

# RIS DISCUSSION PAPERS

**WTO's Emerging Investment Regime and  
Developing Countries: The Way Forward  
for TRIMs Review and the  
Doha Ministerial Meeting**

Nagesh Kumar

RIS-DP # 14/2001



**Research and Information System  
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# **WTO's Emerging Investment Regime and Developing Countries: The Way Forward for TRIMs Review and the Doha Ministerial Meeting**

## **1. Introduction**

Among the many departures that the Uruguay Round (UR) made to the multilateral trade regime was the introduction of investment issue in it. The investment issue was pushed on the agenda of the Uruguay Round by the industrialized countries. Despite the resistance of developing countries, the Final Act of the GATT included an Agreement on Trade Related Investment Measures (TRIMs). TRIMs Agreement requires member countries to phase-out performance requirements especially those relating to trade such as local content requirements and foreign exchange neutrality. TRIMs Agreement also provided for a Review within five years to review the operation of the Agreement and to 'consider whether the Agreement should be complemented with provisions on investment policy and competition policy'.

Besides the TRIMs Agreement, the industrialized countries have made a number of attempts to widen the scope of multilateral regime on investment beyond what is covered in Agreements on TRIMs and GATS (viz. commercial presence as a mode of delivery of services). These attempts include initiative to negotiate a Multilateral Agreement on Investment (MAI) in 1995 under the aegis of OECD, an attempt that failed. Since the First Ministerial Meeting of the WTO at Singapore in 1996, the industrialized countries have pushed to bring a more comprehensive agreement on investment than TRIMs on the WTO agenda. It is expected that the attempts to include investment on the agenda of the WTO will be made at the forthcoming Doha Ministerial Meeting scheduled to take place from 9-13 November 2001.

Against that background, this note reviews the issues concerning the on-going review of the TRIMs Agreement as well as for the move of the industrialized countries to bring investment issue on the WTO agenda from a developing country perspective and suggests a way forward. Given the important developmental consequences of foreign direct investment (FDI)

flows, the preparations of developing countries for these negotiations is likely to be of critical importance. Section 2 discusses the issues for the TRIMs Review. Section 3 deals with the issues concerning the proposed multilateral investment framework. Section 4 makes some concluding remarks.

## **2. TRIMs Agreement and Its Review**

### ***The Agreement***

The TRIMs Agreement requires that the trade related performance requirements imposed by the host country governments on foreign affiliates are notified within 90 days of the Agreement coming into force and eliminated in a phased manner. A transition period of two years is allowed for industrialized countries, five years for developing countries and seven years for least developed countries. The Agreement also provides an illustrative list of TRIMs that are deemed inconsistent with its provisions. These include local content requirements, requirements limiting imports to the value of exports, or restrictions on exports. Therefore, all other types of performance requirements such as export obligations, technology transfer requirements that are imposed by governments are not inconsistent with the provisions of the Agreement and can still be employed.

The Agreement allows developing countries to deviate temporarily from the provisions on account of the balance of payment difficulties under Section XVIII of GATT. Furthermore, it provides for extension of the transition period on request for developing and least developed countries that are facing particular difficulties in implementation, keeping in mind their development, financial and trade needs.

The Article 9 of the Agreement provides for a Review of the Agreement by the Council for Trade in Goods before the end of five years of operation. The review may propose to the Ministerial Conference amendments to the text of the Agreement. The Council shall also consider whether the Agreement should be complemented with provisions on investment policy and competition policy. The Review is already on although no papers have been submitted. The issues for the Review are the following.

### ***Developmental Implications of TRIMs: The Evidence***

Developing countries seek FDI inflows as developmental resources. FDI inflows are expected to assist their host countries by supplementing the domestic resources of capital, technology,

skills and market access. However, there is a great variation in the developmental impact of different FDI projects on the host countries depending upon the extent of new knowledge brought in, employment, value added and exports generated, and contribution made to the local technological capability building. In other words the quality of FDI inflows varies a great deal (see Kumar, 2001a,b, for a detailed treatment). The empirical evidence is now available that suggests that in some sample countries FDI substituted domestic investments and proved to be immiserizing, while in others such as Pacific Rim countries it complemented or crowded-in domestic investments and had more favourable developmental effects (Fry, 1992). Host country governments have employed a variety of policy measures to influence the quality of FDI in tune with their developmental objectives. These include screening mechanisms and performance regulations. Some of the performance regulations that have been used include the local content regulations and foreign exchange neutrality obligations that have now become inconsistent with provisions of the TRIMs Agreement. Therefore, TRIMs Agreement curtails the ability of the host governments to improve the quality of FDI in tune with their development objectives.

A detailed empirical analysis of US and Japanese FDI in a sample of 74 countries in manufacturing over 1982 to 1994 period found the local content regulations to be favouring the extent of localization of MNE affiliates' production in the host countries (see Kumar, 2000; 2001a). Therefore, local content regulations could be an important means of deepening the commitment of MNEs entering an economy and for generating local value added, and hence, on employment and the related spillovers of knowledge.

