their main objections to the MAI. An additional argument was that this clause would give foreign investors and their lawyers too much control over systemic policy issues and the law-making process emerging from the application of the MAI rules.

Some countries did not object to investor-to-State dispute resolution in principle, but did raise objections to the extension of such a system to the pre-establishment phase, i.e. how to give non-investors the locus standi to file a claim against a potential host country.

Failure to resolve this matter would have thrown into question one of the main pillars of the MAI. Thus, there was a proposal for the creation of a standing appeals body to entertain both investor-to-State and State-to-State disputes, similar to the WTO appeals system. Such an appeals body would have been relatively easy to construct for State-to-State disputes. However, the issue raised technical difficulties with respect to investor-to-State, which were not examined in detail before the negotiations ended.

L. Extraterritorial application of national laws and secondary investment boycotts

A proposal existed for a draft article on conflicting requirements which would prevent a party from prohibiting an investor from another party outside its territory from acting in accordance with the latter party's laws, regulations or express policies, unless those laws, regulations or express policy were contrary to international law.

Another draft article on secondary investment boycotts was tabled which would prohibit parties from taking measures that impose liability on investors from another party, or to prohibit, or impose sanctions for, dealing with investors of

another party, because of investments an investor of another party makes, owns or controls, in a third country in accordance with regulations of such third country.

This issue emerged out of the debate generated by the Helms-Burton Act (Muchlinski, 1999b). It raised important long-term technical questions regarding the extraterritorial application of national laws – an issue that had been dealt with by the OECD for quite some time – and led many delegations to ask for additional safeguards against extraterritoriality.

A separate understanding was reached in 1997 between two delegations which envisaged the development of disciplines governing transactions in so-called illegally expropriated property, and on extraterritorial measures, as well as a provision on conflicting requirements to be eventually incorporated into the MAI.

M. Taxation

There were some initial discussions as to whether taxation, an issue of importance in investor location decisions, should be included in the MAI. This would have made taxation matters subject to national and MFN treatment, with country-specific exceptions. The discussions took place in a special working group of tax and investment experts and was a controversial issue during the first year. However, most delegations agreed to carve taxation out of the MAI negotiations, except for expropriation and transparency commitments, in order to avoid any potential clashes with the many bilateral agreements on the avoidance of double taxation.

Section III
The Broader Political Context

Independently of difficulties regarding the main outstanding issues in the MAI, a number of factors of a broader political nature intervened to bring about the MAI's demise. Different opinions have been expressed as to what caused the MAI to fail, each reflecting its own side of the debate, and it is perhaps premature to draw definitive conclusions on the matter.[17] Time and perspective will write the final story. But there is one thing on which most commentators seem to agree, namely, that the fate of the MAI was the result of a convergence of forces of a political, policy, social and economic nature, not all of which were foreseen when the negotiations began. Some of the main reasons that have been advanced in this respect are outlined below.

One reason for the failure of the MAI was a change in the political climate during the course of the negotiations and the emergence of a backlash against globalization. The new centre/ left Governments in a number of influential OECD countries brought in new political priorities, while the Asian crisis and its aftermath called for new caution regarding capital mobility. In 1995, when the negotiations began, it was generally believed among negotiators that the MAI exercise was primarily a task of assembling the technical elements from various existing international investment agreements into a rational whole and that the resulting agreement would have substantial systemic benefits which would appeal to their political constituencies. Three years later, a technical exercise had become a political one – and politicians tended to focus more on its costs.

Another important reason was that, although consultations with capitals and stakeholders had taken place during the preparatory process, negotiators underestimated the intensity of the public debate the MAI would provoke in some countries. (This had however been foreshadowed by public discussions in North America in connection with NAFTA, especially regarding the importance of labour and environmental issues.) Indeed, NGO influence – often through direct links to parliamentarians – brought about unexpected developments at a relatively late stage of the negotiations, which appeared to have caught negotiators by surprise. This was so, in particular, with respect to the issues of indirect expropriation and investor-to-State dispute settlement, issues that initially had been perceived to be relatively easy to deal with, as they had already been included in numerous international investment agreements. The NGOs' use of the Internet brought a new dynamic to the negotiating process, particularly when negotiating texts were distributed instantaneously.[18] In part, that was a reaction to what was perceived by NGOs as lack of appropriate consultations with key stakeholders in the framework of a process they considered to be closed and opaque (Dymond, 1999; Kobrin, 1998). But NGOs argued that their fears were just as much the result of real concern over the underlying philosophy and approach of the MAI, its structure and objectives, as well as a number of substantive issues; its failure to deal with competition, corruption and investor behaviour; the increase in

investor rights as regards the definition of investment; pre-establishment protection; performance requirements and expropriation (WWF, 1999).

The business community (which, along with trade unions, was associated with the negotiations through their advisory committees to the OECD) was initially an important constituency behind the MAI negotiations. However, it appeared to have lost interest as negotiations progressed, especially after it became clear that taxation provisions would be carved out of the MAI,[19] provisions on the environment and labour would be added and no significant new liberalization would be gained immediately.[20]

An added difficulty (pointed out especially by NGOs) was that the developing countries were not able to make a direct input into the negotiations. This was all the more important as the MAI was ultimately intended to be open to accession by all countries. The concerns of these countries were therefore not brought directly to the table, except through those developing countries that had obtained observer status.[21]

Thus, on the one hand, from the perspective of national decision makers there were no truly compelling problems of investment protection in the OECD area;[22] they needed to consider the possibility that the MAI might lower the protection standards that had already been accepted in BITs (with the possible effects that this might have on the negotiation of future BITs); they were uncertain as to whether many developing countries would join an agreement (which, considering that the OECD was already largely liberalized, was seen by some as the real payoff of an agreement); and they realized that an agreement would not necessarily lead to improved market access in the OECD area (at least in the short term). On the other hand, national decision makers saw no strong support from the business community; faced broad opposition from NGOs, who saw the MAI as “a metaphor for all that was to be feared from globalization” (Sauvé, 1998, p. 5); and (in some countries) even expected difficulties within their own coalition Governments. On balance, therefore, a political cost/benefit calculation suggested to some Governments that the value-added of the MAI was limited. In an organization that decides on the basis of consensus, the declared desire of even one Government not to proceed was sufficient to bring about an end to the negotiations.

Conclusions: Lessons

Countries have pursued various bilateral, regional, plurilateral and multilateral negotiating initiatives related to foreign direct investment. The MAI was only one of these initiatives. Treaty-making continues to be very active, with new issues being introduced in a number of cases.

Each individual negotiation of an international investment agreement has its own dynamics. It is therefore difficult to discern general negotiating principles. However, the intense activity that has taken place in recent years regarding international cooperation and rule-making in the area of FDI allows for some lessons of a general nature to be drawn from these experiences. They include:

Global and policy context

The processes of economic globalization and the new orientation of many Governments’ economic policies make international investment agreements instruments that contribute to establishing a predictable environment for the promotion, protection and treatment of FDI. Indeed, a number of common elements may now be found among such agreements. At the same time, given that FDI issues are closely interwoven with domestic policy matters, international investment agreements are subject to particular scrutiny.

Negotiating approaches

The complexity of negotiations increases as more and more countries are involved. By the same token, the more countries are involved, the more it may be advisable to take a modest and incremental approach. This raises questions of how broad the agenda of any particular set of negotiations should be, and how ambitious parties want to be concerning the nature of commitments. Too ambitious investment negotiating agendas at the international level may have a lesser likelihood of success than more modest and incremental propositions. In any event, the success of negotiations also depends upon the clarity with which each participant perceives the aims and objectives of the negotiations as a whole, as well as the forum in which negotiations take place. Given the complexity of negotiations, pre-negotiation preparation by the parties, and careful preparatory work on the substantive provisions, is therefore important.

Moving from the bilateral to the regional level and from the regional to the multilateral level involves not only quantitative changes (in terms of numbers of countries involved) but also qualitative changes (in terms of the nature of the agreements involved). In particular, while investment agreements, be they bilateral, regional or multilateral, by definition are legally binding, multilateral agreements are often perceived as having a more extensive international legislative character, whereas bilateral agreements are seen more as creating special law between the parties. Therefore, the existence of a network of BITs cannot be assumed to signal the preparedness of countries to move to another level, in spite of a convergence of perspectives in certain substantive areas as signified by existing BITs. At the same time, investment rule-making, which takes place in a framework that allows for broader trade-offs between the parties, may prove easier, whether this is at the bilateral, regional or multilateral level. In the final analysis, the desirability and effect of any particular agreement depends on its content.

Content

The negotiation of international investment agreements includes interrelated, difficult policy issues that at least in principle touch upon a whole range of domestic concerns, including, increasingly, social and environmental matters. Indeed, such agreements reflect increasingly the growing internationalization of the domestic policy agenda. Failure to take related issues of national policy properly into consideration and to reflect a certain balance between rights and responsibilities – either by including them within the same instrument or by establishing bridges with other binding and non-binding international instruments – might affect the overall acceptability of a particular investment agreement.

While international investment agreements by definition contain obligations that, by their very nature, limit to some extent the autonomy of participating parties, the need for a certain degree of flexibility to allow countries to pursue their development objectives in light of their specific needs and circumstances must be addressed. The more investment agreements go beyond promotion and protection issues and in particular attempt to include commitments to liberalize, the more complicated their negotiation becomes. Where liberalization is sought, progressive liberalization of investment regulations (going beyond "standstill") may be more acceptable than up-front and all-embracing commitments to liberalize.

Procedures

Transparency in the conduct of investment negotiations plays a key role in securing the necessary support and legitimacy for international investment agreements. The awareness, understanding and input of civil society from both developed and developing countries is important. The involvement of all interested parties from the initial stages of discussions or negotiations, through appropriate mechanisms, may prove crucial for the success of negotiations.

Notes

[1] The original intention was to complete the negotiations by April 1997 (OECD, 1995b).

[2] In his speech to the National Assembly announcing that France was no longer taking part in the MAI negotiations in the OECD, the Prime Minister of France explained that the process of consultations and evaluation of the negotiations had led his Government to conclude that there were some fundamental problems with the draft MAI, as it placed private interests above State sovereignty. France, he noted, would propose the fresh start of new negotiations in a forum where all actors, notably the developing countries, could be involved (France, le Premier Ministre, 1998).

[3] For a detailed discussion of the rationale for the MAI, see Witherell, 1995.

[4] The MAI was preceded by a number of OECD instruments on investment, notably the Codes of Liberalisation of Capital Movements and Current Invisible Transactions; the Declaration and Decisions on International Investment and Multinational Enterprises which, in turn, encompass decisions on National Treatment, Incentives and Disincentives and Conflicting Requirements; and Guidelines for Multinational Enterprises; the Convention on Combating Bribery of Foreign Officials; and the draft OECD Convention on the Protection of Private Property, which sets out standards for the treatment and protection of foreign investors in host countries (the Convention was approved by the OECD Council but never opened for signature; it had a major influence on the development of BITs which OECD countries negotiated with developing countries in order to protect their investors against non-commercial risks) (UNCTAD, 1996a).

[5] Taken together, and through their various review processes, the OECD instruments currently provide for pre- and post-establishment national treatment; free repatriation of profits and capital; transparency of regulations; a mechanism for consultation to deal with problems; peer review to

promote rollback of remaining restrictions; and voluntary guidelines for the behaviour of transnational corporations, notably with respect to adherence to economic and social objectives of host countries, environmental and consumer protection, competition and restrictive business practices, corporate governance, accounting and reporting, taxation, conditions of labour, and science and technology.

[6] For a brief account of the highlights of the main provisions of the MAI and the MAI negotiating process, see UNCTAD, 1998b, chapter III.

[7] The texts of the provisions discussed in this section are those contained in the MAI Negotiating Text, as of 24 April 1998 (OECD, 1998d; reprinted in UNCTAD,2000a). There were many country proposals for the draft text. These were included in annex 1. Annex 2 contained the Chairperson's package proposal including texts on environment and related matters and on labour, among other things.

[8] Article V of GATS dealing with economic integration provides that the GATS shall not prevent any of its members from being a party to or entering into an agreement liberalizing trade in services between or among the parties, provided that certain conditions are met. In evaluating whether these conditions are met, consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization among the countries concerned (GATS, Article V, 1.2).

