Investment policies in multilateral and regional agreements: a comparative analysis

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The objective of this article is to examine issues and alternatives for reform of the international public policy regime for investment. It focuses on a comparative analysis of agreements concerning investment in the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO), as well as the investment policies of two regional agreements—the North American Free Trade Agreement and the European Energy Charter Treaty. The analysis of these agreements is used as a basis for developing priorities and proposals—particularly for the Multilateral Agreement on Investment at OECD and for the agenda of WTO. The concluding recommendations emphasize the need to give more attention to exceptions to accepted principles such as national treatment, the concerns of developing countries and the combined issues of investment incentives and performance requirements.

Focus and scope of the analysis

The purpose of this article is to identify best practice,[1] as well as deficiencies, in existing regional and multilateral investment agreements. The article is designed to contribute to the discussions taking place on a new interna-

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[1] The terms "best practice" and "state of the art" refer to investment rules which, in the authors' view, are furthest advanced in terms of their contribution to the liberalization process, and therefore represent a starting-point in ensuring that any new set of rules is at the forefront of current practice.

tional architecture of rules on investment and to help ensure that these new rules are complementary to, and do not conflict with, existing agreements. It thus focuses on the new agenda of international economic negotiations at OECD and WTO. The present authors (Brewer and Young, 1995a, b, c) and others (Bergsten and Graham, 1992; Fatouros, 1996; Guisinger, 1993; OECD, 1996; Witherell, 1995) have highlighted the need for international investment rules and the problems that emerge from the present patchwork of bilateral, regional and multilateral agreements concerning investment. In recognition of these facts, investment issues are now central to the agendas of both OECD and WTO: negotiations are progressing at OECD on a Multilateral Agreement on Investment (MAI), and at the same time implementation of the Uruguay Round agreements is increasing the involvement of WTO in investment issues.

The article presents a comparative analysis of the contents of eight multilateral and regional agreements concerning investment. The agreements incorporated in the analysis were selected to emphasize those with a substantial investment-policy content. Four OECD agreements are included: the Code of Liberalization of Capital Movements, the Code of Liberalization of Current Invisible Operations, the National Treatment Instrument and the Guidelines for Multinational Enterprises. Although only the two codes are legally binding on the signatories,[2] there are consultation procedures for all of the agreements; and all of them have become more prominent in recent years because of OECD's work on MAI, which may incorporate elements of these existing agreements in a more comprehensive binding agreement (OECD, 1996). The existing OECD agreements are particularly important because they represent a base on which a new MAI is being built.

The two Uruguay Round/WTO agreements that deal directly with investment issues are included—the General Agreement on Trade in Services (GATS), which in fact is also an agreement on investment in service industries, and the agreement on Trade-Related Investment Measures (TRIMs). These are both significant because they establish investment issues on the WTO agenda for the indefinite future. Although the agreements on Trade-Related Intellectual Property Rights (TRIPs), dispute settlement and subsi-

[2] Some of the reporting requirements are obligatory, even though other elements of the Guidelines are not. It should be further noted that the country coverage of a new MAI could be wider than the OECD membership since it could be a "free-standing" agreement open to accession by non-OECD countries.

dies all have direct implications for investment, they are not given extensive attention here because they are not specifically investment agreements.[3]

Among regional agreements, NAFTA receives special emphasis because it is commonly cited as a state-of-the-art agreement on many investment-related issues. Also included is the new Energy Charter Treaty (ECT), which is a sector-specific, regionally-oriented agreement concerning the economies of Central and Eastern Europe. The ECT is recognized as including some state-of-the-art provisions; its inclusion is also justified because of the economic significance of the sector and economies involved.[4] All eight instruments are contained in UNCTAD-DTCI, 1996a, a three-volume compendium of the most important instruments dealing with foreign direct investment and transnational corporations. Although these eight agreements are therefore the most useful for our immediate analytic purposes, they are of course not the only international agreements in the current investment regime. In order to limit the scope of the present paper to manageable proportions, we have excluded the Asia Pacific Economic Cooperation (APEC) statement of non-binding principles and the ASEAN agreements because they are not very fully developed. The World Bank (1992a; 1992b) guidelines on investment principles are also excluded because they do not constitute an international agreement. Furthermore, although bilateral investment treaties are of course also central to the current international regime, they are not included here because our present focus is a comparative analysis of regional and multilateral agreements.

Context and rationale

The rationale for multilateral FDI policies is clear, namely, to achieve an internationally efficient allocation of resources. As many authors have pointed out, it is the widespread recognition of the benefits associated with international investment in both developed and developing countries that has led to a worldwide liberalization of national policies, to the expansion of

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[3] However, for investment-related aspects of these additional Uruguay Round agreements, see Zampetti (1995); Brewer and Young (in progress) on the Subsidies and Countervailing Measures agreement; and Brewer (1995) on the Dispute Settlement Understanding. For the evolution of the negotiations on these and other Uruguay Round agreements, see Croom (1995).

[4] However, all of these other agreements, as well as the World Bank guidelines are included in a more comprehensive and more lengthy analysis that is in progress.

bilateral investment treaties and ultimately to support for regional and multilateral policies (see, e.g., UNCTAD-DTCI, 1994, 1996a). Without the latter, the present patchwork of rules can only expand, creating problems of inefficiency and non-transparency. In relation to multilateral rules, however, the answer to the question of "what policies?" or more precisely "what policy priorities?" is less clear. The basic issues include the liberalization of capital movements and freedom of market access, meaning the dismantling of impediments to investment and eliminating discriminatory treatment. On this basis, discussions (see, for example, European Commission, 1995a, b) on investment liberalization typically begin with the basic concepts of:

- Freedom of entry, that is, a commitment to grant foreigners the legal right to invest in the economy (sometimes referred to as pre-establishment national treatment or the right of establishment).[5]

- National treatment for foreign investors, so that the host country treats the investor operating in its territory in a generally similar way as a domestic investor or enterprise (i.e., post-establishment national treatment).

