Foreign direct investment and the multilateral trading system

Renato Ruggiero*

There can be no doubt that foreign direct investment has joined international trade as one of the primary motors—some would say *the* primary motor—of globalization, that is, the organization of production and supply of goods and services on a global basis. Indeed, in today's world economy, trade and investment are not merely increasingly complementary but also increasingly inseparable as two sides of the coin of this process of globalization. The aim of this article is to discuss the implications of this development for the future evolution of the multilateral trading system.

The relationship between trade and investment

At heart, the international trading system and an open regime for foreign direct investment (FDI) have always been mutually supportive. The aim of a liberal international trading system is to facilitate a mutually beneficial division of labour in which each country specializes in what it does best. The multilateral trading system is thus a key element governing the international allocation of investment, whether national or foreign. But the latter type, FDI, plays a particularly important role in facilitating an international division of labour that takes advantage of international trade opportunities. It does this, first, because it increases the mobility of factors of production—not only capital but also, probably more importantly, technology, managerial skills and other know-how. It also brings with it market access for exports of components to global production systems and for exports of finished products to distribution systems. Thus, a liberal international

* Director-General, World Trade Organization, Geneva. This article is based on a speech given at the seminar organized by UNCTAD on "Foreign Direct Investment in a Globalizing Economy", 12 February 1996, Divonne-les-Bains, France.

trading system and liberal regimes around the world for FDI are complementary and mutually reinforcing motors for the generation and diffusion of wealth and incomes around the world.

When the Havana Charter was drawn up in the years after the last World War, the need to integrate rules on investment and cross-border trade, as well as on competition policy, was already seen. However, this vision of its architects proved premature. Instead, the General Agreement on Tariffs and Trade (GATT) was born which was primarily concerned with the treatment at the border of imports of foreign goods.

If anything, in the years that followed, there was a tendency, at least in some countries, to see FDI and cross-border trade as alternatives. Countries often used to regard tariffs and other trade barriers as convenient mechanisms for inducing FDI. Protection of the domestic market offered attractive profits to foreign investors. The poor experience of countries with such import substitution FDI, taking place behind artificially constructed trade barriers, led to the adoption of new policies.

Now the emphasis in policies, both of governments and of the investors themselves, is on the complementarity of trade and investment. One aspect of this is the growing perception of the need for businesses to have a commercial presence in markets in order to be able to supply them effectively. This is clearly the case for many types of services, but it is increasingly recognized that the same applies for many goods. For example, a recent survey of corporate investment plans around the world indicates that the top priority in the foreign investment plans of manufacturing companies is setting up foreign distribution networks.

A second aspect of the integration of trade and investment in corporate decision-making is the role of investment in giving access to key factors of production to supply inputs into the production of goods and services for worldwide markets. These factors of production may be technical know-how, skilled or unskilled labour or natural resources or a combination of these, depending on the country. Much FDI, especially in developing countries, is aimed at the production of components or final products for the world market. Indeed, the figures produced by the UNCTAD Division on Transnational Corporations and Investment show that over one-third of international trade in goods and services consists of intra-firm transfers and a further one-third consists of exports from transnational corporations.

The establishment and maintenance of open and liberal trading and investment regimes around the world is critical for the welfare of humankind. By enabling business to determine on the basis of market forces the optimal arrangements for the production of goods and services for the supply of world markets, the efficiency of investment is maximized. At the same time, it represents the most effective mechanism available to us for the diffusion of productive know-how and capital around the world and the general creation of wealth. It can release much of the untapped production potential of today's developing and transition economies, while at the same time opening up new markets for high value-added products and services of the industrial countries that generate high-income jobs.

Developments relating to investment policy in the WTO framework

The tendencies towards increasing integration of issues of investment and trade in the world economy have already manifested themselves in the work of GATT and of WTO. While, originally, GATT dealt primarily with the treatment at the border of imports of foreign goods, subsequently GATT found it necessary to deal increasingly with internal policy instruments that can distort the conditions of international trade: such matters as subsidies, agricultural support policies, technical standards and government procurement. Although, for the most part, these policy instruments were looked at in terms of their impact on the cross-border movement of goods, the rules developed are also, in many cases, relevant to the competitive conditions which foreign investors face. For example, GATT and now WTO rules on subsidies are of relevance to the use of investment incentives.

A more recent and, to investment policy, more directly relevant development has been towards establishing international rules that govern the treatment of foreign affiliates operating within a country's territory. This is the issue at the heart of investment policy. This started in the Tokyo Round with the government procurement negotiations but, as a result of the Uruguay Round, has become a key feature of the agreements in the new areas of services and intellectual property.

The General Agreement on Trade in Services (GATS) integrates questions of trade and investment into a single agreement, treating the supply of the market by foreign affiliates through a local "commercial presence" as a form of trade in services. The GATS deals, in the area of services, with questions of rights of establishment and the treatment of foreign investors once established. Also relevant to FDI is the treatment in the GATS of another mode of supply of services, the temporary movement of natural persons; intra-firm transfers have been a focus of attention in this respect. Of course, the GATS should be seen for what it is, a first but very important step in establishing an international framework for trade, including FDI, in services. Like GATT before it, it is intended to be a framework for the progressive liberalization of trade in services through further negotiations. The GATS thus constitutes a framework with an inbuilt agenda for further negotiations on FDI matters in the area of services. Such negotiations have been taking place since the entry into force of WTO in the areas of financial services, maritime transport and basic telecommunications, and also of relevance to investment have been the further negotiations on the movement of natural persons. More generally, the GATS requires members of WTO to enter into successive rounds of negotiations, beginning not later than the year 2000, with a view to achieving progressively higher levels of liberalization.