[9] For an in-depth discussion of the issues raised in the MAI negotiations with respect to intellectual property, see Gervais and Nicholas-Gervais, 1999.

[10] On completion of the Uruguay Round, only three OECD countries (Japan, New Zealand and the United States) undertook specific commitments in the audio-visual industry; the other OECD countries, including the European Union and its members, did not agree to a standstill commitment with respect to mode 3 of the GATS – establishment and commercial presence – in this industry. In fact, out of 134 countries participating in the GATS negotiations, only 13 undertook specific commitments.

[11] See Chairperson's Proposals, MAI Negotiating Text of 24 April 1998, annex 2, op. cit.

[12] The United States-based Ethyl Corporation sued the Government of Canada for damages when the Canadian Parliament, for environmental and health reasons, prohibited the importation and trade between Canadian provinces of a fuel additive produced by Ethyl. The Ethyl Corporation claimed that Canada had violated its NAFTA commitments on expropriation and compensation, performance requirements and national treatment (Kobrin, 1998). In the end, the parties agreed to settle the case.

[13] On regulatory takings see Graham, 1998.

[14] See MAI Negotiating Text, annex 2, "Chairman's proposals on environment and related matters and on labour." One delegation also contributed a package of additional proposals on environment, including new language for an interpretative note on "in like circumstances" in the national and MFN treatment articles (UNCTAD,2000a).

[15] However, out of some 1,700 BITs, less than 10 per cent are between OECD countries.

[16] In early 1999, Canada sought to introduce interpretative changes to the NAFTA to restrict the ability of private companies to seek compensation for government regulations that damage their business.

[17] Indeed, the failure of the MAI has already inspired considerable literature. See, among others, Canner, 1998; Dymond, 1999; Gervais and Nicholas-Gervais, 1999; Graham, 1998; Henderson, 1999; Huner, 1998; Kline, 1999; Kobrin, 1998; Lalumière et al., 1998; Muchlinski, 1999b; Picciotto, 1998; Sauvé, 1998, 1999; WWF, 1999. For sources of information on the MAI and arguments in favour and against it, see the OECD website on the MAI (http://www.oecd.org/daf/cmis/mai/negtext.htm); for links to other websites, go to www.foreign policy.com.

[18] For a discussion of the impact of an electronic global civil society on political authority and power, see Rothkopf, 1998, and Mathews, 1997.

[19] The business community was interested in an additional national treatment tool and access to investor-State dispute settlement procedures on this issue.

[20] Parts of the business community had suggested investment negotiations in the WTO; see ICC, 1996.

[21] The following non-OECD economies participated in the negotiations as observers: Argentina; Brazil; Chile; Estonia; Hong Kong, China; Latvia; Lithuania; and the Slovak Republic. In addition, the OECD secretariat carried out an outreach programme.

[22] According to one negotiator, "the success of the negotiations would have the same result as their failure" (Dymond, 1999).

Chapter 27. Foreign Direct Investment and Development*

Executive summary

This chapter considers the role of foreign direct investment (FDI) in development. It is meant to give an overview in respect of this topic. At the same time, it provides the broader economic underpinnings for the specific issues relating to international discussions or negotiations on investment which are addressed in other chapters in these volumes.

The chapter starts with a discussion of the effects of FDI on development through trade, one third of which takes place within corporate production systems. The reason for starting with the trade effects of FDI are twofold. *Primo*, trade has traditionally been the principal mechanism linking national economies. FDI does have a similar linking function and, therefore, it is interesting to ascertain whether, and to what extent, the two linking functions reinforce each other. *Secundo*, and perhaps more importantly, the close, and growing, interrelationship that exists between trade and investment implies that trade policy issues and investment policy issues increasingly cannot be adequately addressed in isolation from one another. Further progress in the field of trade liberalization, therefore, is likely to necessitate an in-depth assessment of the trade implications of investment; and, conversely, effective action on FDI issues cannot be carried out without paying due attention to the interconnections that exist between trade and investment.

The trade effects of FDI depend on whether it is undertaken to gain access to natural resources or to consumer markets, or whether FDI is aimed at exploiting locational comparative advantage and/or other strategic assets such as research-and-development capabilities. Such trade effects are the result of the package of tangible and intangible assets that transnational corporations (TNCs) can bring to a host country through FDI or such other relationships as subcontracting, and which, in an increasingly liberalizing and globalizing world economy, acquire considerable importance, particularly as regards developing countries, for competing successfully in world markets.

The impact of FDI on development goes well beyond its linkages with trade. By its very nature, FDI brings into the recipient economy resources that are only imperfectly tradable on markets, especially technology, management know-how, skilled labour, access to international production networks, access to major markets and established brand names. These assets can play an important role in the modernization of the national economy and in the acceleration of economic growth. In addition, FDI can make a contribution to growth in a more traditional manner, by raising the investment rate and expanding the stock of capital in the host economy.

It has thus been widely recognized by governments – as reflected in paragraph 36 of "A Partnership for Growth and Development" adopted by UNCTAD IX in 1996 – that "foreign direct investment (FDI) can play a key role in the economic growth and development process. The importance of FDI for development has dramatically increased in recent years. FDI is now considered to be an instrument through which economies are being integrated at the level of production into the globalizing world economy by bringing a package of assets, including capital, technology, managerial capacities and skills, and access to foreign markets. It also stimulates technological capacity-building for production, innovation and entrepreneurship within the larger domestic economy through catalysing backward and forward linkages" (UNCTAD, 1996e).

There are areas, however, in which the impact of FDI can be negative, e.g. in cases where competition is stifled, restrictive business practices are used or transfer prices are manipulated. Small economies, furthermore, may need to guard against

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too much FDI too quickly: flows of FDI that are too large for the absorptive capacity of the host economy are likely to bring about negative side effects such as the appreciation of the exchange rate, which in turn has a negative impact both on export development and import substitution. The impact can also be suboptimal; this is the case where FDI leads merely to the exploitation of static comparative advantage and to a continuing reliance on existing local endowments. Finally, the impact of FDI can be optimized by appropriate policies aimed at encouraging the full exploitation of dynamic competitive advantages through the upgrading and strengthening of the domestic productive and technological base.

Thus, the effects of FDI on development often depend on the initial conditions prevailing in the recipient countries, on the investment strategies of TNCs and on host government policies. Governments, therefore, cannot be passive. The contribution that FDI makes to development can be enhanced by policies that do not remain confined to the mere liberalization of FDI regimes and the granting of legal protection and guarantees to foreign investors. There does indeed exist a wide array of policies that can be used to stimulate greater learning, innovation and linkage effects as well as to promote trade and employment gains. Government action needs to aim at fostering, channelling and complementing FDI. Beyond these challenges to national policy, the growth of FDI and the emergence of integrated international production systems raise a number of new policy issues which, increasingly, require international attention. It is the purpose of this chapter to assist both in the assessment of relevant issues by national policymakers and in discussions at international fora.

Introduction

TNCs are firms that control assets and engage in the production of goods and services in more than one country.[1] These activities cover the entire value-chain of investment and production, ranging from raising capital, establishing new production facilities or acquiring productive assets, and engaging directly in the manufacture of goods and services, to developing new technologies. TNCs engage in these activities in countries outside their home economies by means of FDI,[2] as well as of non-equity arrangements (such as licensing, franchising, original equipment manufacturing, or the subcontracting of components or finished goods) that may be closer to arm's-length arrangements (Buckley, 1993). International production by TNCs, based on resources and capabilities drawn from the different locations in which TNCs operate, has important implications for development, especially of host developing countries.

Firms invest abroad because of the existence of a conjunction of firm-specific assets from which they can derive rents (ownership advantages); difficulties or higher costs in exploiting these assets through arm's-length transactions (internalization advantages); and location-specific advantages of individual countries (Dunning, 1981, 1992a, 1992b). The location-specific advantages that are found to be the most appealing to TNCs are the size of the domestic market, the growth of the domestic economy, openness to international trade, and attractive combinations of cost and productivity, along with a base of capable suppliers (UNCTC, 1992a; UNCTAD, 1998b). FDI, non-equity arrangements and trade are all part and parcel of the overall strategies of TNCs. Given the importance of TNCs and FDI in the world economy, the manner in which these strategies are pursued has important effects on development. These effects are primarily related to the capital, technology, managerial capabilities, employment, skills and access to markets that TNCs can provide. The intangible assets with growth-promoting qualities that TNCs can provide are particularly important for developing countries.

The globalization of the world economy entails a growing interpenetration among economies (UNCTAD, 1994a, chapter III). The role of FDI in this process has become increasingly important (table 1); in recent years, world FDI has grown more rapidly than world exports, and sales of foreign affiliates exceed world exports in value (UNCTAD, 1996d). FDI, moreover, involves a linking of production systems and, thus, represents "deep" integration, as it involves relationships at the level of production that bring factors of production together, as compared with "shallow" integration through trade, which generally involves arm's-length relationships (UNCTAD, 1993b). Integration through FDI itself is becoming deeper as an increasing number of TNCs pursue complex integration strategies that create closely integrated production and distribution networks rather than stand-alone or simple integration strategies with limited linkages within the overall networks of

Table 1. Selected indicators of FDI and international production, 1982-2003
(Billions of dollars and per cent)

Item	Value at current prices ($ billion)			Annual growth rate (Per cent)						
	1982	1990	2 003	1986-1990	1991-1995	1996-2000	2000	2001	2002	2003
FDI inflows	59	209	560	22.9	21.5	39.7	27.7	-41.1	-17.0	-17.6
FDI outflows	28	242	612	25.6	16.6	35.1	8.7	-39.2	-17.3	2.6
FDI inward stock	796	1 950	8 245	14.7	9.3	16.9	19.1	7.4	12.7	11.8
FDI outward stock	590	1 758	8 197	18.1	10.7	17.1	18.5	5.9	13.8	13.7
Cross border M&As	..	151	297	25.9 [a]	24.0	51.5	49.3	-48.1	-37.7	-19.7
Sales of foreign affiliates	2 717	5 660	17 580	16.0	10.2	9.7	16.7	-3.8	23.7	10.7
Gross product of foreign affiliates	636	1 454	3 706	17.4	6.8	8.2	15.1	-4.7	25.8	10.1
Total assets of foreign affiliates	2 076	5 883	30 362	18.2	13.9	20.0	28.4	-5.4	19.6	12.5
Export of foreign affiliates	717	1 194	3 077	13.5	7.6	9.9	11.4	-3.3	4.7	16.6
Employment of foreign affiliates (thousands)	19 232	24 197	54 170	5.6	3.9	10.8	13.3	-3.2	12.3	8.3
GDP (in current prices)	11 737	22 588	36 163	10.1	5.1	1.3	2.7	-0.9	3.7	12.1
Gross fixed capital formation	2 285	4 815	7 294	13.4	4.2	2.4	3.8	-3.6	-0.6	9.9
Royalties and licences fees receipts	9	30	77 [b]	21.3	14.3	7.7	9.5	-2.5	6.7	..
Export of goods and non-factor services	2 246	4 260	9 228	12.7	8.7	3.6	11.4	-3.3	4.7	16.6

Source: UNCTAD, 2004b.

[a] 1987-1990 only.
[b] 2002.

TNCs. Under complex integration strategies, firms engage in considerable cross-border specialization through a vertical and horizontal intra-firm division of labour across borders, including increasingly at the functional level (UNCTAD, 1993b, chapter V).

From the viewpoint of TNCs, complex integration strategies allow firms to reap gains associated with economies of scale and scope for the production of an intermediate product or a production-related function. Such strategies also permit firms to locate each production activity or corporate function where the cost-productivity combination is the most favourable from the viewpoint of achieving maximum profitability for the TNC as a whole. One implication is that countries, regardless of their level of development, maybe in a position to host a specific TNC activity that matches their locational advantages. Not having to attract the full range of production activities of a TNC gives countries the ability to specialize in "niche" production.