- Most-favoured-nation treatment (non-discrimination), meaning that host governments do not accord preferential treatment to investors from certain nations and thereby discriminate against them.

- In addition, investment-protection rules and dispute-settlement procedures establish the bases of relations between investors and host country governments.

These principles (which in reality present fundamental problems in terms of their implementation) may be regarded as *Phase I integration.* In considering deeper (*Phase II*) integration,[6] there is merit in recalling some of the economics literature concerning the rationale for government intervention. A distinction has been made between *structural market failure* and *endemic market failure* (Dunning, 1992, 1993). The former is caused by the anti-competitive behaviour of participants in the market, whether consumers, producers or, indeed, governments. Endemic market failure arises when the nature of market conditions in which goods and services are bought and

[5] A legal distinction is sometimes made between entry and establishment (Fatouros, 1996, p. 53).

[6] Graham (1995) has included some of the elements of Phase II integration as exceptions to national treatment or as conditional national treatment.

sold means that the market does not operate efficiently: either transaction costs are significant or there are externalities which mean that the private market will under-invest in the activity (research-and-development investment is a common example cited). These basic principles may be applied by national governments to improve the functioning of markets, but they equally become a requirement for creating a level playing-field for investment and creating the conditions for worldwide market efficiency.

A wide-ranging policy agenda stems from the above. Within the framework of structural market failure, there are several sets of policy issues (which apply both to international investment and international trade):

- ***Competition policy.***[7] Anti-competitive behaviour by firms becomes a major concern in an era of the globalization of markets. The nature of possible anti-competitive behaviour has also changed with the growing importance of strategic alliances and joint ventures. Within the context of competition policy, too, the behaviour of state monopolies needs to be added, which (like any other monopoly) have the potential to exploit their dominant position. State aids also have the potential to distort competition, especially when they favour certain undertakings or the production of certain goods; falling into this category are state aids for rescuing and restructuring enterprises, aid for privatization programmes, regional and sectoral aid, etc.

- ***Investment incentives and performance requirements.***[8] The recently-completed Uruguay Round negotiations reiterated long-standing GATT performance requirements within the context of its TRIMs agreement. Performance requirements are on occasion linked to investment incentives, and a common, if not unanimous, view is that both have the same effect as trade restrictions in reducing allocative and dynamic efficiency (for a fuller discussion, see Graham, 1994b; Guisinger, 1985; UNCTAD-DTCI, 1995, pp. 288-305). There are also

[7] The domain of *competition policy* may be defined quite differently. For example, the European Union approach has been to use *competition policy* almost as the equivalent of *industrial policy.*

[8] Although performance requirements, for example, are traditionally included within trade-policy discussions, they are a form of interference with the market mechanism by governments. Unilateral approaches to these issues cannot handle, for example, international incentive bidding wars. Thus international competitive pressures may compel governments to offer foreign investors higher incentives than those justified under objective criteria (UNCTAD-DTCI, 1996b).

distributional as opposed to efficiency issues which complicate matters when dealing with TRIMs in a developing country context. Thus, within a strategic trade context of imperfect competition, TRIMs may play a positive role in stimulating development and embracing host country welfare (UNCTC-UNCTAD, 1991). In any event, it is widely accepted that unilateral policy approaches are inadequate to address these issues.

- ***Elimination of non-tariff barriers.*** Within this category are technical barriers emerging from divergent company laws and government-procurement regulations. The latter is a particularly contentious issue in relationships among the Triad members. Evidence from the European Union experience shows that the time-scale for the effective elimination of non-tariff barriers is lengthy: statutory liberalization is only the first step in removing barriers which have long-standing nationalistic and cultural roots. It would be possible to add to this list physical barriers (e.g., customs and immigration controls) and fiscal barriers (e.g., different value-added taxes and fiscal duties), but removal of these barriers could hardly be on the agenda of even the most ambitious multilateral negotiations. There is, however, another issue, namely the liberalization of country policies regarding entry and residence of foreign personnel employed by TNCs in host nations, which is more easily addressed. There are sensitivities here, especially in developing countries; but, certainly, ease of entry and employment rules for key personnel are important for foreign investment projects.

The agenda emanating from the above discussion on structural market failure is lengthy, detailed and problematic for international investment negotiations. There are issues—investment incentives and performance requirements being illustrations—that are on the borderline between the competence of national as opposed to international authorities. The inclusion of endemic market failure adds greatly to these problems. It is recognized that a key requirement for improving country competitiveness is government investment in public goods, including education and training, transport and communications infrastructure, and research and technological development. As has been shown in the case of research-and-development policy in the United States and the European Union, however, there are dangers of discrimination in favour of national producers (Warner and Rugman, 1994). This is the case despite the obvious advantages to host countries in many circumstances in opening up membership of government-supported research consortia to foreign companies in an era of globalization.

It may be that the borderline for inclusion in multilateral investment negotiations should at this stage be the issue of research and innovation. This excludes a wide range of domestic government responsibilities to improve the functioning of markets, including improving information about overseas market opportunities for small firms, ensuring that intellectual property legislation meets the needs of innovators, and establishing professional investment-promotion agencies.

The above constituents of *Phase II integration* must be included within a broad agenda for multilateral investment policy. As will be discussed, prioritization is essential if any negotiations are not to become bogged down in detail. Before doing this, however, two important issues require some comment: the first concerning the choice between binding and non-binding rules, and the second relating to developed and developing country priorities.

