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**UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT**

# **LESSONS FROM THE MAI**

UNCTAD Series  
on issues in international investment agreements



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## NOTE

UNCTAD serves as the focal point within the United Nations Secretariat for all matters related to foreign direct investment and transnational corporations. In the past, the Programme on Transnational Corporations was carried out by the United Nations Centre on Transnational Corporations (1975-1992) and the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development (1992-1993). In 1993, the Programme was transferred to the United Nations Conference on Trade and Development. UNCTAD seeks to further the understanding of the nature of transnational corporations and their contribution to development and to create an enabling environment for international investment and enterprise development. UNCTAD's work is carried out through intergovernmental deliberations, research and analysis, technical assistance activities, seminars, workshops and conferences.

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The following symbols have been used in the tables:

Two dots (..) indicate that data are not available or are not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;

A dash (-) indicates that the item is equal to zero or its value is negligible;

A blank in a table indicates that the item is not applicable;

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Use of a hyphen (-) between dates representing years, e.g. 1994-1995, signifies the full period involved, including the beginning and end years.

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## *IIA Issues Paper Series*

The main purpose of the UNCTAD Series on issues in international investment agreements is to address key concepts and issues relevant to international investment agreements and to present them in a manner that is easily accessible to end-users. The series covers the following topics:

- Admission and establishment
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- National treatment
- Trends in international investment agreements: an overview
- Scope and definition
- Social responsibility
- State contracts
- Taking of property
- Taxation
- Transfer of technology
- Transfer pricing
- Transparency

## Preface

The United Nations Conference on Trade and Development (UNCTAD) is implementing a work programme on a possible multilateral framework on investment, with a view towards assisting developing countries to participate as effectively as possible in international investment rule-making at the bilateral, regional, plurilateral and multilateral levels. The programme embraces capacity-building seminars, regional symposia, training courses, dialogues between negotiators and groups of civil society and the preparation of a series of issues papers.

This paper is part of that series. It is addressed to government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers. The series seeks to provide balanced analyses of issues that may arise in discussions about international investment agreements. Each study may be read by itself, independently of the others.

The paper's main purpose is to consider the factors that contributed to the decision to discontinue the negotiations on a Multilateral Agreement on Investment, with a view to drawing lessons therefrom that could be of use for future negotiations of international investment agreements. However, that is not to say that the detailed and extensive exchange of views, and the consideration of numerous concepts and provisions, not all of which were traditionally reflected in bilateral investment treaties, did not result in some common understanding. Indeed, there was a convergence of views on some of the substantive areas, but these achievements are beyond the scope of this paper.

The series is produced by a team led by Karl P. Sauvant and Pedro Roffe. The principal officer responsible for its production is John Gara, who oversees the development of the papers at various stages. The other members of the team include S. M. Bushehri, Obiajulu Ihonor and Jörg Weber. The work is carried out under the overall direction of Lynn K. Mytelka. The series' principal advisors are Arghyrios A. Fatouros, Sanjaya Lall and Peter T. Muchlinski. This paper is a slightly revised version of a text contained in UNCTAD's *World Investment Report 1999: Foreign Direct Investment and the Challenge of Development* (New York and Geneva: United

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A handwritten signature in black ink, reading "R Ricupero", with a horizontal line underneath the name.

Geneva, November 1999

Rubens Ricupero  
Secretary-General of UNCTAD

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UNCTAD has carried out a number of activities related to the work programme in cooperation with other intergovernmental organizations, including the Secretariat of the Andean Community, L'agence intergouvernementale de la Francophonie, the Inter-Arab Investment Guarantee Corporation, the League of Arab States, the Organization of American States, and the World Trade Organization. UNCTAD has also cooperated with non-governmental organizations, including the Centro de Estudios Interdisciplinarios de Derecho Industrial y Económico – Universidad de Buenos Aires, the Consumer Unity and Trust Society – India, the Economic Research Forum – Cairo, the European Roundtable of Industrialists, the Friedrich Ebert Foundation, the International Confederation of Free Trade Unions, Oxfam, SOMO – Centre for Research on Multinational Corporations, the Third World Network, Universidad del Pacífico, University of the West Indies, and World Wildlife Fund International.

Funds for the work programme have so far been received from Australia, Brazil, Canada, France, the Netherlands, Norway, Switzerland, the United Kingdom and the European Commission. Countries such as China, Egypt, India, Jamaica, Morocco and Peru have also contributed to the work programme by hosting regional symposia. All of these contributions are gratefully acknowledged.