### ***Local Content Regulations in the Industrialized Countries***

Local content regulations have been used by a large number of developed and developing countries (Sercovich 1998, for illustrations). Among the developed countries, for instance, Italy has imposed 75 per cent local content on Mitsubishi Pajero, UK has imposed 75 per cent rule on Toyota Camry and UK 90 per cent on Nissan Primera. Australia imposed 85 per cent local content rule on motor vehicles until 1989 (Pursell 1999). The European Union countries have extensively used the screw driver regulations which are in effect like local content regulations to deepen the local commitment of Japanese corporations in consumer goods industries in the past. Even currently the industrialized countries especially the EU and NAFTA member countries, taking advantage of RTA exceptions that are available under Section XXIV of GATT, are effectively using the Rules of Origin to increase domestic value

addition. Rules of origin determine the extent of domestic content a product must have to qualify as an internal product in a preferential trading agreement. Hence, they have the same effect as the local content requirements. By now considerable evidence is available on the use of rules of origin by EU and NAFTA countries to increase the extent of localization of production by MNEs supplying to them (see Box 1).

### **Box 1**

#### **Rules of Origins Imposed by NAFTA and EU to Increase Local Content: Select Case Studies**

##### **NAFTA Rules of Origin**

The objective of the US effort in NAFTA through rules of origin has been to prevent "screwdriver" assembly operations from being set up within the region that could utilize low-cost inputs from outside. NAFTA rules of origin require that a substantial portion of inputs originate within the region for automobiles, electronic products (printers, copiers, television tubes), textiles, telecommunications, machine tools, forklift trucks, fabricated metals, household appliances, furniture, and tobacco products. For example:

- ◆ **Telecommunications:** NAFTA rule requires that 9 of every 10 printed circuit board assemblies, the essential component of office switching equipment, be packaged within the NAFTA countries. In response, AT&T shifted some production from Asia to Mexico, and Fujitsu and Ericsson brought new investments to Mexico as well.
- ◆ **Color Televisions:** NAFTA requires that television tubes be produced within the region to qualify for preferential status. Prior to NAFTA, there was no North American manufacturer of television tubes; in the first two years after NAFTA's passage, five factories took shape within the NAFTA region, with investments from Hitachi, Mitsubishi, Zenith, Sony, and Samsung.
- ◆ **Computers:** US negotiators proposed a rule that would have required two of the three key components (the motherboard, flat panel display, and hard disc drive) to be North American in origin. With forceful opposition from IBM and other companies that wanted to maintain their more flexible international sourcing patterns, the negotiators settled on a final rule requiring at least the motherboard to be North American.
- ◆ **Office Equipment:** NAFTA tightened origin rules for printers, photocopiers, and fax machines, requiring more components to be manufactured locally. For printers and photocopiers, all major subassemblies have to be produced in North America (equivalent to an 80-percent domestic-content requirement). Apparently this rule was instrumental in motivating Canon to construct a plant costing more than \$100 million in Virginia, rather than somewhere in Asia where the production costs would be lower.
- ◆ **Automobiles:** The domestic content rule was raised from 50 percent in the United States-Canada Free Trade Agreement to 62.5 percent in NAFTA. It required Japanese and European firms to replace imports from their home countries.

##### **EU Rules of Origin**

The European Union has adopted high domestic-content rules of origin in automobiles and other industries such as photocopiers, as well, and has also entertained proposals for even tighter requirements for printed circuit boards and telecom switching equipment. The European Union also established product-specific rules that require printed circuit board assembly within Europe. It has negotiated association agreements in Central and Eastern Europe that require 60 percent domestic content for products to qualify for entry into the European Union. Select examples are as follows:

- ◆ **Semiconductors:** In 1989, the European Union abruptly changed the rule of origin to require that wafer fabrication for semiconductor be done within Europe to avoid 14 percent semiconductor tariff. Whereas US companies performed most of their diffusion operations in the United States prior to the decision, 7 of the largest 10 US producers built fabrication facilities in Europe

following the rule change. Citing the need to comply within the new rule of origin, for example, Intel invested \$400 million in Ireland for wafer fabrication and semiconductor assembly. Even though wafer fabrication was not cost-competitive in Europe, compared to Asia or the United States, 22 new fabrication facilities were set up in Europe within two years of the change in the rule of origin.

- ◆ Automobiles: The United Kingdom and France proposed an 80 percent local content rule for the Nissan Bluebird to qualify as an EC product. In the end, they backed down in the face of Italian and German opposition and decided to rely on quantitative restrictions to protect against Japanese imports. The 60 percent domestic content in the automotive sector has forced the General Motors engine plant in Hungary to use high cost German steel as an input, preventing utilization of locally available cheaper Steel.
- ◆ Textiles and Apparel: The near 100 percent domestic-content requirement in textiles and apparel has forced the German partner in the Brinkmann-Prochnik joint venture in Poland to load a truck with cotton fabrics, thread, buttons, and even labels in Germany; transport it to Lodz for stitching into trench coats; and re-import it for sale in the European Union-rather than allow the Polish partner to source from cheaper supplies locally.