Legally binding and non-binding agreements. Theory does not assist in terms of a preference for legally binding agreements, as opposed to soft-law policy measures. The World Bank (1992a) has pointed out that efforts of international agencies to develop codified, universally agreed laws on foreign direct investment (FDI) in the past have been protracted and either failed or resulted in a limited agreement representing the lowest common denominator. This has meant limited progress in terms of encouraging desirable practice and a more attractive investment climate. It was for this reason that World Bank efforts have been directed towards setting out *guidelines* on what may constitute acceptable and desirable standards (World Bank, 1992a). In a similar vein, Fatouros (1996, p. 60) has argued that: ''The prospect of a binding agreement may 'freeze' states (and other actors) in positions intended to maximize bargaining advantage'' and thereby hinder and perhaps distort moves to liberalization. It is true that voluntary guidelines which are in some sense an ''ideal'' are helpful in setting aspiration levels, provided they are complementary to existing sets of rules. However, there is a danger of non-binding agreements being ignored or sidelined, and the OECD Guidelines for Multinational Enterprises have suffered from this problem (Hamilton, 1983). Self-evidently, legally binding agreements have greater status, especially when there is a proliferation of FDI agreements which may confuse participating actors. And even if the standards set are lower than with voluntary codes, the liberalization gains cannot readily be reversed. In truth, it may not be a choice between binding or non-binding agreements: in order to make progress on a series of fronts, a combination of

approaches may be utilized (see the discussion of the issue of firms' obligations below).[9]

Developed and developing nations. Irrespective of whether future negotiations take place in OECD and/or WTO, recognition will need to be given to the differing interests of developed and developing countries. The latter are particularly concerned, of course, about the developmental implications of transnational corporations (TNCs) and technology transfer. Attention has been drawn in some recent work to the continued relevance of theories of underdevelopment where firms lack competitive, indigenously generated technological capacities, and to the problems of technology transfer into lower-income developing countries (Tolentino, 1993; Lee and Young, 1995). Recognition by developed nations of these issues and concerns is important for the future of multilateral rules. The agreements on intellectual property rights and services in WTO were widely regarded as reflecting developed country priorities and agendas. The relative weakness of the TRIMs agreement also reflected the inability of developed and developing countries to make progress on performance requirements.

UNCTAD-DTCI (1996b) has confirmed that competition among countries to attract and retain FDI through incentives is strong and pervasive. It is arguable that the economic distortions produced by incentives will increase as competition for investment projects becomes global as opposed to chiefly regional, as is the case at present. Incentive bidding may rise as the (limited) constraints imposed by regional agreements (such as those in the European Union) prove inadequate. Multilateral disciplines are therefore required, and since these disciplines will primarily act as constraints on developed countries, there may be greater tolerance by developing countries of international rules generally (UNCTAD-DTCI, 1996b). Questions of definition and scope and types of disciplines need to be addressed (OECD, 1996). Discussions on incentives will also need to include investment-distorting mandatory performance requirements which are frequently linked. Although there have been calls for MAI to cover mandatory performance requirements in a comprehensive manner (OECD, 1996), the developing country concerns, which derive from evidence such as that noted above, need to be considered.

A clear shift in emphasis has occurred from one focusing upon *firms' obligations and governments' rights* to one emphasizing *firms' rights and government obligations.* This is a reflection of changing attitudes and prior-

[9] We are grateful to A. A. Fatouros, who has drawn our attention to the variability in the legal strength among the ECT's provisions by virtue of their language, and we are also indebted to Madalena Oliveira e Silva for clarification of key provisions of the ECT.

ities at the host country level and the recognition of the beneficial contribution of international investment. Of the range of multilateral and regional agreements in existence at present, the OECD Guidelines (which are often ignored by TNCs) focus upon the obligations of firms, and there are brief references to firms' obligations, specifically concerning environmental protection in the ECT and more generally concerning compliance with host laws in the APEC principles. For future negotiations, it may be unrealistic to expect to ignore issues concerning the obligations of firms, given the bargaining power of global TNCs and the distributional implications of their actions, especially in developing countries.

In terms of the agenda items which emanate from the analysis of structural and endemic market failure, there are other issues where insuperable implementation difficulties mean that progress at the level of multilateral rules can only be very long-term. The elimination of non-tariff barriers represents one of these issues where there are fundamental areas of disagreement among Triad nations themselves without extrapolating developed-country practice onto the global scale.[10]

Comparisons of agreements

As table 1 reveals, the eight international agreements concerning investment vary greatly in terms of their country coverage, objectives and other characteristics. In contrast with the *non-binding* OECD National Treatment Instrument and Guidelines, most agreements emphasize *binding*

[10] There are many other issues that also need attention. Here we can mention them only very cursorily. One set of issues concerns the relative emphasis to be given to policies concerning outward versus inward investment. It is already clear from background papers from the European Union (Brittan, 1995a) that the prime interests are in liberalization to facilitate market access for European TNCs investing overseas. By contrast there seems to be little concern—except among academic observers—about the critical area of international competition policy, which involves home as well as host countries. Trade-investment and other policy inter-linkages are of course another area of much concern. It is now widely recognized that trade and investment along with licensing and other contractual arrangements are complementary modes of doing business abroad, and hence investment policy must not be seen in isolation. In the terms of Julius (1990) the aim of public policy should be "modal neutrality", i.e., non-discrimination between trade and investment. The case is easily illustrated in respect of non-tariff barriers which restrict both trade and investment. Aside from the investment/trade policy linkages, the need to ensure a holistic approach to policy has been argued extensively (Sauvé and Zampetti, 1995). In addition, Dunning (1992) has expressed the problem of policy inter-linkages in terms of optimizing the economies of common governance of a range of macro-organizational strategies, including trade, investment, regional, transport, competition, fiscal, environmental, education and training and technology policies. In the European Union context, Brewer and Young (1995a) have highlighted the policy overlaps, contradictions and gaps that derive from the absence of an international investment-policy framework.

commitments.[11] Although a number of the agreements are recent and reflect the present liberalization trends in the global economy, the OECD Codes are long established. Thus the OECD Codes on Liberalization of Capital Movements and on Current Invisible Operations date back to 1963, and the National Treatment Instrument and Guidelines for Multinational Enterprises were adopted in 1976. Exceptions to the OECD rules, however, have been widespread, and the momentum for implementation was rather uneven until the recent past. As evidence of this, within the European Union it was not until the passing of the Capital Movements Directive in 1988 that there was a concerted impetus towards the liberalization of capital movements among Member States and the removal of exchange controls; Greece was the last country to liberalize on 16 May 1994.