This chapter examines the role of TNCs in host developing countries' growth and development.[3] It is organized as follows. Section I reviews briefly the recent changes in developing countries' attitudes and policy regimes towards TNCs and the surge of FDI to developing countries during the 1990s. Section II looks at the relationships between, and impacts of, FDI and other forms of TNC activity on trade, and, through trade, on growth and development. Section III examines channels through which FDI affects directly growth and development in host developing countries; these include, in the main, effects on savings and capital formation, technology transfer and domestic innovation, local entrepreneurship, and employment, training and human capital formation. Section IV draws the discussions of trade effects and development effects together, and considers some policy implications for host and home countries.

Section I
Trends in Policies and Investment Flows to Developing Countries

During the past 20 years or so, there has been a sea-change in the attitudes of developing country governments towards FDI. Until the mid-1980s, many governments viewed TNCs with suspicion and tended to curtail their freedom of action through outright prohibitions, limitations on the industries in which they were allowed to operate, restrictions on profit remittances and capital repatriation, or the imposition of stringent performance requirements (albeit often in exchange for tax breaks or subsidies). By contrast, all developing countries now welcome FDI and have liberalized considerably their rules and regulations in this respect (UNCTAD,1995a, chapter VI; UNCTAD and the World Bank, 1994): over the period 1991-2003, some 94 per cent of a total of 1,885 changes in the FDI regimes of

countries were in the direction of a more favourable environment for TNCs (UNCTAD, 1998b, 2004b).

The liberalization trend entails a reduction of obstacles to the operation of TNCs; a strengthening of the standards of treatment of foreign affiliates; and efforts to ensure the proper functioning of markets, especially through the use of competition policies. For example, in most developing countries, TNCs are now allowed to operate in most industries of the economy. In addition, limitations on profit remittances, the repatriation of capital and other transfers of funds have been generally dropped or relaxed significantly. The practice of imposing performance requirements (UNCTC and UNCTAD, 1991; UNCTAD, 2003c), often as a counterpart for tax incentives, is also becoming less important.[4] Access to incentives available to domestic firms has been granted in most of the reformed FDI regimes. In fact, some countries are granting foreign affiliates better than national treatment, in the sense that they are the beneficiaries of incentives that are not available to domestic producers. It was often the case in the past that foreign affiliates were denied access to domestic capital markets, on the ground that this restriction forced TNCs to finance their investments in the host country by bringing in scarce foreign exchange; in many countries these limitations have either been dropped or are simply no longer operative. Similarly, there is now a much more widespread acceptance of the principles of national treatment and fair and equitable treatment of foreign investors (Fatouros, 1993). The liberalization trend has also meant a dramatic decline – even virtual disappearance – of nationalizations of foreign affiliates since the peak reached in the mid 1970s; indeed, there is a widespread trend towards privatization (including of erstwhile nationalized foreign affiliates). Finally, an increasing number of countries are revising their intellectual property regimes and adopting new competition laws.

These numerous and diverse changes in policies at the national level in respect to all aspects of policies related to FDI and TNC activities are a significant part of the context of the proliferation of international investment agreements. This is also the case because the liberalization trend is strong in all regions of the developing world and in the economies in transition, having gone furthest in Latin America, in part because policies in that region used to be very restrictive before the recent changes.

The liberalization of FDI regimes has been complemented with the signing of an increasing number of bilateral investment treaties. Of the 2,265 treaties in existence as of 31 December 2003, about two-thirds date from the 1990s and the early 2000s (UNCTAD, 1998b, 2004b). Increasingly, these treaties are no longer between developed and developing countries alone, but also between developing countries and between these countries and countries with economies in transition (UNCTAD, 2003a, 2004b). At the regional and multilateral levels, too, an increasing number of agreements deal with investment issues.

Indeed, and more generally, the situation is now one of competition over FDI, with incentives to attract such investment becoming more widespread and generous (UNCTAD, 1996f). Developing countries now perceive FDI as making a positive contribution to their development. Generally, changes in FDI regimes have been part and parcel of a broader set of reforms that include the opening up of the economy to foreign trade, greater emphasis in development strategies on attaining international competitiveness, and deregulation.

The swing in attitudes has been such that expectations may have become too high in terms of what TNCs can do. While they can, indeed, contribute to the development effort in many ways, the performance of the domestic sector is typically much more important. Moreover, the quantity and quality of FDI and the role of TNCs in development depend also on the policy environment in host countries and, equally importantly, on the productive assets available locally. On the policy side, this goes well beyond the mere liberalization of FDI regimes to include policies related to trade, exchange rates and, generally, macroeconomic stability. Deliberate efforts to improve human capital and the physical and social infrastructure can also be valuable ways to enhance the quality of FDI that countries can attract.

As the regulatory frameworks of developing countries have evolved, TNCs are engaged in a process of stock adjustment which has led to successively higher FDI inflows into developing countries since about the mid-1980s: from an average of $20 billion annually during 1983-1988 to an average of $93 billion in 1994-1995, reaching $172 billion in 2003. The share of

all developing countries in total FDI flows has grown significantly since the mid-1980s, from one-fifth to two-fifths (table 2). Asia alone is now receiving nearly a fifth of world FDI inflows, compared with one-tenth during the 1983-1988 period. Countries in Latin America and the Caribbean, on the other hand, saw their share of total FDI inflows decline sharply in the 1980s, owing to the protracted economic crisis in much of the region; during the 1990s, however, FDI inflows have returned substantially to that region. In Africa, FDI flows have moved up only slowly, implying a declining share in world flows. Reflecting the overall rise in FDI flows to developing countries, the ratio of FDI inflows to gross fixed capital formation in developing countries is now about one-and-a-quarter times that of developed countries – 10 per cent as compared with 5.6 per cent in 1996 (UNCTAD, 1998b, 2004b).

The flows of FDI have tended to concentrate in a few Asian and Latin American countries. In Asia, inflows into China loom large: its huge market and the availability of skilled and low-wage labour have been very attractive to TNCs. Since the opening up of the Chinese economy to inward investment, FDI inflows have surged, and the country now receives around 10 per cent of world inflows. These flows have also increased relative to the size of the Chinese economy, having risen from 0.6 per cent of gross domestic product (GDP) in 1983-1988 to about 5 per cent in the mid-1990s and roughy 4 per cent in 2003.

Investment in other Asian countries has also been large, representing, in the case of some East and South-East Asian countries, an intensification of trends that started in the early 1980s. During the 1990s, there have been sharp increases in FDI flows to India, Indonesia, Malaysia, Pakistan, Philippines, Republic of Korea and Singapore. Very recently, FDI inflows have been rising significantly in other countries as well (e.g. Thailand, Viet Nam and Sri Lanka). The region's economies have received investments not only from TNCs based in traditional home countries (especially Japan), but also from TNCs from the region itself, in particular from the Republic of Korea, Taiwan Province of China, Hong Kong (China) and Singapore. The underlying fundamentals suggest that Asia will remain an attractive investment location in the future as well.

In Latin America,[5] the countries receiving the largest inflows have been Brazil, Mexico, Chile, Argentina and Venezuela. However, several smaller recipients (e.g. Bolivia, Ecuador, Paraguay

Table 2. Regional distribution of FDI inflows and outflows, 1992-2003
(Billions of dollars)

Region/country	FDI inflows							FDI outflows						
	1992-1997 (Annual average)	1998	1999	2000	2001	2002	2003	1992-1997 (Annual average)	1998	1999	2000	2001	2002	2003
Developed countries	180.8	472.5	828.4	1 108.0	571.5	489.9	366.6	275.7	631.5	1 014.3	1 083.9	658.1	547.6	569.6
Western Europe	100.8	263.0	500.0	697.4	368.8	380.2	310.2	161.7	436.5	763.9	859.4	447.0	364.5	350.3
European Union	95.8	249.9	479.4	671.4	357.4	374.0	295.2	146.9	415.4	724.3	806.2	429.2	351.2	337.0
Other Western Europe	5.0	13.1	20.7	26.0	11.4	6.2	15.1	14.8	21.2	39.6	53.3	17.9	13.3	13.3
Japan	1.2	3.2	12.7	8.3	6.2	9.2	6.3	20.2	24.2	22.7	31.6	38.3	32.3	28.8
United States	60.3	174.4	283.4	314.0	159.5	62.9	29.8	77.6	131.0	209.4	142.6	124.9	115.3	151.9
Developing economies	118.6	194.1	231.9	252.5	219.7	157.6	172.0	51.4	53.4	75.5	98.9	59.9	44.0	35.6
Africa	5.9	9.1	11.6	8.7	19.6	11.8	15.0	2.2	2.0	2.6	1.3	-2.5	0.1	1.3
Latin America and the Caribbean	38.2	82.5	107.4	97.5	88.1	51.4	49.7	9.5	19.9	31.3	13.7	12.0	6.0	10.7
Asia and the Pacific	74.5	102.4	112.9	146.2	112.0	94.5	107.3	39.6	31.6	41.6	83.9	50.4	37.9	23.6
Asia	74.1	102.2	112.6	146.1	111.9	94.4	107.1	39.6	31.6	41.7	83.8	50.3	37.9	23.6
West Asia	2.9	7.1	1.0	1.5	6.1	3.6	4.1	0.5	-1.0	2.1	3.8	5.1	2.5	-0.7
Central Asia	1.6	3.0	2.5	1.9	3.5	4.5	6.1	-	0.2	0.4	-	0.1	0.8	0.8
South, East and South-East Asia	69.6	92.1	109.1	142.7	102.2	86.3	96.9	39.0	32.5	39.2	80.0	45.1	34.7	23.5
South Asia	2.5	3.5	3.1	3.1	4.0	4.5	6.1	0.1	0.1	0.1	0.5	1.4	1.2	0.9
The Pacific	0.4	0.2	0.3	0.1	0.1	0.1	0.2	0.1	-0.1	-	0.1	0.1	-	-
Central and Eastern Europe	11.5	24.3	26.5	27.5	26.4	31.2	21.0	1.2	2.3	2.5	4.0	3.5	4.9	7.0
World	310.9	690.9	1 086.8	1 388.0	817.6	678.8	559.6	328.2	687.2	1 092.3	1 186.8	721.5	596.5	612.2

Source: UNCTAD, 2004b.

and Costa Rica) have also had sharp increases in inflows of FDI over the 1990s (ECLAC, 1998, p. 7 and UNCTAD, 2004b, annex tables). FDI has responded favourably to improved macroeconomic conditions. In a number of countries, inflation has been brought under control and growth has resumed, albeit with some fluctuations. In addition, privatizations of public utilities and other State-owned firms have attracted large inflows of FDI.

The creation of the North American Free Trade Agreement (NAFTA) has been an important factor influencing FDI in Mexico. Several TNCs have established or upgraded production there in order to take advantage of the enlarged market provided by Mexico's membership in NAFTA. Investment inflows into Brazil have also responded to the pull of the larger market provided by the country's membership in the Southern Common Market (MERCOSUR) (together with Argentina, Uruguay and Paraguay). In Chile, there has been a long upswing in FDI, mainly in mining and other natural resource-related industries, dating back to 1987. A debt-equity swap programme that operated between 1985 and 1990 started the upsurge and attracted the attention of investors. The country's association with MERCOSUR is likely to encourage investment in manufacturing for that market.

Finally, concentration also characterizes FDI inflows to Africa. The largest recipients are Morocco, Equatorial Guinea and Angola, accounting together for about one third of FDI flows to the continent. Of the total, North Africa attracts more than a third, sub-Saharan Africa the balance.

Taking the developing world as a whole, FDI inflows are heavily concentrated in a few host developing countries: 18 economies accounted for over 90 per cent of total FDI inflows into developing countries in 2003 (i.e. 29 per cent of total world inflows). However, it is also the case that many small countries are able to attract large and growing FDI inflows relative to the size of their economies. In some countries where the absolute magnitudes of FDI are small – such as Chad, Gambia and Mali – the ratio of FDI to gross fixed capital formation is between 22 and 127 per cent (UNCTAD, 2004b, annex table B.5). Nonetheless, the fact remains that African countries have been unable to attract FDI in the amounts that would be warranted by their natural resources base and potential market size. The problems that make these economies less attractive to foreign investors are manifold, including political, economic, legal and institutional factors. Governments in Africa are acutely aware of them, and are making efforts to overcome them (UNCTAD, 1995b).

