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Investment on the WTO Agenda: A Developing Country Perspective and the Way Forward for the Cancún Ministerial Conference*

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1 Introduction

Investment has emerged as the most contentious issue in the WTO negotiations. At the fourth ministerial conference of the WTO at Doha, the finalisation of the draft declaration was held up because of differences between the developed and developing countries on the investment issue, among others. The declaration was only adopted following the clarification by the Chairman of the ministerial council of the fact that the decision to launch it will be taken at the fifth ministerial meeting, subject to an explicit consensus on the desirability of the negotiations and not merely on the modalities of negotiations. In the light of this, the fifth ministerial meeting, scheduled to take place in September 2003 in Cancún, Mexico, will be of critical importance. The developed countries will seek a negotiating mandate at the conference. The developing countries will need to examine the various pros and cons of a multilateral framework of the type that the developed countries are seeking to put in place through multilateral trade negotiations for their process of development. They will also need to think about the form and content of a possible multilateral framework on investment, should a negotiating mandate be given by the ministerial conference.

Against this backdrop, this paper examines the relevance of a multilateral framework on investment from a developing country perspective in the light of the evidence available on the role of foreign direct investment in development. It also suggests policy options that developing countries might consider at the Cancún ministerial conference on the issues of trade and investment. It reflects on approaches which would make different elements of a possible multilateral framework on investment more pro-development and balanced, in case a negotiating mandate is unavoidable at Cancún.

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The structure of the paper is as follows: Section 2 summarises the broad trends and patterns in global FDI inflows and highlights the nature of the North–South dimension of this. Section 3 presents a brief review of the literature on the developmental impact of FDI on host economies and the role of host government policy. Section 4 examines the relevance of the multilateral framework on investment. Section 5 discusses the possible positions that developing countries could adopt at the Cancún ministerial conference, including a possible compromise of negotiating a multilateral framework outside the Single Undertaking of the GATT/WTO. Section 6 discusses the issues involved in incorporating the development dimension in different elements of a possible multilateral framework on investment negotiated outside or within the Single Undertaking of the GATT. Finally, Section 7 makes a few concluding remarks.

2 Trends and Patterns in FDI Inflows and the North–South Divide

FDI flows have expanded at an unprecedented rate during the 1990s, becoming the most visible and prominent manifestation of the increasing global integration of economic activity. Compared to the average annual growth of trade in goods and services of about 6–7 per cent in the 1990s, FDI inflows grew at an average annual rate of 20 per cent in 1991–95 and 32 per cent in 1996–2000 despite the economic crisis in some important regions of the world. As a result, the magnitude of global FDI inflows increased from US$159 billion in 1991 to US$1.27 trillion in 2000 (see Table 8.1).

Table 8.1: Global FDI Inflows by Broad Host Groups, 1991–2000 (US$ million)

Host region	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
World	158936	173761	218094	255988	331844	377516	473052	680082	865487	1270764
Industrialised Countries	114792	119692	138762	145135	205693	219789	275229	480638	636449	1005178
Developing Countries	41696	49625	73045	104920	111884	145030	178789	179481	207619	240167
% Share of Developing Countries	26.23	28.55	33.49	40.98	33.71	38.41	37.79	26.39	23.98	23.89
% Share of Developing Countries excl. China	24.15	23.65	23.89	32.01	25.68	31.08	31.37	21.33	20.26	16.21
Least Developed Countries	1830	1459	1743	1168	2001	2394	2524	3715	4527	4414
% Share of LDCs	1.15	0.83	0.79	0.45	0.60	0.63	0.53	0.54	0.52	0.34

Source: UNCTAD data

To a large extent, the recent growth of FDI flows has been fuelled by cross-border mergers and acquisitions in North America and Europe as part of ongoing wave of

industrial restructuring and consolidation. However, FDI has become an increasingly important channel of market servicing as a part of the trend of globalisation. Table 8.2 shows that sales of foreign affiliates of corporations were roughly of the same order ($2 trillion) as world exports in 1982. By 2000, sales of affiliates had grown to more than twice the volume of world exports at $ 15.7 trillion, compared to world exports of $7 trillion.

Table 8.2: Relative Importance of FDI and Exports as Means of Market Servicing (US$ billion)

	1982	1990	2000
Sales of Foreign Affiliates	2465	5467	15680
Exports of Goods and Non-factor Services	2124	4381	7036

Source: UNCTAD, World Investment Reports

The bulk of FDI flows originate in developed countries and developing countries are on the receiving end most of the time. The top ten industrially and technologically most advanced countries account for as much as 74 per cent of FDI outflows (Kumar, 1998b). So the North–South divide is quite prominent in the case of investment.