Table 2 evaluates the extent of coverage in the agreements, using a subjective rating. It is clear from that table, even at this level of generalization, that the regional and multilateral agreements vary in terms of both width and depth. The OECD Codes generally have only partial coverage of a few issues, the notable exceptions being the extensive coverage of national treatment in the National Treatment Instrument and the coverage of funds transfers in the Codes. Despite the large number of countries involved in the Uruguay Round negotiations, some progress was made on a range of issues in the GATS; TRIMs, by contrast, is very specific and deals only (and weakly) with performance requirements. Among the regional investment agreements, APEC's non-binding, broad statement of principles means inevitably that its coverage of investment issues is not detailed. As might be expected, the most specific agreements (NAFTA because its country coverage is restricted to Canada, Mexico and the United States; and the Energy Charter Treaty because of its sectoral focus) are both deeper and wider than the others. NAFTA is especially comprehensive in this regard, and it is because of this that there has been particular interest in using NAFTA as a model for other agreements.

Generalizing on the architecture of the agreements, there is undoubtedly now a good deal of experience on the core Phase I integration issues, with the Energy Charter Treaty, NAFTA and the OECD National Treatment Instrument together providing extensive coverage. In terms of the Phase II "deeper" integration, however, coverage is much more limited. The suggestion from table 2 is that NAFTA provides fairly extensive coverage of three important non-tariff barriers, namely state monopolies, performance requirements and technical standards and certification, with partial coverage in the

[11] Since 1988, there has been a standstill on new measures that would be exceptions.

Table 1. Summary characteristics of agreements

			OECD[c]				WTO[d]	
Characteristics	ECT[a]	NAFTA[b]	Cap	Cur	NTI	MNE	GATS	TRIMs
Binding	yes	yes	yes	yes	no	no	yes	yes
Year	1994	1993	1963	1963	1976	1976	1994	1994
Country coverage (number)	51	3	26	26	26	26	124	124
Objectives	Liberalize energy trade & investment in Central and Eastern Europe	Liberalize regional trade & investment	Liberalize restrictions on capital transactions	Liberalize restrictions on financial transactions	Establish national treatment principles	Establish guidelines for firms' behaviour	Establish services trade & investment framework	Limit performance requirements in manufacturing
Features	Detailed sector-specific and region-specific coverage	Detailed coverage of numerous issues	Covers many types of capital transfers	Focused on balance of payments current account transactions	Many sectoral exceptions	Brief statements on selected issues	Complex architecture	Narrowly focused

[a]Energy Charter Treaty

[b]North American Free Trade Agreement

[c] OECD agreements are:

Cap = Code of Liberalization of Capital Movements

Cur = Code of Liberalization of Current Invisible Operations

NTI = National Treatment Instrument

MNE = Guidelines for Multinational Enterprises

[d] WTO agreements are:

GATS = General Agreement on Trade in Services

TRIMs = Trade-Related Investment Measures

Table 2. Coverage of elements in agreements[a]

Element	ECT	NAFTA	OECD				WTO	
			Cap	Cur	NTI	MNE	GATS	TRIMs
Phase I integration								
Freedom of entry	*[b]	**	**	*	*	*	**	*
National treatment	**	**	*	*	***	*	**	*
MFN treatment	**	**	*	*	*	*	**	*
Investment protection	***	***	*	*	*	*	**	*
Expropriation	***	***	*	*	*	*	*	*
State-investor disputes	**	***	*	*	*	*	*	*
Funds transfers	***	**	***	***	*	*	**	*
Phase II integration								
Monopolies & restrictive practices	**	**	*	*	*	*	**	*
Competition policy	**	**	*	*	*	*	*	*
State monopolies	**	***	*	*	*	*	**	*
Privatization	*	*	*	*	*	*	*	*
Incentives	*	**	*	*	*	*	*	*[c]
Performance requirements	**	***	*	*	*	*	*	**
Technical standards & certificates	*	***	*	*	*	*	*	*
Government procurement	*	**	*	*	*	*	**	*
Personnel movements	**	**	*	*	*	*	**	*
Personnel nationality	**	**	*	*	*	*	*	*
Data transfer	*	*	*	*	*	*	*	*
Other issues								
Transparency	**	**	*	*	*	*	**	**
State-state disputes	**	***	*	*	*	*	***[d]	***[d]
Firm conduct	*	*	*	*	*	**	*	*
Sub-national obligations	*	***	*	*	**	*	*	*
Policy inter-linkages	**	**	*	*	*	*	**	*

[a] Definitions of asterisks:

*** Extensive coverage, with exceptions or conditions.

** Partial coverage, with exceptions or conditions.

* No coverage, or virtually no coverage.

[b] The ECT concerns post-establishment issues; however, a supplementary treaty concerning pre-establishment issues is being negotiated.

[c] The Subsidies and Countervailing Duties agreement contains restrictions on some investment-related incentives.

[d] State-state disputes concerning GATS or TRIMs are subject to the extensive dispute-settlement procedures of WTO established by the Dispute Settlement Understanding of the Uruguay Round.

fields of competition policy, incentives and government procurement. Among the other regional agreements and WTO, there is only partial coverage of a limited range of barriers, with the Energy Charter Treaty being the most comprehensive.