An important aspect of the surge in FDI during the 1990s is the impressive increase in outward investment by TNCs based in developing countries themselves, mostly (but not exclusively) to other developing countries (UNCTAD, 1993c; 1997c). Whereas only 2-3 per cent of all FDI outflows originated in developing countries at the beginning of the 1980s, this share was more than 7 per cent in 2000-2003 (table 2) (UNCTAD, 2004b, annex table B.2).

South, East and South-East Asian firms account for the bulk of these outflows. In these countries, export-oriented growth has led to the emergence of TNCs that invest in other countries of the region and in final markets in developed countries (UNCTAD, 1997c). As firms from the region improve their own competitive and technological capabilities, they have also begun to assume a leadership role. The most important feature of this pattern is that it is oriented towards the exploitation of new comparative advantages on world markets. This has required high rates of investment relative to GDP, as well as access to international markets (UNCTAD, 1995a, chapters IV and V); TNCs have had a role in this respect in several of the countries of the region. The growing degree of economic integration achieved within the region and the pattern of growth that has emerged (the so-called "flying geese formation") owes much to TNC activity (UNCTAD, 1995a, chapter V; Ozawa, 1992). In fact, for some of these countries, FDI outflows are now relatively more important than for major home countries of TNCs. The ratio of outward FDI to gross fixed capital formation in the early 2000s has averaged over 27 per cent in Singapore and about 50 per cent in Hong Kong (China). This ratio is higher than the one for developed countries, which was at about 15 per cent (UNCTAD, 2004b).

Some Latin American firms have also begun to make large investments abroad, mainly in other countries in the region. Companies that have developed firm-specific assets have led the process. There have also been instances of investment in final markets to support the exports of the investing firms, and an embryonic trend can be observed towards integrated production for regional markets, particularly in the context of

MERCOSUR. These trends in outward investment have contributed to the changes in attitudes towards FDI and TNCs in the countries concerned.

Section II
Effects on Development through Trade

This section discusses the relationship between FDI and trade and also the effect of TNCs on growth and development through trade. FDI has conventionally been regarded as a substitute or alternative to trade. Thus the first question that needs to be addressed relates to the relationships that exist between FDI and trade. In the manufacturing sector, the sequence that firms have usually followed in their internationalization is that they first export a product to overseas markets and, at a later stage, begin producing it in those markets (UNCTAD, 1996d, chapter III). This is because trade is less risky than FDI, partly because it involves less sunk costs. As a foreign market becomes consolidated, FDI may become desirable, first in small amounts and in ancillary activities (trading services, storage, repair, after-sales servicing), and later for the full production of the product. If the sequence holds, the direct effects of FDI are trade-replacing as far as any given product is concerned. This is of some concern for home countries and for their labour unions, who sometimes tend to oppose outward FDI on the grounds that it leads to job losses. However, even in this case, FDI may have positive indirect effects on trade and further investment flows, as it may give rise to a stream of exports of inputs, intermediate goods, machinery, and services. As a result, even in the manufacturing sector, the net effect of FDI on trade may well be positive and beneficial to the economies of host and home countries.

In the case of export-oriented investment, and as trade and investment barriers fall, such investments become increasingly important compared to those that are made just to service the domestic markets of the host country, increasing the likelihood of positive effects of FDI on trade. More generally, with the rise of integrated international production, trade and investment are now linked in complex ways and are increasingly jointly determined by the locational decisions of firms (UNCTAD, 1996d, chapter IV).

In the case of natural resources, FDI has always led to the expansion of trade. In fact, FDI has often been a precondition for trade on a large scale by many resource-based countries and is clearly trade creating. On the other hand, in the services sector, there are technical barriers to cross-border trade, as many services can be delivered to foreign markets only through FDI. However, investment in such services often creates new flows of imports of goods and tradable services into the host economy and, at the same time, strengthens the infrastructure of the production of tradable products.

The presumption of this section is that, for most developing countries, trade has positive effects on long-term growth.[6] There are two important reasons for this. The first is related to market size; most developing countries have relatively small domestic markets, because of low *per capita* income and/or small populations. The second reason is that, in most developing countries, investment and productivity growth are highly dependent on imported capital goods and technology. This means that investment and technology acquisition depend ultimately on the capacity to generate foreign exchange. In order to ensure a sustained rise in the investment rate and high productivity growth, a steady expansion in exports is required. Given the characteristics of developing country exports, which tend to be concentrated in one or a few commodities with low price and income elasticities of demand in world markets, the only way to achieve high and sustained rates of export growth without deteriorating terms of trade is through export diversification.

A. Direct effects

What do TNCs have to do with all this? The activities of TNCs, both of the FDI variety and also more arm's-length relationships between TNCs and firms in developing countries, have significant effects on trade flows. In order to understand the ways in which TNCs and FDI affect trade, one must distinguish between different types of FDI (and other TNC activity) according to the different objectives of TNC involvement in developing countries. Broadly speaking, one can distinguish between natural-resource-seeking investment, market-seeking investment, efficiency-seeking investment, and strategic-asset-seeking investment.[7]

Natural-resource-seeking FDI is the oldest form of TNC involvement in developing countries. It is undoubtedly trade-creating on the

production (or output) side: FDI is often a precondition for the production of primary commodities for foreign markets, especially in developing countries, and generates a stream of exports of natural resources that would not have otherwise occurred. From the side of inputs used and consumption generated, there are also positive trade effects, since natural-resource-oriented FDI is usually accompanied by a flow of imports of capital goods, specialized intermediate inputs, and consumer goods.[8] Additional gains can be derived by host countries through the processing of natural resources; trade policies prevailing in importing countries, however, particularly those leading to tariff escalation, tend to discourage local processing in developing countries.

Market-seeking FDI became the predominant motive for investing in the manufacturing sector of developing countries in the 1960s and 1970s during the heyday of import-substitution industrialization. This motivation also was paramount in the wave of United States investments in Europe in the early postwar period and in Japanese investment in the United States since the early 1980s. Generally, market-seeking investment in manufacturing is a gross substitute for exporting from the home country, and its existence is often due to import barriers in host countries. It has trade-reducing effects on the production side, but trade-creating effects in so far as inputs used in production are concerned, since import substitution leads to a change in the *composition* of imports towards intermediate inputs and capital equipment. Any market-seeking investment will also normally have multiplier effects on domestic demand and production, which could lead to significant indirect increases in imports.

There are causes other than trade barriers for market-seeking investment. In some cases, significant transport costs may make investment in a host country an efficient alternative to exporting to it. Differences in consumer tastes and the need to adapt a product to local conditions and inputs may also recommend catering to the domestic market through investment rather than exporting. In these cases, market-seeking FDI has no trade effects in production (since it does not replace exports) and positive effects in consumption. Indirect effects on trade are also positive.

Recently, the formation or strengthening of regional groupings has given rise to significant investments to serve the enlarged markets.[9] This has been most evident in the case of NAFTA, where there have been large investments in Mexico for the United States markets (both by United States-based TNCs and by TNCs from other home countries, especially Japan), and in Europe, where the Single Market programme (officially completed in 1992) gave rise to a wave of FDI inflows in the late 1980s and the early 1990s (UN-TCMD, 1993a). It has also been in evidence with investments by European TNCs (and others) in Central and Eastern Europe (countries with which the European Union first signed trade agreements and a number of which eventually became members of the European Union), and in Argentina after the establishment of MERCOSUR in the late 1980s.

While these investments may have an element of investment diversion and may have taken place elsewhere in the absence of the integration schemes, the large markets to which they are directed ensure economies of scale often absent in earlier market-seeking FDI.

This means that the probability that market-seeking investments may reduce the recipient country's welfare is much lower in these cases than in the tariff-hopping investments made during the import-substitution period. To the extent that they lead to efficient production and to the spread of such production, they may turn out to be welfare improving when the world economy is considered as a whole. They raise the rate of growth of recipient countries when they increase their capital stock. In these cases, investment is trade-creating in both production and consumption: it generates a new stream of exports from host countries and a stream of imports of components, inputs, capital equipment, and services from home countries.

Much of FDI in services is market-seeking. Since many services can only be delivered to foreign markets through FDI, in such cases FDI has no adverse trade effects on production and may have positive trade effects on consumption by inducing new exports of machinery and other services (consultancy and design, for example) from the home country of the investing TNC (UNCTC, 1989; Sauvant and Mallampally, 1993; UNCTAD and the World Bank, 1994). It may have indirect, longer-term positive effects on the exports of goods (or services) from host countries. For example, FDI in banking, telecommunications, or public utilities may lower the costs of these non-traded inputs and render host country producers internationally competitive in several sectors where no exports had taken place prior to the foreign

investments. This situation may change as services become more tradable (Sauvant, 1990; UNCTAD, 1994b, 2004b).

Efficiency-seeking FDI occurs when TNCs locate part of their value-added chain abroad in order to improve the profitability of their overall operations. The oldest such investments have been labour-seeking investments. As wages rose in home countries, TNCs sought to obtain access to low-cost labour in developing countries by locating in them the labour-intensive segments of their production processes. This has been a characteristic of some Japanese investment in Asia; United States investment in Mexico, Central America and Asia; and European investment in Central and Eastern Europe. More recently, as real wages have risen over time in some of the Asian countries that were first to industrialize with an outward-oriented strategy, labour-seeking investment has moved on to other, lower-wage Asian countries.

Labour-seeking investments are generally trade-creating, since they give rise to exports from host countries. In many cases, they also lead to a diversification in the composition of host-country exports towards manufactures. On the consumption side, such investments also tend to be trade creating, since a large share of the raw materials used in production (and a certain proportion of wage goods) are imported.

Of course, labour-seeking operations of TNCs in developing countries can take forms other than FDI. Labour-intensive processes can be shifted to developing countries through various contractual arrangements between domestic firms and TNCs or foreign buyers (and even large firms from home countries that are not, strictly speaking, TNCs). All of these forms of relationships with international firms are trade creating. The benefits of FDI and other forms of involvement by TNCs in labour-intensive industries in developing countries are closely related to assisting host countries in overcoming informational disadvantages related to accessing markets. In the absence of TNC involvement, it may be very costly for firms in developing countries to penetrate the markets of developed countries. Information is opaque and costly to obtain. TNCs and buying groups in developed countries provide several kinds of information that are crucial to success in these markets: they have ready-made marketing channels and contacts with clients and distributors, and they often supply product design, technology, and key inputs.

The shifting of labour-intensive processes to developing countries has probably been the most important factor behind the growth of their manufactured exports in the past three decades, and TNCs have been among the most important agents of their comparative advantage (UNCTAD, 2002c). However, local firms have also played an important role, especially in East Asia. Elsewhere, TNCs (including those from other developing countries) have been more significant, but the benefits have been highly concentrated in a few countries. Furthermore, the fact that export activity has been driven by a static set of advantages (cheap labour) has sometimes meant that the benefit to countries diminishes once this is exhausted (when wages rise). TNCs can and do upgrade their export activity from host countries, but this is sometimes in response to government policies to raise the quality of factor inputs and to induce investors to move into more complex activities. It is not always because TNC investment is raising the basic competitive capabilities of host countries: TNCs respond to opportunities presented by growing skills and supply efficiency that arise from other sources.

The location of labour-seeking operations abroad has often been criticized in home countries of TNC parent firms, in particular by trade unions, on the grounds that they cause unemployment. This need not be the case, since, as pointed out earlier, they create a flow of exports of components, inputs and machinery; in addition, they create employment in highly-skilled services (e.g. design or marketing). More than reducing employment at home, labour-seeking investments change its composition towards higher-wage employment, which causes unemployment at the lower end of the wage scale but raises the demand for highly skilled and high-wage labour.

Labour-seeking investments also occur in the services sector. For example, a growing part of data processing, which is very labour-intensive, can and does takes place in developing countries, where labour costs are lower than in the home country of the investing TNC (e.g. software development in India or data-processing in Barbados). These services can be undertaken on behalf of a services or manufacturing TNC, either by an affiliate or by a subcontractor in a developing country (UNCTAD, 2004b).