*Source*: Compiled from Moran, 1998; Belderboss, 1997, and other sources.

### *Other Asymmetries in the TRIMs Agreement*

The TRIMs Agreement requires the phasing out of restrictions on exports or imports imposed by the host governments. However, it does not require phasing out of the export restrictions that are imposed by the MNEs on their affiliates. MNEs often impose restrictions on exports of their subsidiaries, affiliates and licensees or on the sourcing of their purchases. The surveys of foreign affiliates operating in India conducted by the Reserve Bank of India have repeatedly observed high incidence of restrictive clauses imposed by MNEs on their local affiliates through technology transfer agreements. The latest Survey for the 1986-94 period finds as many as 40 per cent of technology transfer agreements containing export restrictions (see Table 1).

**Table 1: Incidence of Export Restrictions Imposed by MNEs on their Indian Affiliates, 1986-94**

Type of Affiliate	Affiliates Covered	Affiliates Having Technology Transfer Agreements	No. of Agreements	Agreements with Export Restrictions	Proportion of Agreements with Export Restrictions, %
Majority Owned	132	60	109	43	39.45
Minority Owned	572	351	637	268	42.07
Technology Licensees	404	404	753	291	38.65
All	1108	815	1499	602	40.16

*Source*: extracted on the basis of RBI (1999) *Foreign Collaboration in Indian Industry: Sixth Survey Report*, Mumbai: Reserve Bank of India.

As is clear from Table 2, the bulk of these restrictions (62 per cent) imposed by MNEs on their Indian affiliates prohibit their export to all the countries or specified countries. Another

27 per cent require the affiliate to obtain their parent's permission for exports. Obviously these restrictions are as trade distorting as those imposed by the host governments and should come under the purview of the TRIMs Agreement.

**Table 2: Types of Export Restrictions Imposed by MNEs on their Indian Affiliates**

Types of Export Restrictions	Majority Owned	Minority Owned	Technology Licensees	Total
1. Ban on Exports: total or to specified countries	25 (58.14)	183 (68.28)	167 (57.39)	375 (62.29)
2. Permission of collaborator for exports is needed	13 (30.23)	66 (24.63)	82 (28.18)	161 (26.74)
3. Exports only through collaborator/ his agents/distributors	0 (0.00)	9 (3.36)	14 (4.81)	23 (3.82)
4. Prohibition on the use of trade marks for exports	0 (0.00)	1 (0.37)	3 (1.03)	4 (0.66)
5. Restriction on export prices	5 (11.63)	0 (0.00)	3 (1.03)	8 (1.33)
6. Any other export restriction	0 (0.00)	9 (3.36)	22 (7.56)	31 (5.15)
<b>Total</b>	<b>43</b> <b>(100)</b>	<b>268</b> <b>(100)</b>	<b>291</b> <b>(100)</b>	<b>602</b> <b>(100)</b>

Source: extracted on the basis of RBI (1999) *Foreign Collaboration in Indian Industry: Sixth Survey Report*, Mumbai: Reserve Bank of India.

### ***No Phase out of Investment Distorting Investment Incentives***

Yet another asymmetry in the TRIMs Agreement is its failure to discipline the investment incentives given by host governments to attract FDI inflows. The empirical evidence has shown that these incentives tend to distort the investment patterns much in the same way as export subsidies do patterns of trade (see Kumar, 2000, for evidence). Industrialized countries have largely indulged in the incentive wars to attract foreign investments to particular locations and have been offering substantial subsidies to MNEs to attract investments (see Table 3 for some illustrations). Because developing countries lack in their capacity to provide

**Table 3: An Illustrative List of Investment Incentives Given by Industrialized Country Governments**

Site	MNE and Year	Subsidy	Jobs created	Subsidy per job
Kentucky, US	Toyota, 1985	\$150 million	3,000	\$50,000
S. Carolina, US	BMW, 1992	\$150 million	1,900	\$79,000
Alabama, US	Mercedes Benz, 1996	\$300 million	1,500	\$200,000
New Mexico, US	Intel, 1993	\$289 million	2,400	\$120,000
Setubal, Portugal	Ford, 1991	\$484 million	1,900	\$254,000
Germany	Dow, 1996	\$6.8 billion	2,000	\$3,400,000
United Kingdom	Samsung, 1994	\$89 million	3,000	\$30,000
United Kingdom	Siemens, 1995	\$77 million	1,500	\$51,000



United Kingdom	Lucky Goldstar, 1996	\$320 million	6,100	\$48,000
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Sources: Moran (1998), UNCTAD (1996) and sources cited therein.

matching subsidies, investment incentives do tend to distort the normal pattern of location of investments in favour of industrialized countries.