It is apparent from these brief observations that international investment agreements to date are generally fairly weak on some key non-tariff restrictions, and, even with NAFTA, it is too early to be certain of the effectiveness of the provisions. Since the European Union has extensive experience on a range of these Phase II integration issues, its lessons are reviewed briefly at the end of this section.

Constituents of agreements

Turning to the details of the agreements, the provisions of NAFTA receive more attention, since, as noted above, they are the most comprehensive and represent best practice on many issues:

National treatment

This concept means that a government treats a foreign-owned corporation no less favourably than a domestically-owned corporation—that is, it does not discriminate against foreign investors in favour of locally-owned firms.[12] The nominal commitment to national treatment, however, is substantially diluted by each country's industry-specific exceptions—which are evident in NAFTA, the OECD National Treatment Instrument[13] and the GATS.[14] These industry exceptions are of course central to the negotiation of any international investment agreement providing for liberalization of government restrictions on the right of establishment for foreign investors; these

[12] ''National treatment'' does not necessarily mean *identical* treatment for foreign affiliates and domestically-owned firms. Thus, for instance, the OECD Committee on International Investment and Multinational Enterprises has issued a ''clarification'' of the National Treatment Instrument providing for ''equivalent'' treatment for ''situations where identical treatment cannot be accorded to [branches and other unincorporated] entities because of their special nature. These situations are those where prudential considerations relating to financial or insurance sector activities, or legal/technical differences preclude a [signatory] from according identical treatment . . . . The difference in treatment should, however, be no greater than that which is strictly necessary to meet prudential requirements or other legal/technical differences, and should not, beyond that, result in requirements that unfavourably affect the equality of competitive opportunities on the market'' (OECD, 1993a, p. 22).

[13] The OECD National Treatment Instrument provides for national treatment only for foreign affiliates' post-establishment operations; it does not provide for national treatment for the right of establishment. However, conditions concerning establishment are addressed in the OECD Code of Liberalization of Capital Movements. In the case of an investment in a new line of business by an affiliate of a foreign-owned firm, the distinction between pre-establishment and post-establishment national treatment can become problematic since the investment might be considered a new investment by the affiliate (in which case pre-establishment policies apply) or an investment by an already-established firm (in which case post-establishment rules apply).

[14] The APEC principles concerning national treatment are non-binding so there is no need for industry exceptions.

negotiations are often conducted on a bilateral basis within the larger regional or multilateral negotiations. The intensity of the desire to seek exceptions varies across industries or countries, but there are some recurrent patterns—such as exceptions for national security-sensitive industries (e.g., nuclear energy) or highly regulated industries (e.g., banking and insurance) or other industries where there are monopolies and/or significant government ownership (e.g., transportation and communications). In addition there are industries that are so central to the economy (e.g., oil in some countries) or are politically sensitive for other reasons (e.g., culturally sensitive industries such as film) or have yet other features that give them special status in the political system so that they can gain exemption from national treatment. In some instances, the negotiations on specific industries become sufficiently problematic and idiosyncratic that special, industry-specific arrangements are made. For instance, there are semi-autonomous negotiations for separate agreements (e.g., textiles in the Uruguay Round), or deferred negotiations on the contents of an annex (e.g., financial services in the GATS) or overlapping negotiations on separate chapters with extensive industry-specific provisions that cut across more general investment-related provisions (e.g., the automotive industry in NAFTA).

The industry exceptions can be recorded through either a *negative list* or a *positive list* approach. Whereas a negative list registers specific itemized industry *exceptions* to a commitment to provide national treatment, a positive list presents those industries for which a national treatment commitment *is being made*. Although in the abstract the two approaches can logically yield identical results (at least at a given fixed point in time), in actual practice a negative list approach is more likely to provide more encompassing national treatment and to be more transparent; it is therefore generally regarded as best practice.[15] In any case, it is necessary to examine each individual country's list of industry exceptions in negative lists or each individual country's industry commitments in positive lists. The longer the

[15] NAFTA and the OECD National Treatment Instrument both employ a negative list approach. However, in the case of the GATS, there is a complex two-tier architecture according to which a positive list approach is used to specify industries for which commitments are being made, and within that positive list there are negative lists for both national treatment and market-access commitments. Although the approach is thus a combined positive-negative list approach, the GATS approach is not widely considered best practice because the first-level specification of industries is a positive list. The architecture of the GATS is sufficiently complex that it has prompted one observer (Sauvé, 1994, p. 16) to suggest that there is a need for "the development of a methodology allowing for an in-depth review of national schedules of commitments under the GATS. This would allow insights to be gained—across countries, sectors and modes of delivery—regarding the nature and incidence of impediments to trade in services (including impediments to investment/commercial presence)".

lists and/or the more economically significant the industries in a negative list approach, or the shorter the lists and/or the less economically significant the industries in a positive list approach, the more the country's economy that is closed to foreign investment.[16]

Most-favoured-nation treatment

Aside from national treatment, the other core principle of non-discrimination is most-favoured-nation (MFN) treatment, i.e., the commitment to extend the same level of liberalized policy measures to investors from all signatory countries regardless of their nationality. There are accordingly provisions for MFN in the APEC principles, the ECT, NAFTA and the GATS. The language of NAFTA is particularly expansive in this regard. In article 1103, it provides MFN for "investors" (para. 1) and for "investments" (para. 2) as follows: "Each Party shall accord to investors [investments] of another Party treatment no less favourable than it accords, in like circumstances, to investors [investments] of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