There are other, more complex, forms of efficiency-seeking investments that are closely related to the emergence of integrated international production. One increasingly important form for

developing countries is *component outsourcing* (UNCTAD, 1995a, chapter IV). The main driving force of this has been the increase in wages in the developed countries, particularly in Japan and Europe. A secular appreciation of the yen and European currencies *vis-à-vis* the United States dollar can be an incentive for this kind of FDI by Japanese and European TNCs wishing to remain globally competitive. It has also been extensively used by TNCs from the United States in certain industries, such as automobiles, electronics and personal computers. The main locational advantage of some developing countries is low unit labour costs (related not only to relatively low wages, but high labour productivity as well). These operations require greater skills than is typical of labour-seeking FDI. Therefore, they tend to be concentrated in the outward-oriented and relatively industrialized developing countries.

The extreme form of component outsourcing is original equipment manufacturing, wherein a firm in a developing country undertakes to supply a TNC with a fully made manufacturing product that will bear the brand name of the TNC. This is one of the forms that inter-firm agreements have taken so far between TNCs and firms in developing countries. Several firms from the Republic of Korea began their penetration of markets of developed countries through original-equipment-manufacturing products, which they later partly replaced with their own brand names. Besides advantages related to knowledge of the market and to technology, TNCs possess service and distribution systems, which developing country firms would have to set up from scratch. For this type of relationship to be possible, the level of managerial, entrepreneurial and technological capabilities of the developing country firm must be fairly advanced (Ernst, Ganiatsos and Mytelka, 1998).

Component outsourcing generates trade and represents a step up the “quality ladder” from simple labour-seeking relationships. Not only does it expand exports (and imports), but it also leads to a diversification of exports in the direction of more complex products.

In both labour-seeking and component-outsourcing activities, access to markets plays a key role as regards the contribution of TNCs to development, be it through FDI or through contractual relationships. Besides the informational advantages of TNCs, when a product is traded within the network of a TNC, it may be less likely to be subject to protectionist threats than when the exporter is an independent developing country firm. There are, in fact, laws in developed countries that favour the processing abroad of inputs originating in the importing country (in the United States, the Tariff Schedule 806/7 rules of origin). This processing is normally undertaken by a foreign affiliate of the originating company or by a subcontractor. There is evidence, however, that rules of origin can make it more difficult for exporting countries to diversify their markets since, in order to qualify for the duty-free entry of their processed products, they must import higher cost components from the country/ies applying the rules of origin than are available from third parties.

Still another form of efficiency-seeking FDI is *horizontal FDI* in differentiated products; this is less common in developing countries and tends to be associated largely with investment flows among developed countries (for example, in automobiles, computers, chemicals, consumer goods). It occurs because of the need to adapt products to the tastes or quality requirements of a particular market. These investments require a relatively large market, as they are related to the demand for different brands of a similar product in industries that are characterized by significant economies of scale. As the markets of developing countries are enlarged through regional trading arrangements, these investments are likely to become more common in those countries as well (Robson, 1993). In fact, there are growing cross-border investments in these industries in NAFTA and MERCOSUR. They are trade-creating and welfare-enhancing. The recipient country ends up exporting some brands of the product and importing others, at lower cost to the consumer. Welfare increases, not only because of lower costs of production, but also because of the availability of greater variety.

Strategic-asset-seeking FDI usually takes place at an advanced stage of the globalization of a firm’s activities when firms, including a few from developing countries, invest abroad in order to acquire research-and-development capabilities (e.g. Japanese or Korean investment in microelectronics in the United States). As already noted, integrated international production involves the location of *any* component in the value-added chain where it contributes most to a TNC’s profitability. Thus it may be efficient for a firm to relocate design, research and development (or other high value-added activities) from its home base to a foreign affiliate. Some developing countries are, or can make themselves, able to attract this kind of FDI

through investment in human resources and infrastructure; for example, the availability of skilled personnel and the requisite telecommunications infrastructure have contributed to the location of research-and-development centres and headquarters' services by TNCs in Singapore, software development in India, and service centres for airline reservations in the Caribbean. These investments are trade-creating in production and consumption. For the developing countries involved, this kind of FDI is tantamount to exporting high-skill labour services. And it usually gives rise to exports of services and equipment from home countries.

B. Indirect effects

The trade effects of FDI do not stop here. There are also indirect effects through the exchange rate and the availability of foreign exchange. Balance-of-payments effects figured prominently in the literature on FDI in the 1970s (for example, Lall and Streeten, 1977; see also Gray, 1993; UNCTAD, 1997a, chapter II, for a summary of empirical findings); at the same time, most developing countries faced a binding foreign exchange constraint on growth. Therefore, countries were interested in FDI not only for its more direct contribution to development, including through the trade effects discussed above, but also for the additional imports that it made possible through the relaxation of the foreign exchange constraint. However, since FDI inflows eventually give rise to outflows of profits, associated with repayments of loans from parent firms to foreign affiliates as well as payments for licences and technical assistance, outflows could eventually exceed inflows. More precisely, the issue revolves around the comparison between the inflow of foreign exchange associated with an investment project and the present value of future outflows of profits, using as the discount factor the international interest rate at which the country can borrow. Normally, one can expect that discounted future outflows will be larger than the capital originally invested, since profit rates, particularly in developing countries, tend to be well above international interest rates.

However, an investment project may have other balance-of-payments effects that must be taken into account: it may generate net exports or it may save foreign exchange by substituting domestic production for imports. By contrast, investments in non-export oriented firms in general and in non-tradable products in particular (most services, construction), usually have negative direct balance-of-payments effects, since most such projects require imported inputs and neither generate nor save foreign exchange on the output side.[10] This provides a rationale for the preference of developing countries for FDI in export industries.

The evaluation of the balance-of-payments effects of FDI depends crucially on the most likely counterfactual: what would have happened in the absence of the FDI (Lall and Streeten, 1977)? Would the activity have been undertaken by a domestic firm, perhaps under license of a TNC, or in a sub-contractual relationship, or not at all? This is, of course, a matter of conjecture. The issue is now less pressing, as, in the present times of much higher international capital mobility, growth in developing countries is not as constrained by foreign exchange availability as it was in the 1970s and 1980s. This is not to say that balance-of-payments effects are unimportant for all countries or that they could not become important again in the future (UNCTAD, 1997a, chapter II, pp. 85-94).

FDI may also be expected to have an impact on the real exchange rate and, through this channel, on future trade flows. Normally, all increases in capital inflows, irrespective of their type and of the place where they are invested, are likely to lead to an appreciation of the exchange rate,[11] simply because it raises the supply of foreign exchange and thereby lowers its real price. In other words, capital inflows imply an increase in absorption and a rise in domestic demand, which bid up the prices of non-tradables, while (in small countries) the prices of tradables remain constant.[12]

It is important to distinguish between the short-term (or "impact") effect and long-run effects of FDI on the real exchange rate. The total effect can be obtained by adding both effects. As already noted, the impact effect of all capital inflows is to appreciate the exchange rate. However, FDI has less of an impact effect on the exchange rate than other purely financial types of foreign capital inflows, since a significant share of FDI takes the form of imported capital goods. Over time, the long-run effect on the real exchange rate will depend on the sectoral allocation of FDI. If foreign capital is invested primarily in tradables, the additional generation or saving of foreign exchange will appreciate the exchange rate further. This is particularly the case when the investment projects involved raise productivity. On the other hand, FDI

into non-tradables increases their supply (and often productivity) and lowers their relative price, thereby counteracting the impact effect of capital inflows towards appreciating the real exchange rate. Experience has shown, however, that, in practice, the impact effect dominates long-term effects and the exchange rate tends to appreciate when there is a surge in FDI, regardless of the sector to which it goes.

These considerations are particularly important for small countries that suddenly become attractive as investment sites to TNCs. When locational advantages are perceived to have improved, the capital stocks desired by TNCs in a particular country may experience a dramatic increase, leading to very large inflows of FDI for a period that can be quite protracted. This may cause a significant real appreciation of the currency and discourage exports – the disadvantage of being small in a large international capital market.

C. Transfer pricing

Transfer pricing of transactions conducted within TNCs – between parent companies and their foreign affiliates and among the latter – was a serious concern of host developing countries in the 1970s (chapter 20; Plasschaert, 1993). At that time, profit remittances were often restricted, and profit tax rates in host countries were often higher than those applied in home countries. It is of less concern now as foreign affiliates can remit profits with greater ease and as income-tax rates on foreign company profits have tended to decline in most developing countries, which now usually apply national treatment to TNCs on tax matters.

Nonetheless, the issue is still important. If foreign companies are able to extract their profits from host countries via intra-company transactions at artificial prices, the benefits of FDI to host economies are accordingly reduced. Incentives may still remain for doing so, especially in countries that have not signed double taxation treaties with home countries of TNCs. Also, in some developing countries, corporate taxes are higher than in the home countries of investing TNCs. The more complex the relationships between parent firms and foreign affiliates, the greater are the opportunities for abusive transfer pricing. Such relationships can include loans from parent firms to their affiliates, management and consultancy contracts, technology-licensing arrangements, purchases of inputs, and sales (or purchases) of components to (from) parent firms or from affiliates in third countries.

The signing of double taxation treaties goes a long way towards solving the problem, because it removes much of the incentive for abusive transfer pricing (chapter 21). This is especially so in the case of host countries whose corporate income tax rates are lower than the tax rates of home countries: with a double taxation treaty, profit taxes paid in the host country are credited against the tax liability of the parent company at home. However, in some developing countries corporate tax rates are higher than in the home countries of TNCs, in which case double taxation treaties may not be enough to dissuade affiliates from transferring profits to their parent firms through abusive transfer-pricing practices. Moreover, some TNCs channel part of their profits through tax havens, in which case double taxation treaties are useful for neither host nor home country. The basic dilemma is that TNC activities are global and taxing authorities are national or sub-national. Therefore, the adoption of clear accounting rules can be an added advantage in this respect.

In short, transfer pricing and other tax issues associated with FDI require international cooperation among governments so that the interests of governments as well as TNCs are addressed effectively. International cooperation, however, has so far focused mainly on the bilateral level.

D. Summary

FDI and TNC activity increasingly tend to concentrate on production for regional or global markets. FDI in services is also very important, and is likely to be trade-creating and to enhance the competitiveness of developing country exports in the long run. The transition from shallow to deep integration and the emergence of integrated international production in some industries has tightened the relationship between trade creation and FDI.

However, a passive reliance on TNCs to lead export development may lead to the exploitation of static comparative advantages, and a continuing reliance on existing endowments, unless the country itself plays an active role in upgrading its productive base. Moreover, much of the export dynamism in export oriented countries of East Asia has come

from local firms subcontracting to foreign buyers rather than through FDI. Specific actions by governments, in particular with a view towards improving the physical, financial and technical infrastructure, are essential for the enhancement of competitive advantages.

Countries with small economies, especially, may need to guard against too much FDI too quickly. As has been remarked: “the rest of the world’s pockets are very deep relative to a small economy’s ... absorptive capacity” (Dornbusch and Edwards, 1994, p. 103). Flows of FDI that are too large for the absorptive capacity of a host economy appreciate the exchange rate and run the risk of retarding outward-oriented development. Policies to smooth out FDI stock adjustment over time can be used, especially in countries that suddenly become very attractive as sites for FDI.

The dangers of transfer pricing have diminished as foreign exchange constraints in developing countries have eased and corporate tax rates have fallen. But they have not disappeared altogether, and the issue needs to be followed closely at the national and international levels, including through the signing of double taxation treaties. In the meantime, it is important that developing countries adopt clear accounting rules regarding transfer pricing.

In any case, the closer linkages between trade and FDI mean that trade policy issues and investment policy issues cannot be understood and assessed in isolation from one another. Thus, trade-related investment measures (TRIMs) and investment-related trade measures (IRTMs) (chapter 25) are both becoming more frequent issues of interest to countries.