### **The Way Forward for the TRIMs Review**

It is clear that even some of the most industrialized and developed countries of the world as the NAFTA and EU members have been applying the policy measures very similar to the local content requirements in order to achieve their development objectives even now. TRIMs Agreement threatens to take away the freedom from developing countries to use performance regulations as a part of their development policy. Developing countries need it much more critically than the industrialized countries. Furthermore, while TRIMs takes away the ability of host governments to import trade restrictions, it does not prevent similar restrictions imposed by corporations on their foreign affiliates that are as trade distorting as government imposed TRIMs. These asymmetries should be addressed to in the Review of the Agreement that is built into it. In particular the following approach may be adopted for the Review.

- Strengthen the Development Dimension: Because TRIMs are primarily imposed by developing countries as policy tools for deepening their industrial structure as a part of the strategy to industrialize in the same manner as EU and NAFTA members are using rules of origin, they should seek exceptions from the provisions of TRIMs based on low level of industrialization and development in the Review. Article 5(3) of the Agreement could be amended to provide this exception linked to a per capita manufacturing value-added (MVA) threshold. All the countries with MVA per capita below that threshold level should qualify for exemption from the provisions of TRIMs. The Agreement would, in this way, have taken care of the development dimension as well as the graduation because once a country reaches the threshold level, it will have to phase out TRIMs. The two year extension to the transition period for implementation as proposed in the Draft of Seattle Meeting is not appropriate as different developing countries are at different levels of development and their requirements are different. One size does not fit all!
- Phase out the Trade Distorting Restrictive Conditions Imposed by Corporations: Evidently MNEs impose certain restrictions on exports and imports of their affiliates which distort their trade patterns. Given the trade distorting effect of these restrictions,

developing countries should seek to discipline the restrictive conditions that MNEs impose on their foreign affiliates in the Review of the Agreement.

- Resist the Expansion of the Scope of the Agreement: Some industrialized countries may seek to expand the list of types of performance requirements that are inconsistent with the provisions of the TRIMs Agreement or to broaden the scope of the Agreement with a more comprehensive instrument on investment taking advantage of the Section 9 of the Agreement. Such attempts need to be resisted. Like local content requirements other performance requirements are also used as a part of development policies by countries at the lower levels of development. It is important to retain the freedom to apply them as and when needed. The empirical evidence shows that export performance requirements have served a useful purpose in setting up export-oriented manufacturing bases in a number of Latin American and East Asian countries (see Moran, 1998; Kumar, 1998, 2001). Similarly a more comprehensive investment regime will hurt developing countries interests by taking away the freedom to regulate the quality of FDI without giving anything in return, as will be seen later.
- Discipline the Investment Incentives: The Review of the TRIMs Agreement should consider an instrument to phase out the investment incentives. This could be done in conjunction with the Review of the Agreement on Subsidies and Countervailing Measures (ASCM). Because of the prisoners' dilemma inherent in the investment incentives competition, an international discipline to limit the investment-distorting incentives would maximize the collective welfare of the participating countries.

### **3. Possible Multilateral Framework on Investment**

The built-in provision for a review of TRIMs also provides for a consideration whether the Agreement should be complemented with provisions on investment policy and competition policy. The developed world, however, without waiting for the upcoming review of the TRIMs Agreement, had initiated moves to push for a Multilateral Agreement on Investment (MAI) under the aegis of OECD in 1995. MAI was to be a legally binding treaty open to even non-OECD member states to ensure higher standards of protection and legal security for foreign investors. In any case OECD expected the proposed MAI Treaty to become a sort of benchmark for investors to rate the treatment accorded to foreign investors. The OECD negotiations in MAI, however, could not be successfully concluded because of differences among the OECD countries and have since been abandoned in 1998. However, even before

the experiences of MAI negotiations in OECD were available, an attempt was made to push the investment issue on the WTO's agenda. The EU and Canada proposed to create a Possible Multilateral Framework on Investment (PMFI) under the auspices of World Trading Organization (WTO) at its first Ministerial Meeting in Singapore in 1996. OECD's MAI was to provide a model for PMFI, if not to be adopted bodily. This has led to the setting up of a Working Group on Trade and Investment Policy in WTO to study the issue. The EU with the support of other industrialized countries would like PMFI to be pushed on the agenda of the new Round of WTO negotiations that they are seeking to launch at the Doha Ministerial Meeting.