While the MFN principle is firmly embedded in existing international agreements, as with national treatment, there are many exceptions to it in practice. In recent years, two tendencies have been undermining MFN as a keystone of the international trade regime and by implication threaten to undermine efforts to reform the investment regime. The first tendency is to approach issues bilaterally through a focus on bilateral disputes (e.g., Japanese-United States trade in the motor-vehicle industry) or conditional MFN in negotiations (e.g., financial services and other industries in the GATS).[17] It should be noted, however, that there is a fundamental difference between MFN on trade issues such as tariff levels and investment issues such as the right of establishment. Whereas tariff levels can be negotiated down incrementally, the right of establishment is categorical, except for any industry exceptions that are negotiated. Another tendency has been to seek "carve-outs" for regional economic international organizations in agreements. This has become an issue, for instance, for the European Union in the OECD negotiations on the MAI. The two major recent documents of the

[16] In the case of federal political systems, there can be separate lists for sub-national governmental commitments, as there are in the OECD National Treatment Instrument, or different phase-in transition periods, as there are in NAFTA. These and other issues involving sub-national governmental units are treated in more detail below.

[17] See the list of article II (MFN) Exemptions in the Appendix to the GATS.

European Commission (1995a, b) that deal with investment issues are nearly silent on a commitment to MFN. The only reference to MFN is in the context of a brief discussion of bilateral investment treaties: "Without [global MFN,] attempts to provide equal treatment for foreign investors will be thwarted by those who continue to discriminate through the use of non-standardized BIT[s]. MFN should be supported by a standstill agreement which will prevent countries from reducing access to all of its trading partners. Equally, it will be important to assure equal treatment for host countries." In contrast, the APEC espousal of "open regionalism" can be interpreted as a commitment not to undermine the traditional multilateral systemic principle of MFN, though many of the statements of the principle of open regionalism with regard to APEC have in fact omitted any reference to MFN.[18] Along with the half-century commitment to MFN in the GATT/WTO agreements on trade (and now selectively for investment as well in the GATS), at the same time there has been the acceptance of regional agreements that are GATT/WTO "consistent" even though they inherently violate the MFN principle. Issues concerning the criteria and procedures for determining whether regional agreements are GATT/WTO consistent have themselves been the subject of considerable controversy, enough so as to prompt the negotiation of the Uruguay Round "Understanding on the Interpretation of Article XXIV." Although that understanding establishes criteria as well as notification procedures for regional economic arrangements to determine whether they are GATT/WTO consistent, it leaves many issues unanswered for both regional trade and investment policies (UNCTAD-DTCI, 1994, pp. 29-43).

Sector-specific provisions

The international agreements being considered here have addressed sector-specific issues through several different architectural arrangements.[19] Although the architecture varies, there is a fundamental similarity in the net results, namely, a further complication of the already complex patchwork of agreements. There is also a further de facto dilution of national treatment and MFN. Two prominent examples are the automotive industry and financial services. The separate NAFTA chapter annex on the automotive indus-

[18] This issue is discussed in Green and Brewer (1995, ch. 14).

[19] In some instances (e.g., telecommunications), there are industry-specific technical issues that purportedly require special treatment; in others (e.g., banking), there are distinctive regulatory issues; and in yet others (e.g., textiles, maritime transport, air transport), there are long-standing traditions of protectionism that create particularly strong political resistance to liberalization measures.

try, for instance, includes elaborate and discriminatory, industry-specific provisions concerning rules of origin, which have far-reaching implications for firms' FDI decisions as well as the more obvious trade implications. As for financial services, the separation of financial services from the other sectors covered by the GATS and the associated deferral of the completion of negotiations has made possible a more effective domestic political campaign in the United States by that industry to resist the completion of those negotiations.[20] On the other hand, the development of semi-autonomous industry-specific agreements may facilitate the horizontal integration across policy areas; thus, for instance, investment policy-trade policy and investment policy-regulatory policy linkages can perhaps be more directly addressed on a sectoral basis. For instance, the linkages between trade-performance requirements and trade subsidies, on the one hand, and investment incentives, on the other, are central issues in the automotive industry, but not in financial services. In contrast, the linkages between domestic regulatory issues such as capital requirements for banks, on the one hand, and obstacles to establishment for foreign investors, on the other, are obviously of special interest in financial service industries.[21] There is then an issue about how best to address industry-specific questions without unduly complicating or diluting more generic agreements. The diversity in the architecture of existing agreements reflects the complexity of the varying requirements of diverse industries and the political realities of international and domestic negotiations.

Performance requirements

NAFTA and the TRIMs agreement represent extremes in the treatment of performance requirements. The TRIMs agreement only restates existing GATT obligations and offers a short "illustrative list" of prohibited policies. NAFTA Article 1106, in contrast, contains an extensive list of prohibited policies concerning: export percentages, domestic content percentages, domestic purchase requirements or preferences, relationships between imports and exports or foreign exchange inflows, relationships of domestic sales to exports or foreign earnings, technology transfer requirements, or exclusive supplier arrangements. Thus, NAFTA represents a significant advance in attempts to limit performance requirements.

[20] Questions about the aggregation-disaggregation of negotiations across industries involve a complex array of calculations about both international and domestic trade-offs for support across countries and industries.

[21] Similarly, there are significant industry differences in the interface between FDI issues and issues concerning monopolies, state enterprises and privatization.