Section III
Direct Effects on Development

The impact of TNCs and FDI on development of course does not stop at their linkages with trade. On the one hand, by their very nature, TNCs possess valuable resources that are only very imperfectly tradable on markets. These resources usually have growth-enhancing characteristics: technology, management know-how, skilled labour, international production networks, access to markets and established brand names. In addition, TNCs can make a contribution to growth in a more traditional manner, through raising the investment rate and expanding the stock of capital located in a host country. On the other hand, TNC activity can have adverse effects on development, precisely for the same reasons: the entry of large firms with efficient internal markets and considerable size and market power may deter the full development of the imperfect markets and factors in host developing countries, or may prove more costly than alternative means of acquiring the assets that TNCs provide. Thus, when a country is in effect able to develop indigenous resources, there is a need to articulate properly the contribution that TNCs can make to the enhancement of local capabilities. Their potential negative effect in inhibiting their emergence was, indeed, a traditional argument in favour of restricting FDI to those activities that cannot be developed by domestic entrepreneurship. Like the infant-industry argument for import substitution, this position can be labelled the “infant entrepreneurship argument” (for an argument along these lines, see Bruton, 1988).

A. Savings and investment

There has been an unsettled controversy about the effects of capital inflows on savings and investment that has raged since the early 1970s (Weisskopf, 1972) and that has been revived recently. In the 1990s, large capital inflows into several developing countries have not generally led to increases in total investment. In fact, in many countries that have experienced surges of foreign capital, investment has remained unchanged and domestic saving has fallen (Agosin and French-Davis, 1996). If foreign savings merely crowd out domestic savings with no change in the investment rate, the usefulness of foreign capital for capital formation, a key factor in development, can be questioned.

Clearly, however, FDI is a distinctive form of foreign capital. The channels through which capital inflow can discourage domestic saving are as follows: if the exchange-rate appreciates, it encourages consumption and may also relax liquidity constraints to the consumption of durables, since an important portion of capital inflow is intermediated by the banking system. If, in addition, capital inflow causes stock market and real-estate booms, the wealth effects on consumption can be quite significant. However, FDI is less likely than other kinds of capital

inflows to have these effects because it is associated with *real* investment. As already noted, FDI puts less downward pressure on the real exchange rate than do other forms of capital inflow. Indeed, it has been observed that countries in which FDI dominates capital inflows have experienced more significant increases in investment than countries in which capital inflows have been mostly of the financial variety.

The argument has frequently been made that FDI is likely to have more favourable effects on capital formation when it takes the form of greenfield investment rather than that of mergers and acquisitions, which play an important role in world FDI flows (UNCTAD, 2000). This depends to a large extent on the counterfactual situation and also on domestic economic policy more than on whether the foreign investment represents an immediate addition to the country's capital stock. Firms often prefer mergers and acquisitions when entering a foreign country because, through the purchase of an existing firm, the foreign company buys into an ongoing concern and does not have to start *de novo*. However, the purchase is more often than not followed by *sequential FDI* (i.e. by investments in modernization and capacity expansion) and *associated* FDI (e.g. by FDI undertaken by suppliers) which can be larger than the original purchase (UNCTAD, 1995a).[13]

The capital contribution of FDI may be particularly important in privatizations, which usually also require significant sequential investment in order to make privatized firms profitable. Privatized firms are often very large, and sufficient capital resources are usually not available to domestic groups. Even the latter's borrowing capacities on international capital markets may not be large enough for the amounts normally involved. This is also the case with investments in mining. Domestic firms (even state-owned) having the know-how to operate mining concerns may not have access to the large amounts of capital required by this very capital-intensive activity. That is why some countries have sought the participation of consortia of TNCs in the expansion of their mining investments.

It is sometimes claimed that FDI leads to home country investment levels that are lower than those that would have occurred in its absence, and that this is tantamount to exporting jobs abroad. The issue at hand is about the counterfactual to FDI: if investment abroad had not taken place, would the firm have invested the same amounts at home? The answer to this question is not straightforward. If the foreign investment proves not to be profitable, it might not have been profitable to invest at home either. And FDI can stimulate upstream or downstream investments in the home country. The same considerations apply to FDI outflows from developing countries, adjusted for, among other things, the conditions prevailing in individual countries and industries.

B. Technology transfer and innovation

Perhaps the most important contribution that host developing countries desire from TNCs is in the area of technology.[14] Almost by definition, developing countries lag behind developed countries as regards the generation and application of technology. The same goods are produced in developing countries with technologies that are outdated in developed countries; and some goods are not produced at all, because the technological know-how is not available in developing countries. Even where similar technologies are used, developing country enterprises tend to use them less efficiently because they lack the requisite skills and capabilities. Since technology is a non-rival good (in the sense that its use or consumption does not diminish its value for another agent) and is sometimes presumed to be transferable without cost across countries, the technological gap between developed and developing countries needs to be explained. Contrary to what neoclassical growth models postulate (e.g. Mankiw, 1995), technology is not a free good that is clearly specified and readily available for use by any firm anywhere. Moreover, some technology is not accessible if its owners decide not to licence it. In important respects, technological assets contain a tacit element that is not easily transmittable or replicable in another environment, and their effective use entails considerable investments in learning and skill upgrading.

In addition, technology cannot be traded like a physical product: technology markets are opaque and often subject to informational failures. Buyers and sellers have different sets of information. If buyers knew exactly what they were buying, they would not need to make the purchase, since they would already know the technology. On the other hand, sellers have strong incentives to withhold information from buyers. Firms tend to guard carefully their technological assets, since they can be copied and used by others who have not invested in their development. This

is all the more so in countries with poorly developed intellectual property protection regimes. The utilization of ideas also requires human capital that is capable of doing so, and this is a particularly scarce resource in developing countries.

A large proportion of all innovation takes place within TNCs (UNCTAD, 1995a, chapter III.B). There are several reasons for this. In the first place, research and development involves large sunk costs and therefore requires large markets to be profitable. Research and development is thus concentrated in large firms, and – in such areas as biotechnology – in strategic partnerships and alliances among large firms (Mytelka, 1998). Transnationality and research-and-development expenditures are also highly correlated, with causal links running in both directions. Proprietary technology figures prominently among the intangible assets that impel firms to invest abroad through equity participation as well as non-equity arrangements (e.g. licensing, franchising, turnkey operations). At the same time, transnationality enlarges the market over which a firm can exploit technological assets, and it is a strong incentive to undertake research and development. Since, as already mentioned, ideas are non-rival goods with essentially zero marginal costs of production, monopoly rents generated by them – and, therefore, the incentive to produce them – are strongly correlated with the size of the market over which they can be deployed (Romer,1993).

FDI can, under these conditions, make an important contribution to technology transfer and to the effective use of technology. More specifically, FDI can make three sorts of technological contributions to host countries (Romer, 1993):

- It can introduce a new technology not previously in use in the domestic economy and, therefore, lead to the production and consumption of a new good.
- Foreign investment with a technological component usually requires the introduction and/or development of new skills needed to operate the technology (with the attendant externalities).
- Domestic innovation depends on the number of ideas that are available in the economy; thus the introduction of a new idea increases the stock of ideas and stimulates domestic innovation.

These considerations have a great deal of force, but they rest on simplifying assumptions. They equate technology with knowledge in the abstract sense, and ignore the costs and difficulties involved in mastering new technologies, particularly in a developing country. More important, they ignore the difference between learning operational technology and the creation of new technology: FDI may be a very effective way of transferring new operating know-how but not necessarily of the innovation process that underlies the generation and upgrading of that technology. It is widely accepted that TNCs tend to transfer the *results* of innovation but not innovative capabilities themselves, at least to most developing countries: the relocation of their research functions abroad is overwhelmingly to other developed countries. This can lead to a "truncating" of the process of technology transfer and to a relegation of developing host countries to lower levels of technological activity (even when their industrial capabilities have reached a level at which, as in many newly industrializing economies, they are able efficiently to undertake advanced research-and-development work). It is the case that developing economies that have been able to build up powerful autonomous innovative bases (like the Republic of Korea or Taiwan Province of China) have restricted internalized technology transfer via TNCs, precisely in order to allow national enterprises to develop their "infant" innovative capabilities. Moreover, TNCs may transfer the technology that is appropriate to the static factor endowments of host economies and not their dynamic endowments. Thus, they may start with simple assembly technologies and move to lower cost locations when wages rise; it is not in their economic interest to invest in the creation of the high level skills that would make more complex technologies viable. How widespread this is cannot be judged from the available evidence, since it is possible to find examples of both types.

Furthermore, it has not been unusual for TNCs in the past to continue to derive rents from outdated technologies in developing country operations. At the same time, domestic policy can influence the extent to which FDI makes a technological contribution. Pure import-substitution policies may encourage TNCs to undertake market-seeking investments that fail to incorporate state-of-the-art technologies. Export-oriented policies, on the other hand, are likely to encourage the introduction of technology that would make products more competitive in international markets.

The degree of diffusion to a host economy is important when evaluating the contribution of

FDI to technological upgrading. "Diffusion" refers to an important (though not the only) form of externality connected with technology. If there were no diffusion at all, the developmental effects of FDI, even when introducing new technologies, might be small, since a significant proportion of the additional output made possible by an investment project would be captured by the TNC in the form of monopoly rents. Some technologies may be more susceptible to diffusion to domestic firms than others. This is the case of technologies that, in order to operate them, do not require highly specialized human resources unavailable in the host country and available only within TNCs.

The question arises as to whether it is preferable to obtain technology through FDI or in more unpackaged forms (even though these forms may well involve elements of control by parent firms), such as licensing; installation and training related to the supply of machinery and equipment; advice by suppliers to clients on quality control, new materials and other important technological changes; and technology alliances that are at arm's length and enable firms in developing countries to window on a wide number of technological developments and leverage their own work in this area. Japan and the Republic of Korea have relied heavily on licensing and other forms of acquisition of technology from TNCs, while Singapore mainly relied on FDI, attracting it into specific industries. Taiwan Province of China has made active use of both vehicles. There is no ready-made recipe in this respect. Much depends on the expected gains with respect to technological capacity-building and movement towards higher value-added production through one rather than the other. Two considerations are important in making the decision. The first one is whether the technology is available in unpackaged form. Firms are more likely to license older technologies from which they have already derived significant rents than newer technologies that are at the heart of the companies' business interests.[15] The second consideration is the availability in the host country of entrepreneurial and technical skills to operate new technologies and earn profits doing so; the position of countries in this respect is bound to change over time, as human resources and technological capabilities improve. Indeed, TNCs are entering into collaborative relationships with firms and institutions for technology generation and development in some developing countries (UNCTAD, 1995a).

One aspect of technology concerns organizational and management practices, including, among others, strategic marketing capabilities. Management may be considered as a sort of "soft" technology. Management technologies are diffused through various channels (UNCTAD, 1995a, chapter III.C), including joint ventures between domestic firms and TNCs or through the migration of executive personnel from foreign affiliates to domestic companies (Ernst, Ganiatsos and Mytelka, 1998). TNCs can therefore contribute to the spread of modern management techniques to host countries. And such soft technologies may be diffused more easily than hard technologies that are embodied in capital equipment and that require highly skilled complementary human resources. An example is just-in-time management of inventories. Pioneered in Japan, it has been emulated widely by United States and European TNCs. Innovations such as these have a great potential for improving the productivity and competitiveness of developing country firms.

There have been concerns that FDI and non-equity TNC activities could lead to an accentuation of the dualistic nature of the economies in some developing countries, with foreign affiliates or large domestic firms with strong links to TNCs increasing their technological lead over small and medium-sized domestic enterprises. The latter suffer from acute disadvantages with regard to technological or foreign market information and to access to capital markets (UNCTAD, 1993c, 1998c). In some cases, FDI may have led to a widening of the gap between foreign firms and small and medium-size enterprises; in other cases, small firms have been able to participate in sophisticated original equipment manufacturing and even higher-end original design manufacturing. It all depends on the initial degree of dualism in the economy and on active government policies to overcome the relative backwardness of small and medium-sized enterprises.

C. Entrepreneurship and linkages

It is sometimes claimed that FDI may have adverse impacts on the indigenous development of entrepreneurial talents by pre-empting business opportunities and crowding out domestic entrepreneurs. This was one of the rationales for the effort that governments of developing countries

made in the 1970s in the form of operational measures to "unpackage" FDI and to attempt to obtain for domestic firms some of the assets associated with TNCs. In some countries (e.g. the Republic of Korea), such policies paid off in terms of the development of domestic enterprises. In others, results were mixed: domestic entrepreneurship did not fare as well even though FDI was discouraged. The debt crisis also weakened the capacity of developing countries to unpackage, since foreign borrowing was no longer available to them. Nowadays, the bottleneck is mostly on the side of domestically available human resources and entrepreneurial talents.