As observed earlier, the industrialized countries are seeking to bring investment on the WTO agenda beyond the TRIMS Agreement on the model of OECD's failed MAI. Hence, it may be worthwhile to look at the basic characteristics of MAI briefly and their implications. OECD's draft MAI was based on the principles of national treatment and most-favoured-nation (MFN) to foreign investors applicable to both pre- and post investment phases (see OECD, 1996; European Union, 1995). The implication of these provisions was that the host countries would not be able to accord a more favourable treatment to local enterprises over foreign enterprises although a favourable treatment to the latter was not excluded. Since the provisions were to apply to both pre- as well as post- investment phases, the screening mechanisms established by host countries to select FDI projects would not be possible and all types of performance requirements on MNEs will have to be phased out. This includes export obligations imposed on MNE affiliates that are shown to have enabled host countries make MNE affiliates more responsive to contribute to their export expansion efforts as observed earlier. Hence, an Agreement on these lines, if allowed to go through, will foreclose most of the options open to host countries to screen or regulate FDI in tune with their development priorities (see for more details, Panchamukhi, 1996; Kumar, 1996a, among others). In return, the multilateral framework could not guarantee greater inflows of FDI which are determined largely by the income levels, market size, quality of infrastructure, among other considerations, that favour their concentration in developed countries. MAI approached the investment issue from a narrow investor/ home country perspective. The host country concerns and rights are not taken care of in the proposed formulations. It did not address the issues concerning restrictive business practices and anti-trust implications of MNEs' operations.

The MAI negotiations failed because of the failure of OECD members to reach a consensus on the issue. The OECD members were seeking an investment regime of standards from other countries that they are willing to give themselves. It is clear from the fact that the lists of exceptions submitted by different countries to the negotiations ran into 700. Given the fact that WTO membership is infinitely more heterogeneous than the OECD membership covering as diverse a group as rich developed countries, least developed countries, low income countries and so on, it is rather audacious to expect to bring about a consensus in this forum on the issue as contentious as investment regime.

It is difficult to understand the provocation for these initiatives on the part of industrialized countries. FDI regimes have become increasingly liberal over the past decade and will continue to move in that direction in the coming years given the competition among countries for FDI inflows. The multilateral trade negotiations leading to the establishment of WTO have already included an agreement on eliminating the Trade Related Investment Measures (TRIMs) which limits the ability of host governments to regulate the FDI inflows. An international framework for settling investment disputes viz. International Convention on Settlement of Investment Disputes (ICSID) already exists under the auspices of the World Bank. The Multilateral Investment Guarantee Agency (MIGA) has also been launched to protect and insure overseas investments against political risks such as expropriation, blocked currency transfers, breach of contract, war, revolution and insurrection. There have not been any glaring cases of disputes that could not be settled through the existing framework. The argument given in favour of MAI is that it will obviate the need for concluding numerous bilateral investment treaties. Bilateral treaties are concluded between countries to deal with specific issues of concern between a pair of countries and are much easier to be concluded. A multilateral framework may not be able to provide a general solutions of all the issues of bilateral concerns. If at all there is any need for international intervention it is for enforcing certain norms of responsible corporate behaviour given the unprecedented power that MNEs now enjoy. Finally, FDI like domestic investments concerns development more than trade. Hence, WTO is not an appropriate forum to deal with investments. The link between FDI and trade is ambiguous and some FDI inflows, such as market seeking type, actually substitute exports. Therefore, protection in the host countries acts as an inducement for FDI inflows, as noted earlier.

### **Why a WTO Framework on Investment is not appropriate?**

There are several reasons that do not justify a WTO framework on the lines of MAI as follows:

#### ***A Trade Type Regime is not Appropriate for Investment***

The recent attempts to extend trade regime type rules like national treatment to investment is clearly misconceived conceptually as well as in practice. There is a conceptual basis for trade liberalization based on the principle of comparative advantage where countries with different comparative advantage benefit from trading mutually. So one country has one strength the other has another and both benefit by swapping or trading their goods. Therefore, all countries participate in international trade and each country's exports and imports are close to each other in terms of value. The key difference between trade of developing and industrialized countries is in terms of the sectoral composition of goods exported (and imported) with developing countries specializing in labour and raw material intensive goods while industrialized countries, in more knowledge and capital intensive goods.

Unlike trade, FDI flows emerge because of differences in the levels of development and bundles of created assets. Indeed the theory of international firm explains evolution of a national firm into an international corporation in terms of monopolistic ownership of intangible assets that have revenue productivity abroad and which more than offsets the disadvantages of operating in an alien environment. These advantages include proprietary technology, globally reputed brand names, access to cheaper sources of capital, accumulated experience of organizing complex tasks, among others [see Dunning, 1993; and Caves, 1996, for expositions of theoretical approaches to FDI]. From the start, therefore, MNE entrants enjoy an edge over local enterprises, if there are any existing at all, because of their monopolistic Ownership advantages. The margin of the edge enjoyed by them is inversely related with the extent of development of local industrial capabilities and hence level of development. It is particularly wide in low income countries. It is no accident that 90 per cent of global stock of FDI outflows are owned by the industrialized countries. Developing countries nearly always play the host and very seldom a home country of FDI flows.