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## Executive summary

This paper 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 and, therefore, the paper 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

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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 arena moves from the bilateral to regional and from regional to multilateral levels, the complexity of negotiations increases and, thus, it may be advisable to pursue modest and incremental approaches to setting the agenda for the negotiation of IIAs. The existence of a network of 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 a more 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.

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## 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 foreign direct investment (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 Multilateral Agreement on Investment (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, 1998a; UNCTAD, 1998), 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),<sup>1</sup> were encountering significant difficulties, and after France announced that it would no longer send its delegation to participate in the negotiations.<sup>2</sup> The following is a brief discussion of what caused the MAI to fail.

## Notes

- 1 The original intention was to complete the negotiations by April 1997 (OECD, 1995).
- 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).

## Section I

### OBJECTIVES OF THE MAI

Originally, the stated main purposes<sup>1</sup> of the MAI negotiations were to consolidate what the OECD had achieved so far on investment rules<sup>2</sup> 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.<sup>3</sup> The negotiations were preceded 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, 1995, 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, 1995, p. 3).

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As indicated in box 1, the MAI draft consisted of 12 major sections, including issues that are generally covered in bilateral investment treaties (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.<sup>4</sup> 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

/...

**(Box 1, continued)**

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
  - Authorization Procedures
  - Transparency
  - Information Transfer and Data Processing
  - Membership of Self-regulatory Bodies and Associations
  - Payments and Clearing Systems/ Lender of Last Resort
  - Dispute Settlement
  - Definition of Financial Services

/...

**(Box 1, concluded)**

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:* OECD, 1998b; reprinted in UNCTAD, forthcoming.



## Notes

- 1 For a detailed discussion of the rationale for the MAI, see Witherell, 1995.
- 2 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, 1996).
- 3 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.
- 4 For a brief account of the highlights of the main provisions of the MAI and the MAI negotiating process, see UNCTAD, 1998, chapter III.

## Section II

### MAIN OUTSTANDING SUBSTANTIVE ISSUES<sup>1</sup>

#### 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.*

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*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.<sup>2</sup> 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<sup>3</sup>

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.<sup>4</sup>

## 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 non-governmental organizations (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.<sup>5</sup> 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)<sup>6</sup> led NGOs to think that property rights of individuals could be given precedence over the right of society to regulate for environmental purposes.<sup>7</sup> 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.<sup>8</sup> 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-to-State and investor-to-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,<sup>9</sup> NAFTA,<sup>10</sup> 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, 1999). 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.

### Notes

- 1 The texts of the provisions discussed in this section are those contained in the MAI Negotiating Text, as of 24 April 1998 (OECD, 1998b; reprinted in UNCTAD, forthcoming). 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.
- 2 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).
- 3 For an in-depth discussion of the issues raised in the MAI negotiations with respect to intellectual property, see Gervais and Nicholas-Gervais, 1999.
- 4 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.
- 5 See Chairperson's Proposals, MAI Negotiating Text of 24 April 1998, annex 2, *op. cit.*
- 6 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

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- 7 compensation, performance requirements and national treatment (Kobrin,  
1998). In the end, the parties agreed to settle the case.
- 8 On regulatory takings see Graham, 1998.
- 9 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, forthcoming).
- 10 However, out of some 1,700 BITs, less than 10 per cent are between OECD  
countries.
- 10 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.

## 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.<sup>1</sup> 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

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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.<sup>2</sup> 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,<sup>3</sup> provisions on the environment and labour would be added and no significant new liberalization would be gained immediately.<sup>4</sup>

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.<sup>5</sup>

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;<sup>6</sup> 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.



### Notes

- 1 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, forthcoming; Kobrin, 1998; Lalumière et al., 1998; Muchlinski, 1999; 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/cmismai/negtext.htm>); for links to other websites, go to [www.foreignpolicy.com](http://www.foreignpolicy.com).
- 2 For a discussion of the impact of an electronic global civil society on political authority and power, see Rothkopf, 1998, and Mathews, 1997.
- 3 The business community was interested in an additional national treatment tool and access to investor-to-State dispute settlement procedures on this issue.
- 4 Parts of the business community had suggested investment negotiations in the WTO; see ICC, 1996.
- 5 The following non-OECD countries 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.
- 6 According to one negotiator, "the success of the negotiations would have the same result as their failure" (Dymond, 1999).

## 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

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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.

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