Table 3. Specific provisions in agreements

(Article numbers, except as otherwise indicated)

Provision	ECT[a]	NAFTA[b]	OECD[c]				WTO[d]	
			Cap	Cur	NTI	MNE	GATS	TRIMs
Definition of investment	1	1139					x	
National treatment	10	1102+[g]		2	2		17+[y]	2
MFN treatment	10	1103[h]					2[z]	
Sector-specific provisions	e	i	m	o	r		aa	1[dd]
Ownership-share restrictions								
Monopolies, state enterprises	22	1108					8	
Privatization								
Performance requirements		1106						2+[ee]
Personnel movements		1601-8					33[bb]	
Personnel nationality	11	1107						
Data transfer								
Funds transfer	14	1109	11	6			11	
Government procurement		1003					13	
Incentives					s			
Expropriation	12-13	1110						
Exclusions		1108+[j]	3+[n]	3+[p]	t	2[u]	10[cc]	3
Transparency	20						3	6
Firm conduct	6					1-9		
State-state disputes		2011-19[k]				v	13	8
State-investor disputes		1115-38						
Sub-national obligations	23	1108		q			26	
Policy inter-linkages		l				w		
Relation to other agreements	4+[f]	1103	4				26	
Other								

[a] ECT: numbers refer to articles in Energy Charter Treaty, Lisbon, December 1994 (*International Legal Materials*, 1995; Waelde, 1995).

[b] NAFTA: numbers refer to articles in the North American Free Trade Agreement between the Government of the United States of America, the Government of Canada and the Government of the United Mexican States.

[c] OECD: numbers refer to articles in Code of Liberalization of Capital Movements [''Cap''] and Code of Liberalization of Current Invisible Operations [''Cur''], National Treatment Instrument [''NTI''], and paragraph numbers in Guidelines for Multinational Enterprises [''MNE''] (see Brewer and Young, 1995a; Graham, 1995; Ley, 1989; Smith, 1995).

[d] WTO: numbers refer to articles in the General Agreement on Trade in Services [''GATS''] and agreement on Trade-Related Investment Measures [''TRIMs''] (see Sauvé, 1995; OECD, 1994b; UNCTAD-World Bank, 1994). Roman numerals of articles in GATS have been converted for consistency of presentation in the table.

ECT:

[e] Entire treaty is limited to energy sector.

[f] Articles 4, 5, 6, 16 and 25 contain references to other agreements.

NAFTA:

[g] Article 1104 provides for the better of national treatment or MFN. Also see articles 1202 (services) and 1405 (financial services) on national treatment in those sectors.

Firm conduct

There has been a tendency in negotiations in recent years to exclude references to firm conduct, a tendency that is reflected in the abandonment of the United Nations effort to develop a Code of Conduct and the dismantling of the United Nations Centre on Transnational Corporations. However,

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[h] Article 1104 provides for the better of national treatment or MFN. Also see articles 1203 (services) and 1406 (financial services) on MFN in those sectors.

[i] In addition to the provisions in chapter 11 concerning investment in general, there are sector-specific provisions concerning investment in the following sectors: automobiles (ch. 3, annex 300-A), textiles (ch. 3, annex 300-B), energy (ch. 6), agriculture (ch. 7), telecommunications (ch. 13), and financial services (ch. 14).

[j] Annexes I-IV provide for reservations and/or exceptions concerning existing measures (II), state activities (III), MFN (IV); chapter 21 includes exceptions for national security, balance of payments, cultural industries, taxation and other reasons.

[k] Also see: articles 1414-1415 on disputes in financial services, article 1606 on disputes concerning temporary entry of business persons, article 804 on disputes concerning emergency actions (and article 707 on private commercial disputes concerning goods).

[l] Related policy areas are in chapter 15 (competition) and chapter 17 (intellectual property).

OECD/Capital Movements Code:

[m] Sectoral reservations are in Annex B lists of individual countries.

[n] lso Annex B.

OECD/Current Invisibles Code:

[o] Sectoral reservations are in Annex B lists of individual countries.

[p] Also Annex B.

OECD/National Treatment Instrument:

[q] See Annex for individual countries' exceptions.

[r] There is a separate OECD investment incentives instrument.

[s] See Annex for individual countries' lists.

[t] See Annex for sub-national exceptions of Australia, Canada and United States.

OECD/Guidelines for Multinational Enterprises:

[u] Section on Disclosure of Information by *firms*.

[v] Non-binding guidelines.

[w] Sections on competition, taxes, employment and science and technology.

WTO/GATS:

[x] The term investment is not used, but "commercial presence" is defined to mean foreign direct investment.

[y] Also see Schedule of Specific Commitments (articles XIX-XXI and the list in Appendix).

[z] Also list of article II (MFN) exemptions in Appendix.

[aa] Applies only to services; in addition, sector-specific agreements are in annexes and related instruments on air transport, financial services, maritime transport, telecommunications and basic telecommunications.

[bb] Annex and Decision on Movement of Natural Persons.

[cc] Also articles XII, XIV and XIV *bis*.

WTO/TRIMs:

[dd] Pertains to goods only.

[ee] Illustrative list in the Annex includes domestic content, import-export balancing and foreign exchange balancing requirements.

the APEC statement of principles includes the observation that "Acceptance of foreign investment is facilitated when foreign investors abide by the host economy's laws, regulations, administrative guidelines and policies, just as domestic investors should." In addition, the (non-binding) OECD Guidelines for Multinational Enterprises of 1976 could be the basis for a provision on firm conduct in the Multilateral Agreement on Investment. Further, it seems likely that negotiations on any agreement involving non-OECD countries, such as further negotiations in WTO, will consider provisions, for instance, on the restrictive business practices of firms either in the context of an investment agreement and/or a competition-policy agreement. An additional possibility for MAI is an explicit provision that local affiliated firms are obligated to comply with host government policies, not home government policies, in the case of conflicting obligations (Graham, 1994b). This could build on the work of the OECD Committee on International Investment and Multinational Enterprises, which has developed several points for "Practical approaches" to the problem in its consideration of the provisions of the OECD Declaration on International Investment and Multinational Enterprises (OECD, 1994b). However, the entire range of issues concerning firm behaviour remains relatively unsettled and potentially contentious in future regime reform efforts.