Furthermore, MNE affiliates and local enterprises face very different opportunities and react to them differently. The access to information on world markets and opportunities present in different places coupled with the MNEs' objective of global profit maximization may result in rationalization of production internationally on the basis of costs. Local enterprises in

developing countries have to locate their further investments in production facilities and R&D in their home countries, barring a few exceptions. The affiliates of MNEs have wider options and opportunities. A number of empirical studies have found the decisions to enter, diversify, and undertake R&D of MNE affiliates determined less by local conditions than in the case of their local counterparts [see Kumar, 1991]. Given these differences in corporate strategy and decision making, a few preferences for local enterprises may be justified in the early stages of development of a country.

Therefore, MNEs when they enter a country are already much ahead of the domestic enterprises in the potential host country especially in developing countries because of their monopolistic ownership of unique assets. Therefore, offering national treatment to foreign enterprises and domestic enterprises would amount to discriminating against the latter. In most developing countries, the little local entrepreneurship that exists runs the risk of vanishing altogether if forced to compete with the mighty global corporations under 'national treatment'. In developing countries, the leveling of the playing field should actually include creation of support mechanisms to enable development and nursing of local enterprises at least in their infancy. Exemption based on 'infant enterprises protection', low levels of development and balance of payments difficulties are, therefore, important.

### ***Trade – Investment Link is not Unambiguous***

The inclusion of investment on the WTO agenda is justified on the grounds of trade relatedness of investment. However, the trade – investment link, other than what is covered under TRIMs Agreement, is by no means straightforward. The bulk of FDI flows continue to be market seeking (or tariff jumping) type. These inflows actually substitute trade. Therefore, after taking care of possible trade distorting investment policies under TRIMs Agreement, there is very little justification of including a full-fledged investment agreement in the multilateral 'trade' negotiations. As has been observed in Section 2, FDI, like domestic investment, is a development and industrialization issue than trade issue. Bringing it on the WTO agenda would unnecessarily diffuse the attention of WTO from its main purpose i.e. trade liberalization. WTO also does not have competence to deal with the investment and development issue. This is clear from the fact that the Working Group on Trade and Investment set up as per the Singapore Meeting in 1996 has not been able to complete its work so far (WTO, 2000).

### ***The Developmental Impact of FDI Inflows Varies***

The studies examining the developmental impact of FDI from different countries have come up with mixed findings. Some countries have been able to benefit more from FDI inflows than others, as observed earlier (see Kumar, 1996b, for a recent review of evidence). The host governments have used a variety of policies and performance requirements to channel FDI inflows in tune with objectives of their development policy. It is evident that countries which pursued selective policies with respect to FDI, for instance, South Korea, Taiwan and China among other Southeast Asian nations (for instance, in channelling FDI into export-oriented and high technology activities) have had a greater success in achieving their developmental objectives with FDI inflow than those pursued more open policies such as those in Latin American countries. UNCTAD (1999b) after reviewing the literature on FDI and development that observes that ‘the impact of FDI on development goes well beyond its linkage with trade .. and .. can be negative. .. The effect of FDI on development depends on the initial conditions prevailing in the host countries, on investment strategies of companies and on the host government policies. Governments, therefore, cannot be passive.’ A multilateral regime will take away the ability of the host governments’ to direct FDI in accordance with their development policy objectives and the overall ‘quality’ of any FDI inflows received may suffer. As Bhagwati (1998) argues, the FDI policy such as performance requirements is an area where ‘host countries should be free to make their own choices, based on their own (even if often harmful) assumption about externalities and spillover effects on their national economies’.

### ***Countries at Different Levels of Development Receive Different Types of FDI Inflows***

It has been argued in the literature that countries at different levels of development receive different types of FDI (e.g. Porter, 1990; Ozawa, 1992). For instance, a country at the beginning of the factor-driven stage will attract resource-seeking or labour-seeking inward FDI. The transition from the labour-driven to the investment-driven stage attracts inward investments in capital and intermediate goods industries and outward investments to lower wage countries in labour-intensive manufacturing. Similarly, the transition from the investment-driven to the innovation-driven stage brings about inward investments in technology-intensive industries and outward investments in intermediate goods industries (Ozawa, 1992). Naturally the need for policy framework dealing with FDI would depend upon the level of development. The proposed harmonization of investment policy through a WTO regime will not serve the best interests of countries at different levels of development. That an across-the-board approach is not

appropriate is clear from the fact that the negotiating parties to the Draft MAI of OECD had sought 700 exceptions to the Agreement despite the fact that it was negotiated by countries generally at similar levels of development being all members of OECD.