FDI may have crowding out effects on domestic firms if large foreign firms borrow on domestic financial markets: domestic interest rates tend to rise, thus reducing the viability of investment projects for small and medium-sized domestic firms without access to international capital markets; and local bankers – for both risk and profitability reasons – may have a greater interest in lending to larger firms (such as TNCs) rather than to the vast majority of local firms which are small. It may be argued that, if financial markets are integrated, domestic interest rates will tend to move towards levels prevailing in international markets. If this were the case, the problem would lie not with the potential crowding out effects of FDI but with the unwillingness of the authorities to open up domestic financial markets to international trade in financial assets. However, even in developing countries with a substantial degree of financial openness, domestic interest rates tend to be higher than international rates, basically because domestic assets are imperfect substitutes for foreign assets. There is, therefore, some rationale for monitoring the domestic borrowing of large foreign firms and for putting in place lending mechanisms that ensure a sufficient flow of working and investment capital to the small and medium-size enterprises sector should local finance become accessible to TNCs.

On the other hand, FDI projects could promote domestic entrepreneurship in downstream and upstream activities. This issue is closely related to the extent to which FDI generates backward or forward linkages within a host economy (UNCTAD, 2001b). The greater the demand by a foreign affiliate for domestically produced inputs or services, the more favourable will be its impact on entrepreneurial development. Likewise, there will be similar favourable effects if a good or service produced by a foreign affiliate lowers the domestic price of an input that is used further upstream in the production process. Domestic purchases of foreign affiliates tend to increase as companies gain experience in host environments (see studies cited by Caves, 1996, p. 232). Subcontracting relationships often become important over time, with the consequent transfer of technology and managerial skills. In developing countries in which TNCs have invested heavily in the manufacturing sector, there is evidence that subcontracting has been very brisk. In Mexico, for example, 37 out of the 67 affiliates examined in a survey utilized local subcontracting (UNCTC, 1992b). Similarly, in Argentina, the privatization of telecommunications and public utilities has led to the development of equipment and input supplying firms (Chudnovsky, López and Porta, 1996). In the natural resources sector, FDI has traditionally not had strong linkages with the domestic economy; FDI in Chilean natural resource industries, for example, has been observed to have had much less impact on domestic firms through backward or forward linkages than that observed in manufacturing (Riveros, Vatter and Agosin, 1996). Generally, it would appear that forward and backward linkages are more likely to be generated when FDI is in the manufacturing or services sectors than in natural resources where foreign affiliates often have few interactions with the domestic economy. This, of course, does not mean that FDI in mining or petroleum is *per se* undesirable, since it may confer benefits that are unrelated to linkages.

TNCs may be able to raise the capabilities and quality of domestic suppliers and subcontractors to international levels more effectively than domestic firms by transmitting technical information, skills, finance and other forms of assistance. Under import-substitution regimes, many countries sought to force the pace of local content by imposing time-bound rules, often not very efficiently. Performance requirements have increasingly been questioned (and some are not permitted under the WTO TRIMs agreement), although some Asian economies (e.g. the Republic of Korea and Taiwan Province of China) used them effectively by ensuring that supplier capabilities were able to match world levels (Lall, 1996). The increase of TNC linkages is increasingly driven by pure cost and efficiency considerations; as a result, TNCs are changing their sourcing patterns and raising local content in countries that have capable supply clusters while lowering them elsewhere. They are

also often rationalising regional patterns of sourcing to get fewer types of components from particular countries but often on much larger scales.

TNCs will tend to have powerful (but possibly very uneven) effects on the development of local suppliers in developing host countries. As with FDI flows themselves, there appears to be growing concentration in locations that are industrially advanced and able to meet the rigours of world competition without substantial additional cost and effort. Other activities may well receive FDI but may not gain much by way of local depth and linkages. There also appear to be differences by home country of the investor; Japanese investors tend to stick with traditional suppliers (though this seems to be changing with greater international experience and under local pressure), while United States investors are more amenable to developing local suppliers in developing countries (though they are more likely to retain majority or full ownership of their own affiliates).

D. Employment and skill development

There was considerable concern in the 1970s that FDI did not generate enough employment, basically because foreign affiliates tended to transplant the capital-intensive technologies of their parent firms to developing country settings, with little effort to adapt them to local conditions where labour was abundant and capital scarce. In fact, foreign affiliates tend to use more capital-intensive technologies than domestic firms in the same industry, after controlling for other variables such as size. In host countries whose main attraction for TNCs is the high quality of their mineral resources, TNCs create very little employment indeed. Mining is by its very nature a capital intensive activity, and possibilities for technology adaptation are small. However, the relevant question is, again, the counterfactual: would investment by national firms have taken place in the absence of a TNC? In some cases in which technologies are known in host countries, the answer could be affirmative. In industries in which new technologies are needed, it is unlikely that domestic firms would have invested.

Perhaps more importantly, TNCs have generated significant employment through their investment in export-oriented, labour-intensive activities, primarily in manufacturing but also in certain services, in developing countries. This includes the establishment of affiliates in export-processing zones, as well as the subcontracting of labour-intensive tasks to independent suppliers. Although it is limited in both the kind of jobs generated and their long-term sustainability, such employment generation has proved to be a useful strategy for several countries (UNCTAD, 1994a, chapter IV).

FDI can make a positive contribution to human resource development through the training and transfer of skills that are either unavailable or scarce in host developing countries (Enderwick, 1993; UNCTAD, 1994a, chapter V). It is well known that on-the-job training has strong externalities, and, for this reason, market forces tend to provide less than socially desirable levels of it. The technological superiority of TNCs is also a potential source of human capital formation. Managerial skills have already been mentioned. Even when not required to do so, TNCs typically utilize host country personnel in middle (and top) management. The reason is obvious: local managers are better acquainted than expatriates with the ways of doing business, tastes and customs of the host country. Training may also take place at more technical levels or on the shop floor. These activities confer an externality on domestic firms through staff turnover and can, therefore, be encouraged through appropriate policies that are economically justifiable.

At the same time, however, host countries cannot rely on foreign investors to meet their broader or emerging skill needs. TNCs use the technologies that are appropriate to local education levels and train mainly to create efficient operators of such technologies (for instance, simple assembly). They do not generally invest in the more difficult and long-term process of creating new skills needed for more advanced technological tasks. The upgrading of the general skill level and the provision of high level specialised technical manpower is something that host countries need to do themselves. Indeed, such upgrading itself can be used, as in Singapore, to attract higher inward FDI and to induce existing investors to move into more complex activities. Moreover, TNCs from the developed world tend to concentrate on industries with more advanced technologies, leaving a wide range of simpler activities in which skill creation has to depend on local firms. TNCs from other developing countries do also enter into simple labour-intensive activities, but these tend not to involve large amounts of training. Most important, no industry, however attuned to training, can replace the provision of education and basic skills

by the national education system, which thus remains a vital area of host government policy.

E. Other effects

FDI may also *encourage competition and promote gains in technical efficiency* in host countries. This is the case when TNCs enter the domestic markets of developing countries in industries in which domestic firms are already operating. Even in the largest developing countries, domestic markets tend to be small, and oligopoly or monopoly conditions often prevail. Under such conditions, the entry of firms with state-of-the-art technology may prompt domestic firms to make greater efforts to improve their technical efficiency (UNCTAD, 1997a, chapter IV). The entry of TNCs into an industry has been found to have a positive effect on the productivity of domestic firms in a number of countries (Frischtak and Newfarmer, 1993; UNCTAD, 1995a, chapter III; UNCTAD, 1997a, chapter IV).

On the other hand, in certain cases, the entry of TNCs into some industries of host developing economies has been known to lead to greater market concentration. By their very nature, TNCs typically operate in concentrated industries. In addition, they may wind up displacing smaller and less efficient domestic firms, rather than prodding them to increase their efficiency.[16] As in the case of developed countries, an increasing share of FDI consists of takeovers through privatization of small and medium-size enterprises or local private firms. It is feared that TNCs, with their large size, deep pockets, competitive advantages and perhaps aggressive entry tactics, may lead to growing market concentration and the stifling of local entrepreneurship. However, it is difficult to derive welfare conclusions simply from changes in the levels of industry concentration. If concentration rises as a result of TNC entry, it may reflect the realization of scale economies (especially in small host countries) or the introduction of modern technologies, rather than predatory behaviour by TNCs. Moreover, concentrated domestic market structures in a world with liberal import competition and the possibility of new foreign entry have a very different economic significance from similar structures in relatively closed economies: markets are far more "contestable" in the former than in the latter. While the possibility of predatory conduct always remains, the solution seems to be effective competition policy in general rather than any specific policies related to FDI (UNCTAD, 1997a).

Income distribution in most developing countries is more unequal than it is in developed countries. Little is known about the distributional impact of FDI and other TNC activities. One can, however, speculate that, if TNC activities lead to the introduction of new skills or to the training of human resources not previously available or undertaken in host countries, it is likely that they will make income distribution less unequal, since the accumulation of human capital has an equalizing impact on income distribution. If FDI is in labour-intensive industries, wages will be bid up and the impact on income distribution will be, again, positive. On the other hand, FDI in sectors such as mining, which are very capital-intensive and geographically isolated, may employ little labour and generate dual wage structures that contribute to income inequality. However, except in countries where FDI is large relative to the size of the domestic economy (e.g. as in Singapore or Malaysia), its effect on income distribution will probably be of secondary importance.

Section IV Foreign Direct Investment, Trade and Development: Policy Issues

Since the onset of the debt crisis in the early 1980s, FDI has come to be perceived in a much more favourable light than in the past by developing country governments. While debt repayments tend to be fixed and can create serious balance-of-payments problems regardless of the use to which the borrowing is put (especially when they are not devoted to investment intradables), FDI projects generate outflows of profits only when they are successful.

There are good reasons for this reassessment of the potential role of FDI in development. Under current conditions – and if the policy framework is adequate – FDI and other forms of TNC involvement in developing countries have the potential for making a contribution to their development. In an increasingly liberalized and globalized world, the current need of developing countries is to strengthen their competitiveness in world markets, while accumulating capital, both physical and human.

Policies to ensure the deployment of assets associated with TNCs -- in particular, technology, advanced skills and market access -- are a component of an industrial strategy that promotes this goal (UNCTAD, 1995a). FDI in service industries, prominent in recent FDI inflows into developing countries, may assist in improving the systemic competitiveness of host developing countries and, thereby, may eventually encourage new exports by lowering the costs of doing business.

FDI is not a zero sum game. Outflows of FDI to developing countries are likely to have positive effects on home countries as well. They usually lead to an increased flow of exports from the home country. Cheaper imports into the home country may create adjustment problems, but they also involve significant welfare gains for consumers. In some cases, there may be losses in employment in some labour-intensive industries, but there should be gains in employment in others, which often pay higher wages than the industries affected by FDI outflows to developing countries. FDI in services in developing countries should have strong benefits for employment and exports from home countries, since it often leads to the export of machinery and highly-skilled services from the home country.

At the same time that the positive economic effects of FDI in both host and home countries have come to be more fully appreciated, there has been increased interest in the broader role of FDI in sustainable development (Jun and Brewer, 1997). FDI is thus viewed increasingly in relation to environmental and income-distribution issues, as well as issues of civic life, such as transparency and illicit payments. Although an extensive discussion of these issues would be beyond the scope of this chapter, it should be noted that these issues are on the agenda in many host and home countries and therefore increasingly on the international economic policy making agenda as well.

A. Attracting foreign direct investment

Given the importance of FDI as a package of internationally mobile assets for growth and development, it is not surprising that all countries are competing to attract it. Policy efforts to attract FDI take place in many cases not only at the national level but also, and independently so, at various sub-national levels. Typically, these efforts focus on the following areas (UNCTAD, 1998b):

- *Improving the regulatory framework for FDI*. Reference has already been made (section I) to the world-wide liberalization trend and to the fact that unilateral national efforts at liberalization are increasingly being complemented by facilitation and protection efforts at the bilateral, regional and multilateral levels. The principal purpose of these efforts is precisely to create regulatory frameworks that are conducive to FDI. In a highly competitive world market for FDI, "best practices" in this respect by *one* government rapidly become "benchmarks" for *all* governments. And benchmarking among governments is particularly important in a regional context. At the same time, however, countries need to guard themselves against a "race to the bottom" in their policy competition, as this would, ultimately, harm their longer-term development efforts.