Disputes

The distinction between state-state and state-investor disputes is essential to an understanding of provisions for dispute-settlement procedures in investment agreements. The Uruguay Round/WTO Dispute Settlement Understanding and related agreements address only state-state disputes, while NAFTA addresses both types. The newly strengthened GATT/WTO dispute-settlement procedures can include investment disputes directly as a result of disputes concerning either the GATS or TRIMs agreement or indirectly through cross-retaliation procedures whereby retaliation in trade disputes, in limited circumstances, can involve investment policies (Brewer, 1995a, b). The generally tighter schedules for the operation of the dispute-settlement process, the requirement of a unanimous vote to reverse a panel finding and the creation of an appeals process have all significantly strengthened the state-state dispute process in WTO. In NAFTA, there are extensive provisions for investor-state dispute-settlement processes as well, and these are widely regarded as best practice. They include, for instance, a choice of rules between the International Centre for Settlement for Investment Disputes at the World Bank or the United Nations Commission on International Trade Law. Mexico's agreement to the dispute-settlement provisions of

NAFTA in fact marked a significant departure from the previous adherence to the Calvo Doctrine (which asserted the primacy of national legal norms and denied the applicability of international legal norms to investor-state investment disputes).

Other issues

Many of the other items listed in the annex table are rather narrowly defined and specialized matters are beginning to receive more attention (e.g., personnel movements, personnel nationality, data transfer), or they concern issues where there are already more highly developed and widely accepted rules (e.g., funds transfers, expropriation). They are therefore not discussed in any detail here. Selected issues concerning policy interlinkages and relationships among agreements are addressed above and in the next section.

Recommendations

There are three broad challenges that are inherent in any serious attempt to reform the international regime for investment. First, although there is much consensus on core principles, there are also many specific exceptions embedded in particular agreements. One challenge of the reform process is thus to reduce the exceptions to the agreed principles—a process that requires governments to resist pressure from domestic industries. Second, although previously contentious relations between developing countries and industrial countries were not so constraining in the Uruguay Round negotiations as in previous negotiations, there is a danger that MAI negotiations will rekindle some of that contentiousness because of the formal exclusion of non-members of OECD from direct participation in the negotiations. It is thus important that discussions in both OECD and WTO address issues such as restrictive business practices that have been generally avoided in those particular fora. Third, there are issues of general concern such as investment incentives and performance requirements that have not been the subject of much attention in negotiations in any forum. A comprehensive investment regime reform process must be broadened to include these issues as well.

In conclusion, we thus highlight three sets of issues needing priority attention in both OECD and WTO: core principles (particularly national

treatment), developing countries' concerns, and the combined issues of investment incentives and performance requirements.

Core principles

It is evident from the experience of the international agreements studied that there is little disagreement on the core principles of freedom of entry, national treatment, most-favoured-nation treatment and investment protection. Similarly, the Energy Charter Treaty and NAFTA agreements provide state-of-the-art provisions that could be widened out to OECD's MAI. Progress will not be easy in a wider forum, of course, and even the Energy Charter Treaty and NAFTA contain exceptions and conditions that require to be whittled away. Also, national treatment and MFN have been increasingly undermined in recent years by the bilateral and regional emphases of some countries' policies, and by the concomitant adoption of conditional (reciprocal) non-discriminatory policies.

The OECD National Treatment Instrument forms a natural starting point for MAI negotiations on this subject. The major limitations of the OECD instrument concern the range of exceptions and reciprocity conditions. An objective of the MAI negotiations, therefore, should be to secure standstill in both of these areas, together with progressive rollback. Prime target sectors for the latter should be industries in which FDI flows are of the greatest significance, either currently or potentially—for instance, banking, insurance and other financial services and air transport. In the MAI negotiations, high priority should be given to reductions in the signatories' industry exceptions to national treatment.

Developing countries' agenda

As the negotiations to reform the international regime for investment are broadened to include non-OECD economies, either through a stand-alone agreement administered by OECD and/or through negotiations at WTO, additional issues should be on the agenda. These include in particular the *restrictive business practices* of firms—a long-standing concern of developing countries; those issues need to be addressed in both OECD and WTO.

Furthermore, in view of the continuing impediments to developing countries' access to industrialized countries' markets in *agriculture* and

textiles, despite (or because of) the Uruguay Round agreements in those sectors, investment aspects of these sectors should be included on the evolving WTO agenda. WTO should thus expand the Uruguay Round agreements on agriculture and textiles in order to include more explicitly issues associated with investment-policy liberalization.

Investment incentives and performance requirements

With respect to performance requirements, the provisions in NAFTA represent the state of the art in the extensiveness of the types of policies that are covered, and those provisions could be replicated in broader agreements in OECD and WTO. Investment incentives pose much more of a problem, given the very limited progress that has been made to date in any forum on those issues. Reflecting this condition, a report by UNCTAD-DTCI (1996b) suggested a step-by-step approach to international cooperation on incentives. Standstill with progressive rollback would be compatible with this approach. Within WTO, this could be accomplished by extensions of the agreement on TRIMs and the agreement on Subsidies and Countervailing Measures (Brewer and Young, 1996). Within OECD, provisions for standstill and rollback on both incentives and performance requirements should be included, building on the (quite limited) existing agreement on incentives.

Concluding observation: the forum issue

There has been much discussion about the best forum in which to address investment issues in the future. We believe that a pluralistic process involving several international agencies will be appropriate. These agencies include, in particular, WTO and OECD, of course, but also IMF, the United Nations and the World Bank Group. Each of these agencies has relevant technical expertise as well as negotiating experience on selected aspects of the broad range of topics involved in reforming the international institutional framework for investment. There are many coordinating mechanisms possible to avoid potential redundancies and contradictions in the process. The important considerations are to include relevant technical expertise from many different agencies and to include all of the countries in the process in a politically significant manner. ■

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