### ***Multilateral Regime cannot guarantee increased magnitude of FDI Inflows***

Supporters of a MAI type of regime argue that such a framework would help developing countries to increase their attractiveness to foreign investors. However, as numerous empirical studies have shown, FDI inflows are largely driven by the gravity factors such as market size, income levels, the extent of urbanization, geographical and cultural proximity with the major source countries of FDI, quality of infrastructure. The policy factors play a relatively minor role at the margin (that is holding gravity factors constant) [see for instance, Contractor, 1990; Wheeler and Mody, 1992; Kumar, 2000, among others]. After harmonization of policy regimes across the world as proposed, the concentration of FDI in the industrialized countries may increase further. The irrelevance of government policy regime as a determinant of FDI inflows is clear from the fact that many African countries that have liberalised their FDI policy as a part of structural adjustment programmes administered by the IMF and the World Bank during the 1980s have failed to receive any significant FDI inflows. A number of countries with much more restrictive policy framework are able to attract e.g., China attract over \$ 40 billion worth of FDI inflows every year. The share of the 45 least developed countries in the global distribution of FDI inflows has actually declined from 0.8 per cent in the early 1990s to 0.4 per cent in the late 1990s [UNCTAD, 2000]. While the proposed framework can not guarantee bigger inflow of FDI, it threatens to take away the ability of host countries to influence their quality, which as has been observed earlier, can vary greatly.

### ***No Balancing of Rights and Responsibilities***

The MAI Treaty draft that is proposed to be used as a model for PMFI essentially has been written from a narrow investor's point of view and is asymmetric as it only provides for responsibilities of host governments and rights of corporations but not other way round. It does not have any provisions concerning protection of host country interests. A lot of work done in the 1970s demonstrated tremendous economic power wielded by MNEs in the global economy and concerns of possible misuse of this power in private hands had led the international community launch several initiatives at the international level to curb it. These include the international codes of conduct and rules for controlling restrictive business



practices. Some of these initiatives, however, could not be concluded successfully due to differences between the negotiating parties (especially between the industrialized and developing countries on the binding nature of the instruments) [UNCTC, 1988, Chapter XX, for more information on the TNCs Code]. If at all, the economic power of MNEs has certainly increased manifold since the early 1970s when these concerns were first raised with increasing global economic integration. Recent spate of corporate restructuring has given rise to mega corporations with dominant market positions in their respective market segments and gigantic scale of operation. The international initiatives intended to curb possible restrictive business practices, misuse of their economic power and obviating of corporate responsibility for their actions are not of binding nature (in fact the UN Code of Conduct on TNCs and the UNCTAD's Code on International Transfer of Technology were negotiated in protracted negotiations but were not adopted by the UN General Assembly). MNEs follow different standards with respect to environment, treatment of labour, respect of consumer protection and rights in different countries. It is well known that they relocate polluting industries and export products that are banned in their home countries to developing countries that may have lax environmental or product standards. The glaring lack of a binding international regulation of activities of international corporations has often been noted several times over the past decade. For instance, the Bhopal tragedy where the concerned MNE sought to shirk away from the liability arising from actions of its majority owned subsidiary is a case in point. Therefore, an agreement not providing any matching provisions on international regulation of business or obligations of MNEs and rights of host governments is not going to appeal to developing country governments which are net receivers of FDI. Furthermore, while the ability of the host governments to impose performance obligations is sought to be curbed, that of corporations to impose restrictive clauses on their subsidiaries that are often trade distorting, as seen in the previous section, is not regulated. According to Bergsten and Graham (1992) an 'ideal accord would grant specific rights to, and simultaneously place certain obligations on, three sets of actors: (a) governments of nations that are host to FDI (including subnational governmental entities), (b) governments of nations that are home to international corporations, and (c) international corporations themselves.'

### ***Asymmetry between Investment and Labour Mobility***

Capital and labour are two mobile factors of production. The proposed framework on investment proposes to liberalize capital movements without providing for the labour mobility and hence would create asymmetry. As Panagariya (2000) argues 'symmetry dictates that alongside

investment agreement, there also be an agreement on the movement of natural persons. Since the current ethos is unlikely to permit the inclusion of such proposals into the negotiating agenda, there is no reason for inclusion of investment into the agenda either.’ The regional blocs such as the EU that provide for free capital movement between the member states also assure free labour mobility across the member states.

### ***Investment Protection Treaties and Dispute Settlement***

One of the justifications given in favour of MAI is that it will avoid the need for concluding thousands of bilateral investment protection agreements (BIPAs). However, bilateral treaties are more appropriate for the purpose than a multilateral regime. For one, BIPAs provide policy flexibility to the partner countries by respecting the existing policy framework. Secondly, they are much easier to be concluded; some 1700 of them have been concluded by now (see UNCTAD, 2000). Compared to that OECD’s MAI negotiations could not be concluded even after three years of intensive negotiations. Furthermore, there do exist multilateral instruments for protection and guarantee of international investments. These include Multilateral Investment Guarantee Agency (MIGA) under the World Bank which came into being in 1988. The International Convention of Settlement of Investment Disputes (ICSID) also under the aegis of the World Bank has provided a framework for dispute settlement since mid-1960s, besides the UN Committee on International Trade Law (UNCITRAL), and International Chamber of Commerce (ICC).