  Important in this respect is also the fact that countries seek to improve their capabilities to face the challenges of a more interdependent and competitive world (Dunning, 1992b, 1993). Efforts to ensure greater policy coherence, especially between FDI and trade policies, are part of these efforts to obtain greater systemic competitiveness, as are, of course, the more basic efforts to ensure macroeconomic, social and political stability and predictability.
- *Facilitating business*. Beyond the liberalization of regulatory frameworks (a more passive policy approach), more and more countries also give more attention to pro-active policies to attract FDI. Reference has already been made to the growing incentives competition for FDI. Typically, incentives are only one of the tools that governments use to attract FDI (UNCTAD, 1995a, 1996f). Most countries have established investment promotion agencies[17] whose purpose is precisely to attract FDI and look after foreign affiliates once they are established (by providing a range of after-investment services). Investment promotion agencies also search out, more than in the past, non-traditional investors and non-traditional home countries. Among the former, small and medium-size enterprises are particularly noteworthy (UNCTAD, 1998c); among the latter, TNCs from Asia and Latin America

deserve special attention. In addition, many countries are engaged in a continuing process of regulatory reform, in the framework of which they seek to reduce the "hassle costs" of doing business, including through more efficient administrations.

- *Improving the economic determinants*. While the preceding sets of factors are important in terms of creating an appropriate enabling framework for FDI and, more generally, a good investment climate, in the end it is the economic determinants that are most important for the locational decisions of TNCs. Traditionally, the principal economic determinants were market size and market growth, dependent in turn on the income and income growth of a country or region. They certainly continue to be valid, and some of them even play a role in the creation of regional free trade agreements which, increasingly, are also free investment agreements. With markets becoming more open and technology and competitive pressures fostering the formation of integrated international production systems, the skill levels and adaptiveness of human resources, the quality of the physical infrastructure (including telecommunications and transportation) and various created assets (including innovatory capacity) are becoming more important, as is the existence of a vibrant domestic entrepreneurial sector and, in particular, the capacity of local suppliers to provide world-standard inputs. Government policies aimed at attracting FDI – and, even more importantly, seeking to promote the growth of domestic enterprises – increasingly pay attention to upgrading these determinants of locational decisions, be they decisions taken by foreign or domestic firms.

In brief, governments increasingly seek to create an environment in which firms – be they domestic or foreign – can prosper.

B. Increasing the benefits from inward foreign direct investment

The ultimate objective of governments in attracting FDI is, of course, to promote growth and development. FDI can play a role in this respect, but there is no simple and single description of what this role should be. For many countries, the objective is largely achieved when they have, on their territories, vibrant enterprise sectors, regardless of whether enterprises are domestic or foreign owned. Many others, however, and especially governments of developing countries with strong administrative capabilities, seek to play an active role to help the firms located on their territories become internationally competitive; and FDI can play a particular role in this respect. This can perhaps best be illustrated with reference to East and South-East Asia, where it is possible to distinguish four different types of FDI strategies among the fast-growing economies in that region (Lall, 1996; Ernst, Ganiatsos and Mytelka, 1998; Wade, 1990). In brief, these are:

- Passive open-door policies to both FDI and trade, with no intervention to promote industrial development selectively (e.g. Hong Kong, China).
- Active industrial policies and promotion of local enterprises in certain activities, but effective open-door, non-interventionist policies in most export-oriented industries (e.g. Malaysia and Thailand).
- Active intervention in promoting strong TNC participation in manufacturing; no discriminating treatment in favour of local industry, but pervasive and selective guidance and inducement of foreign investors to upgrade their capabilities, including by increasing local technological activity (e.g. Singapore).
- Restriction of FDI and maximization of reliance on "external" forms of technology transfer in the context of a comprehensive set of industrial policies to deepen the indigenous manufacturing sector, promote local linkages and increase local innovative capabilities (e.g. Republic of Korea, Taiwan Province of China and, previously, Japan).

Each of these strategies above reflects the economic position, beliefs and capabilities of the governments concerned. Their experiences suggest that FDI can be treated in many ways, and that it can play very different roles in industrial and technological development. Countries that have wished to promote *indigenous* technological deepening may have chosen to intervene to restrict the entry of TNCs, or to guide TNC activities and maximise their spillovers through operational measures such as performance requirements. Those that have chosen to rely on TNCs have often intervened in the FDI process to target investors, guide their resource allocation and induce them to

undertake more complex value-added activities than they would perhaps otherwise have done. The different approaches to FDI partly reflect resource endowments, as well as differing political beliefs and administrative and productive capabilities. The options applicable to the larger developing economies, with greater scope for internal specialisation and local content, as well as better established indigenous enterprises, have been different from those open to smaller economies with limited internal markets.

What the discussion above suggests more generally is that FDI may have uneven effects on development. Effects are determined to a large extent by the conditions prevailing in host countries, by the investment strategies of TNCs and by the policies of host governments. Host governments do indeed retain a role in influencing the benefits that their economies gain from inward FDI. TNCs can be powerful agents of dynamic comparative advantage if a proactive and efficient government takes their efficiency needs into account and offers the right set of incentives and support measures for upgrading and transferring technology skills.

With the growing liberalization of FDI and trade policies, and with competitive bidding for FDI among all countries, many of the policy elements adopted in the past by economies such as the Republic of Korea and Taiwan Province of China are increasingly difficult to pursue. However, proactive strategies of the sort used by Singapore are available, and are sometimes regarded as "best practice" in FDI promotion and management. More host countries and sub-national authorities may be moving in this direction, away from passive open door approaches that were often considered optimal a few years ago.

C. Dealing with outward foreign direct investment

There is another aspect of the liberalization trend that has received far less attention, namely the liberalization of policy regimes governing outward FDI. Developed countries have traditionally had a liberal regime in this respect, and developing countries are beginning to follow suit (UNCTAD, 1995a, chapter VII). Home countries can also facilitate outward FDI towards developing countries through a variety of policies (UNCTAD, 1995a, chapter VII). Indeed, most developed countries already pursue policies with this objective in mind, and developing countries whose firms are becoming internationally competitive are beginning to adopt them as well. Governments provide information on foreign markets and investment opportunities, as well as on legal and administrative frameworks abroad, to their foreign investors. Some governments also supply finance through specialized public banks. Most home governments have instituted investment-insurance programmes for foreign investors. Some of these forms of assistance have been multilateralized: the World Bank Group's International Finance Corporation provides both equity and loan financing to foreign investors; and the Multilateral Investment Guarantee Agency (MIGA), also of the World Bank Group, insures foreign investors against political risks in countries that have become MIGA signatories.

D. International issues

The policy issues addressed so far all concern national policies. By their very nature, however, FDI, TNC activities and the internationalization of production touch upon the policies, rules and regulations of more than one country. And given the nature of international production – representing, as it does, a deeper integration of national economies than trade – more and more issues are becoming potentially subject to international concern. Indeed, in principle, all issues related to the production process – the essence of a country's economic activity – contain an international dimension. By necessity, this leads, at least in the longer run, to an internationalization of the domestic policy agenda (Ostry, 1992). The growth of FDI and international production – the productive core of the globalizing world economy – creates therefore a range of new challenges that need international responses.

It is not surprising, therefore, that FDI issues are being increasingly addressed at the bilateral, regional, plurilateral and multilateral levels (UNCTAD, 1996a, 1996d, 1997a, 1998a, 1998b). The role of TNCs and FDI in economic growth and development, as reviewed briefly in its multifaceted impact in this chapter, is central to these discussions, in particular for developing countries. In international fora at all levels, therefore, the topics that are addressed in this chapter and in the other chapters in these volume will be on the agenda for many years into the future.

Notes

[1] TNCs are incorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates. A parent enterprise is a firm that controls assets used in production abroad. A (majority or minority-owned) foreign affiliate is an incorporated or unincorporated enterprise in a (host) country in which a firm resident in another (home) country has a stake that permits a lasting interest in the management of that enterprise.

[2] "Foreign direct investment" is defined as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity (the foreign direct investor or parent enterprise) of one country in an enterprise (foreign affiliate) resident in a country other than that of the foreign direct investor. It includes equity investments as well as non-equity arrangements that give rise to the control of assets used in production abroad. (See UNCTAD, 2004b, annex B, for a fuller definition and a description of FDI as it is usually measured.)

[3] For a comprehensive review of the role of TNCs in development, see UNCTC (1988), Lall (1993), Dunning (1992a) and Caves (1996, chapter 9), as well as the individual volumes of the *World Investment Report* series (UNCTC, 1991; UN-TCMD, 1992; UNCTAD, 1993b, 1994a, 1995a, 1996d, 1997a, 1998b, 1999b, 2000d, 2001b, 2002c, 2003a and 2004b) and the volumes of the *United Nations Library on Transnational Corporations*.

[4] Certain performance requirements that affect trade (trade-related investment measures, or TRIMs) are prohibited under World Trade Organization (WTO) rules. These include local content and trade-balancing requirements (UNCTAD, 1996d, p. 151). There are other performance requirements that are not prohibited by WTO. Nonetheless, developing countries have tended to rely less and less on them, partly in hope of attracting additional FDI inflows.

[5] For an in-depth analysis of FDI trends in Latin America and the Caribbean, see ECLAC (1998).

[6] This is a fairly recent notion. Advocates of import substitution have argued in favour of limiting trade flows in order to develop domestic industries (Bruton, 1988). As modern economic history has shown, this view, however unpopular today, has had support in developed as well as developing countries: practically all currently industrialized countries of significant economic size went through an import-substituting phase that allowed them to reap economies of scale and greater degrees of technical efficiency through learning by doing which eventually transformed them into exporters of manufactures. This is the classical argument for temporary infant industry protection. (For a modern version of this argument, see Rodrik (1992).) Most developing countries, however, are too dependent on international trade to benefit from protection.

[7] See, for instance, Dunning (1993, Introduction) and Ozawa (1992).

[8] Newly hired workers will normally consume part of their wages on imports, although, given the capital intensity of TNC activities in many natural resources, this effect may be small.

[9] These investments reflect not only the desire of TNCs to position themselves in specific enlarged markets but also, in some cases, to take advantage of the locational advantages offered by low-wage sites within those markets.

[10] As already noted, some FDI in services may have indirect positive effects on future production of tradables by improving the host economy's competitiveness. See UNCTAD, 2004b.

[11] The nominal exchange rate is defined as the price in domestic currency of one unit of foreign currency; the real exchange rate, as the ratio of the prices of tradables to non-tradables.

[12] In one extreme case, the real exchange rate remains unchanged: when the Central Bank fixes the exchange rate in nominal terms and succeeds in sterilizing completely the effects of capital inflows on the money supply. In practice, most, if not all, episodes of capital inflow have led to exchange-rate appreciation.

[13] For the cases of Argentina and Chile, see Chudnovsky, López and Porta (1996) and Riveros, Vatter and Agosin (1996), respectively.

[14] This subject has been dealt with in several studies. See, for example, UNCTC (1987), UNCTC (1990a), UNCTC (1990b), Cantwell (1993), Chen (1993), UNCTAD, 1999b.

[15] Firms are also prone to license technologies in industries characterized by rapid obsolescence, but they usually do so to other TNCs and in exchange for cross-licensing.

[16] Of course, that is the nature of competition, the other side of the coin of technological progress in Schumpeterian "creative destruction". In the case of relations with foreign firms, however, there are several more complicated issues involved. One has to do with the fact that displaced domestic firms may eventually have become competitive, given appropriate policies in host countries. Another relates to international income-distribution considerations: to the extent that TNCs drive domestic firms out of the market, income distribution at the international level may become more concentrated.

[17] The World Association of Investment Promotion Agencies (supported by UNCTAD, UNIDO, MIGA and OECD) has some 175 members.

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