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement) deals with an aspect of investment policy that has acquired more prominence in recent years, namely the protection of the intellectual property of foreign companies and individuals. In international discussions on investment policy, intellectual property is increasingly treated as a form of investment. The importance of intellectual property protection in providing a legal environment that is attractive to foreign investors, especially those with more sophisticated technology to transfer, is one reason why many countries around the world are upgrading their intellectual property systems without waiting for the end of the transition periods under the TRIPs Agreement.

Investment measures related to trade are more explicitly addressed in the Agreement on Trade-Related Investment Measures (TRIMs Agreement), which forbids the use of certain investment measures, in particular local content and trade-balancing requirements. This Agreement also provides that, within the next four years, consideration would be given to whether it should be complemented with provisions on investment policy and competition policy.

In summary, a number of extremely important aspects of investment policy are already the subject of WTO rules, and there is a substantial inbuilt work programme in this area, including a commitment to consider the need for complementary provisions on investment policy as such in the coming years.

International policy developments outside the WTO framework

The advantages of closer integration into the world market and the need for more competitive production structures have led many countries around the world to liberalize both their trade and investment regimes unilaterally. But as in the trade area, purely unilateral action in the investment area has not been seen as sufficient. The need for international agreements that provide a framework for the promotion and protection of investment has been widely felt. This has been manifested, in part, in a great increase in interest in bilateral investment treaties; some 60 per cent of the more than 900 bilateral investment treaties that presently exist have been negotiated during the course of this decade, including a growing number and proportion among developing countries.

We have also seen a proliferation of regional and other initiatives to address the establishment of international rules relating to FDI. Some of these are long-standing, such as the European Union, whose rules in this area have now been extended to the whole of Western Europe. Another example is the North American Free Trade Area (NAFTA) which integrates issues of trade and investment into a single trade agreement. In the context of a number of regional trading arrangements among developing countries, efforts are also being made. For example in December of last year, the ASEAN leaders agreed to study the establishment of an ASEAN free investment area. More broadly, there is the work of APEC on investment—the conclusion of a statement of investment principles and the further work on this issue under the APEC "Action Agenda", including on the merits of the elaboration of further APEC-wide disciplines in this area. In the context of the Free Trade Area for the Americas initiative, cooperation in the area of investment policy is under study, starting with the creation of an inventory of investment agreements and regimes in the area, as a basis for making recommendations for further action. Another significant development is the European Energy Charter, adopted by 41 countries and the European Community in December 1994, which contains detailed commitments on investment in the energy sector. There are also the negotiations under way in the OECD framework aimed at concluding what is referred to as a "Multilateral Agreement on Investment" by mid-1997.

Viewed from the perspective of the multilateral trading system, this proliferation of initiatives to formulate international rules on investment raises a number of questions. The first is that some countries are not involved in any of these efforts; and some key initiatives, which might well have important implications for the international community at large, are not open to many countries, especially developing countries. A second point of concern is that there is a risk that these various activities could give rise to outcomes that might be mutually conflicting and discriminatory vis-à-vis non-participating countries, especially where strong and coherent multilateral rules do not already apply. A third concern is that of the interaction of these initiatives with the existing multilateral rules and work programme of WTO. As discussed earlier, existing WTO instruments already address in a quite far-reaching way investment issues and there is an important inbuilt work programme in this area.

Looking to the future

While WTO is already heavily involved in dealing with a range of investment policy issues, it is well known that some members of WTO would like to see that Organization take up rapidly other investment-policy questions (see, e.g., Brittan, 1995). I would like to mention a number of factors that I believe should figure in reflection about these matters.

It is clear that international agreements only have a place if they can achieve something which cannot be obtained through purely national action. However, as the proliferation of treaties and initiatives aimed at international rules on investment demonstrates, there can be no doubt of the widespread recognition of the need for international cooperation.

What then are the factors that should be taken into account in assessing whether there is a case for multilateral action? Or put another way, what characteristics might justify multilateral work on investment? I would suggest consideration of the need for the following elements:

- The involvement of a sufficiently representative cross-section of the international community.

- While not necessarily replacing bilateral investment agreements, obviating the need for the negotiation of the tens of thousands of bilateral treaties that would be necessary to provide equivalent international rules.

- Ensuring that regional and any other more limited arrangements fit into a framework that provides adequate safeguards against discrimination to third countries.

- Promoting access to FDI, and reducing the cost of securing it to recipient countries, through providing greater security and common rules, for example against beggar-my-neighbour investment policies.

- Not undermining but increasing the ability of States to determine their own futures. In general, FDI, by increasing wealth, will do this, but it is necessary to be sensitive to the concerns of countries, especially those who perceive themselves as weaker ones, on this score.

- Ensuring an adequate balance that reflects the mutual dependence of home and host countries in any foreign investment.

- Ensuring that the issue is not perceived as one of North/South relations, but as one of common interest.

- Consolidating commitments to and facilitating public support for the free flow of investment and of goods and services. In this regard we should not delude ourselves that public support for outward investment is automatic.

These (and other) elements require careful consideration by all countries interested in FDI in order to arrive at a well-informed conclusion. UNCTAD, as well as other organizations, can contribute to understanding these elements better through policy analysis and consensus building.

In conclusion: when assessing the case for multilateral action, it would also be necessary, not merely to ensure full compatibility with the multilateral trading system, but also to consider at a more fundamental level the relationship between trade and investment. I have attempted here to outline why I believe there is an increasingly symbiotic and integrated relationship between trade and investment. To an important degree, WTO has already responded to this development through the GATS, which reflects a broader conception of market access, encompassing not only transborder movements but also the supply of markets through commercial presence and competition policy considerations. A key question before the multilateral trading system is whether the time is ripe to initiate a consideration as to whether this broader approach to trade policy should be extended to all areas of international trade. ■