### ***Is there a Grand Bargain for Developing Countries?***

Some proponents of investment issue on WTO agenda have argued that developing countries may give in on investment in return for huge gains in other areas. Moran (1998), for instance, argues that a discipline on investment incentives given by industrialized countries could be a grand bargain for developing countries in return for agreeing to a multilateral investment regime. However, disciplining of investment incentives should happen on its own merit and given the prisoners’ dilemma inherent in it, every country will benefit from it. It is certainly no grand bargain given the what developing countries will be giving in return viz. the policy flexibility to screen and regulate FDI inflows. As Hoekman and Saggi (2001) argue in a recent paper prepared for the World Bank, ‘devising a grand bargain (by developing countries) will be difficult. Account must be taken of potential downside – issue linkage can be a two-edged sword.’

## **The Way Forward for Developing Countries**

It is clear from the above discussion that bringing investment agreement on the WTO agenda beyond TRIMs would not be in the interest of developing countries. Hence, the following strategy may be considered to approach the issue at the forthcoming Doha Ministerial Meeting.

### ***First Best Option: No to Investment on the WTO Agenda***

The best interests of developing countries will be served by resisting the efforts of industrialized countries to widen the scope of investment under the WTO regime beyond TRIMs. They will do well by forging a unified position among themselves to resist the moves of the EU to bring investment on the agenda of the proposed new round that they hope to launch at Doha. A number of developing countries such as Malaysia, Indonesia, the Philippines, Thailand, Singapore, India, Pakistan, Hungary, Morocco, Venezuela, Argentina, Jamaica, Cuba, Tanzania, Zimbabwe, among others, have apparently expressed their reservations against the move to bring investment on the agenda of the new round. They feel that time is not yet ripe for negotiating a multilateral framework as a part of the Single Undertaking of WTO and have suggested that the work of the Working Group on Trade and Investment set up as per the Singapore Meeting may continue. These countries need to mobilize other countries and consolidate their position against the move.

### ***Fall Back Position: Containing the Damage***

In case it is impossible to stop investment coming on the agenda of the proposed New Round because of a possible understanding among the Quad countries, what should be the strategy of developing countries? In a situation when we have to negotiate multilateral framework on investment, it would be prudent to minimize the damage by following the following plan:

- Confine the scope of the Agreement only to post-establishment treatment
- Include obligations of the corporations to balance their rights: e.g. disclosure norms, respect for environmental standards, proscribing restrictive clauses imposed on their subsidiaries and other restrictive business practices, manipulation of transfer prices etc.
- A discipline on the investment incentives
- Providing for Development Exceptions: Developing countries having per capita manufacturing value added below a certain level should enjoy exceptions from the obligation to accord national treatment. This would grant them the necessary flexibility to

exercise policy options to regulate FDI inflows in accordance to their developmental objectives.

- Do not agree to investor to state dispute settlement: the scope of dispute settlement should be confined to state to state disputes and investor to state dispute settlement as proposed in the OECD's MAI Draft should not be agreed to at any cost.
- Finally, work on the basis of a positive list approach followed by GATS: This way member countries will be able to notify select sectors where they find it convenient to offer national treatment to outside investors and follow the existing policy regimes in others.

#### **4. Concluding Remarks**

In this Note we have discussed the issues concerning the ongoing Review of the TRIMs Agreement and the proposal to widen the scope of the WTO regime on investment beyond what is covered in TRIMs and GATS Agreements from a developing country perspective. TRIMs like local content requirements have been widely used by governments of different countries as an important policy tool to deepen the industrial structure. Taking advantage of the RTA exceptions provided under WTO, most industrialized countries are still enforcing regulations of very similar type on foreign producers and suppliers. Furthermore, the TRIMs Agreement is asymmetric in that it does not proscribe trade-related restrictions imposed by corporations on their foreign subsidiaries nor does it discipline the investment distorting incentives given by industrialized countries. The Review should address these asymmetries and strengthen the development dimension of the Agreement.

It has been shown that extending the scope of investment regime in WTO beyond TRIMs and GATS is neither justified nor appropriate. Unlike trade, investment takes place between unequal partners. The link between trade and investment other than that covered under TRIMs Agreement is not unambiguous. Countries at different levels of development receive FDI of different types so a 'one size fits all' investment policy is not appropriate. A multilateral framework cannot guarantee an increase in FDI inflows although it threatens to adversely affect the quality of the inflows. There are also other asymmetries present as it does not address the responsibilities of corporations who often impose trade restrictive clauses on their subsidiaries. More importantly the symmetry of capital mobility with liberalizing labour mobility is not addressed.

In view of these, the best way forward for developing countries would be to resist the move to expand the scope of WTO regime on investment beyond what is covered in TRIMs and GATS. If that is not possible, we should attempt to minimize the damage by restricting the scope of the framework by limiting it to post-establishment treatment only, by addressing the asymmetries of balancing the rights and responsibilities, covering a strong development dimension and possibly working on a positive list approach followed by GATS Treaty.

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