VIEW

Development-friendliness criteria for a multilateral investment agreement

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The question of establishing a comprehensive and legally binding multilateral framework for investment (MFI) has now become a priority issue on the international economic policy agenda. Two recent developments, namely, the ongoing negotiations in the Organisation for Economic Co-operation and Development (OECD) to establish a Multilateral Agreement on Investment (MAI) as a free-standing treaty, and the Singapore Ministerial Declaration of December 1996 of the World Trade Organization (WTO), have brought this issue to the centre stage of international debate. The participation of developing countries in such an MFI is regarded as important not only to ensure that the MFI is truly universal in its membership, but also because foreign direct investment (FDI) is increasingly becoming a key vehicle for accessing foreign markets, and many developing countries are increasingly becoming attractive destinations for FDI. However, the willingness of developing countries to participate in an MFI depends on how the development issues are addressed in it, and how it ensures a balance of interests and mutual advantage of all parties. The identification of the specific criteria to assess the development-friendliness of an MFI has thus assumed special importance in the ongoing debate on such a framework.

Before considering the specific criteria, it may be useful to keep in view certain general points:

- It may be true that an investment-friendly MFI would usually be development-friendly also, and that conditions required to promote FDI are precisely the conditions required to promote domestic investment as well. But this assumption requires to be tempered by the fact that while an MFI is FDI-friendly, it needs to recognize equally the developmental needs of developing countries, especially their need to

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foster domestic capabilities through policies designed to favour or support domestic enterprises.

- Development issues cannot be adequately addressed in an MFI merely by hortative statements and "best-endeavour" clauses in the preamble and body of the treaty. Likewise, while longer transition periods and special safeguards or derogations in favour of developing countries may be necessary, they are not sufficient to build the development dimension into the treaty. That dimension needs to be built into an MFI through substantive provisions, one part of which would be to allow sufficient freedom and flexibility to developing countries to pursue their own policies in regard to FDI, and the other part would be to spell out the obligations of investors.

- Political, social and economic development objectives intertwine rather strongly in the realm of FDI, and it is difficult to separate them completely. The sensitivity in regard to FDI and transnational corporations (TNCs) is heightened by the fact that developing countries are net importers of capital and that the size and strength of their enterprises, and in many cases even of their economies, are hardly a counterweight to those of the TNCs of the developed countries. Policies pursued for developmental or social reasons often have a political angle as well. This intermingling of political, social and developmental concerns is particularly relevant for dealing with issues of national treatment or right of entry and establishment in an MFI.

- While an MFI may make a valuable contribution to the enhancement of the investment climate of a host developing country, it may not be prudent to have high hopes about its importance in boosting FDI flows to developing countries. As the pattern of distribution of FDI flows to developing countries shows clearly, the market and investment opportunities offered by host countries, coupled with their macroeconomic conditions and other locational advantages, predominantly determine the locational decisions of foreign investors. As long as host countries keep their investment climate stable and congenial even by their own autonomous measures, they will continue to receive FDI flows in response to the investment and market opportunities they provide. There is no empirical basis for the view that developing countries not signatories to an MFI would be at a serious disadvantage *vis-à-vis* those that are signatories to an MFI in competing for FDI. An unbal-

anced MFI is therefore not in the interests of either developed or developing countries.

Against this background, the following are my priority criteria for determining the development-friendliness of a legally binding MFI:

1. **Definition of investment.** The definition of investment in the current (September 1997) draft of the OECD treaty is very broad, and it purposely goes far beyond the traditional notion of FDI. It includes not only equity capital, but also all forms of portfolio investment, debt capital, intellectual property rights and other tangible or intangible assets. The definition is so wide that it raises the question whether the purpose of the proposed MAI is to set standards for the treatment of (or liberal regimes for) TNCs and foreign investors rather than of FDI *per se*. Even if the OECD treaty finally adopts a dual approach to the definition of investment as is being contemplated, namely, an open (i.e. non-exhaustive) list of assets that are considered as investment, and a short closed list of items or operations that, except for purposes of investment protection, are not considered as investment, the scope and coverage of the treaty will be much too wide for the comfort of developing countries. From the perspective of developing countries, the definition of investment should be confined to the traditional notion of direct investment (i.e. FDI *per se*), as, for example, the definitions used by UNCTAD for the annual *World Investment Report* or by IMF for its statistical purposes. The definition of investment has significant implications not only for the national treatment, investment-protection and dispute-settlement obligations of an MFI, but also, in particular, through the depth of exceptions that may be needed for developing countries under the obligation relating to free transfer of funds by foreign investors. The East Asian currency turmoil is a reminder of how fragile foreign investor confidence can be in times of a crisis and how important it is to distinguish between long-term FDI and short-term volatile capital in a legally binding multilateral treaty.

2. **National treatment**. The issue of national treatment—i.e. non-discriminatory treatment as between domestic and foreign investors —must be considered at two distinct levels, namely, national treatment in the pre-establishment and establishment stages, and national treatment in the operational stage. While the latter may be an acceptable proposition for investments that are made in accord-

ance with the host countries' laws and regulations, as is the case in most of the existing bilateral and regional investment treaties, the issue of national treatment in the pre-establishment and establishment stages is on a different footing.

The building up of domestic industrial and technological capabilities is at the heart of the developmental objectives of developing countries. Experience shows that, without sufficient domestic capabilities, they may not be in a position to cope with, or derive full benefits from, foreign investment and technology flows. The establishment and strengthening of domestic capabilities depend on the freedom and flexibility to pursue their own policies to support or protect domestic industries and to provide a level playing-field for them *vis-à-vis* foreign enterprises with much greater competitive strength. Unqualified national treatment to foreign investors at the entry and establishment stages will inhibit the capacity of developing countries to achieve their developmental objectives, which, as stated earlier, are also often intermixed with their political and social objectives.

The exceptions to national treatment that developing countries may need would be the exclusion or restriction of FDI in certain industries, sub-industries or activities; domestic ownership requirements, including formation of joint ventures; and screening and approval of inward FDI.

Some of the ways for addressing national treatment in the pre-establishment phase from the standpoint of developing countries are:

- excluding the whole issue from an MFI as far as developing countries are concerned and reviewing it, say, after a ten-year period;
- having neither a negative list of country-specific reservations nor a positive list of commitments, but only a requirement for notification from time to time of the exceptions to national treatment followed by each country;
- following the hybrid approach of the General Agreement on Trade in Services (GATS) of WTO, i.e. a positive listing of the industries and activities opened up and a negative listing of the applicable limitations on national treatment and market access;

- freedom for each country to prescribe the quantum of FDI above which only it may grant national treatment;
- freedom from standstill and roll-back obligations in the event that a negative list approach is followed; and
- the inclusion of developmental reasons in the category of general exceptions, in addition to reasons such as national security, public order or culture.

It may not be an exaggeration to say that the touchstone for testing the development-friendliness of an MFI will be the degree of freedom and flexibility it allows to developing countries to pursue policies suited, in their view, to their developmental objectives, or in other words, the extent to which they remain free from the obligation of national treatment in the pre-establishment and establishment stages of an investment.

3. **Performance requirements and investment incentives.** The OECD treaty aims at prohibiting several performance requirements totally, and a number of other performance requirements when they are not connected with the granting of an advantage. It is noteworthy that it may prohibit three types of performance requirements not prohibited by the WTO Agreement on Trade-Related Investment Measures (TRIMs), i.e. the employment of a given level of nationals, establishment of a joint venture with nationals, and a minimum level of local equity participation. At the same time, the OECD negotiations so far have revealed an ambivalent attitude towards disciplining the use of investment incentives. From the perspective of developing countries, the issue of performance requirements should be left to be addressed by the TRIMs Agreement, and an MFI should not become an instrument for imposing additional obligations on them in this matter. This is all the more necessary if an MFI does not include any discipline on investment incentives (including taxation) other than the most-favoured-nation clause, national treatment and transparency. Developing countries should have a certain flexibility in the matter of performance requirements, particularly if they are linked to fiscal, financial or other incentives or if they are applicable to domestic and foreign investors alike.

4. **Restrictive business practices.** An MFI should address the anti-competitive and restrictive business practices of firms. This

important issue should not be ignored on the ground that corporate practices cannot be brought within the ambit of intergovernmental agreements and that they should be left to be regulated by national laws and regulations applicable to domestic and foreign investors alike. An MFI should, beyond prohibiting restrictive business practices that are regarded as illegal *per se*, aim at curbing such practices and thereby strengthen efforts at national levels.

5. **Obligations of investors**. Taken as a whole, an MFI must strike a fair balance between the rights of foreign investors and their obligations. To achieve this balance, an MFI should spell out investors' obligations, legally binding wherever possible, and suggest good corporate practices where this may not be possible. Three multilateral instruments were negotiated under the auspices of the United Nations system to lay down standards for the conduct, behaviour and obligations of foreign investors, especially TNCs. These are the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (negotiated in UNCTAD and adopted as a non-binding code by a United Nations resolution in 1980, the only multilateral instrument on this subject so far); the Draft United Nations Code of Conduct on Transnational Corporations (negotiated in the United Nations as a non-binding code, but not adopted); and the "Draft International Code of Conduct on the Transfer of Technology" (negotiated in UNCTAD as a non-binding code, but not adopted).[1] These three instruments, negotiated over considerable periods of time and stalled by the industrialized countries, provide valuable concepts and formulations concerning the obligations of foreign investors which are relevant to achieving a balance of interests of all parties in an MFI.

6. **Environmental concerns**. Non-governmental organizations have voiced the concern that the "top-down" approach to liberalization of investment regimes contained in the draft OECD treaty would undermine the ability of national governments to regulate access to and use of their natural and biological resources, and that it would put developing countries and transition economies in a particularly disadvantageous position. From the standpoint of developing countries, it is important that the rights secured by them over their natu-

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[1] The three instruments are contained in UNCTAD, 1996. *International Investment Instruments: A Compendium* (Sales No. E.96.II.A.9).

ral and biological resources in multilateral instruments such as the United Nations resolution on Permanent Sovereignty over Natural Resources (1962) and the Rio de Janeiro Biodiversity Convention (1992) are not diluted or whittled down by the national treatment obligations of an MFI (such as right of entry, right of establishment and freedom of access to natural resources on a par with nationals).

7. **Harmonization with the WTO Agreements.** An MFI should not become an instrument for imposing additional obligations and commitments on developing countries in matters falling within the ambit of the WTO Agreements. For example, the services sector should be left to be addressed entirely by the GATS. Article XIX of the latter already envisages successive rounds of negotiations for progressive liberalization of the services sector, taking into account the needs and circumstances of developing countries. The question of treatment and protection of intellectual property rights should similarly be left to be addressed by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) by excluding intellectual property rights from the definition of investment in an MFI. Performance requirements should be left to be addressed by the TRIMs Agreement, the more so when an MFI does not discipline the use of investment incentives. In short, an MFI must be compatible and consistent with the WTO Agreements, as well as the Ministerial Decisions of WTO. If they wish to follow the multilateral route for investment, developing countries would therefore need to consider seriously the question of using WTO as the forum for it. The scope and content of an MFI will be influenced heavily by the forum in which it is negotiated.

To sum up, the development-friendliness of an MFI hinges crucially upon the extent to which it allows freedom and flexibility to developing countries to pursue their own policies and to build up their own industrial and technological capabilities. Development needs must as much be a central aim of an MFI as unhindered market access for foreign investors. An MFI will tend towards development-friendliness if the issue of national treatment is focused more at the operational stage and less at the admission stage. The question of the economic benefits to be derived from foreign investment is not in doubt, nor is the need for fair and equitable treatment and the full and constant security of investment that takes place in accordance with host-country policies and regulations. But what is needed is a sensible balance between the operation of foreign investment and the national objec-

tives of host countries, be they economic, political, social or cultural. As UNCTAD's *World Investment Report 1996* pointed out, "development issues must be and can be addressed"[2] in an MFI if the concerns and circumstances of all the participants are recognized. ■

[2] UNCTAD, *World Investment Report 1996: Investment, Trade and International Policy Arrangements* (Sales No. E.96.II.A.14), p. xxix.