The North–South divide is apparent in the positions adopted by developed countries at international negotiations concerning investment. Keeping in mind the increasing importance of FDI as a channel for servicing markets, a favourable international framework for FDI is seen by developed countries as furthering their commercial interests and national competitiveness. Therefore, developed country governments identify themselves with the investors and have tended to protect their interests at these negotiations. As a part of this, in the 1980s developed countries resisted initiatives of the UN system to promote codes of conduct which would be binding on corporations and have, on the other hand, been seeking to evolve an international regime guaranteeing unfettered movement for their corporations through multilateral trade negotiations.

FDI Inflows in Developing Countries

FDI inflows are expected to be less volatile and non-debt creating. They are also expected to be accompanied by a number of other assets that are valuable for development, such as technology, organisational skills and sometimes even market access, among others. Hence, most countries – developed as well as developing – compete among themselves to attract FDI inflows with increasingly liberal policy regimes and incentive packages. However, the expansion of the magnitude of FDI over the 1990s has benefited only a handful of developing countries, as is clear from the following summary of emerging trends and patterns.

FDI inflows received by developing countries expanded from less than US$42 billion in 1991 to $240 billion in 2000. The growth of FDI inflows in developing countries seems to have been slower than that of global inflows, especially in the late 1990s (see Figure 8.1).

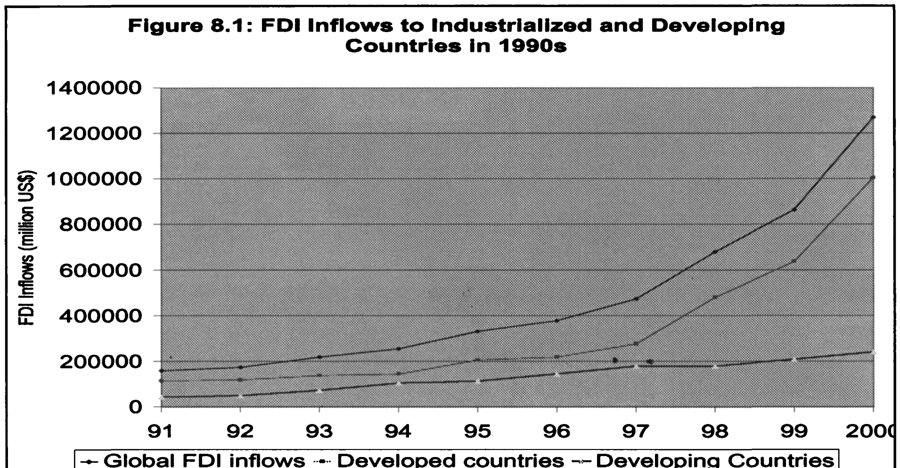


Figure 8.1: FDI Inflows to Industrialized and Developing Countries in 1990s

Source: based on Table 8.1

The share of developing countries in FDI inflows rose sharply during the early 1990s from 26 per cent in 1991 to over 40 per cent in 1994. Since then it has steadily declined to below 24 per cent in 2000 (see Figure 8.2). The sharp rise in the share of developing countries in the early 1990s was largely owing to the emergence of China as the most important host of FDI in the developing world.

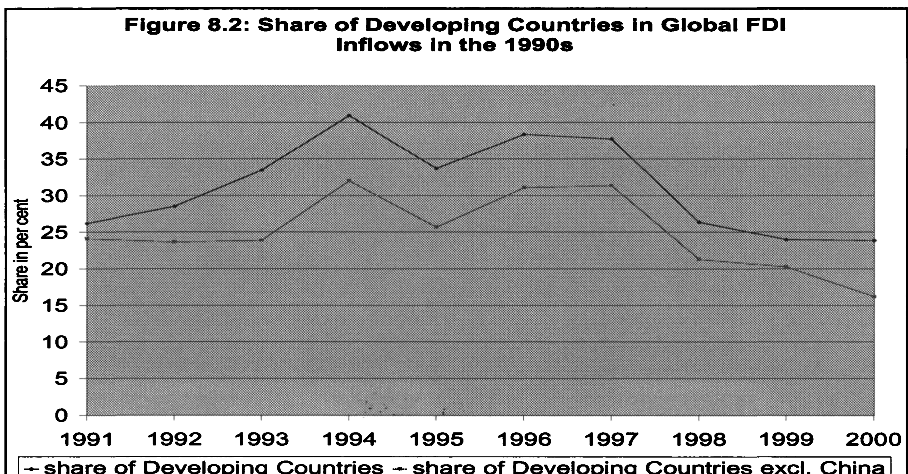
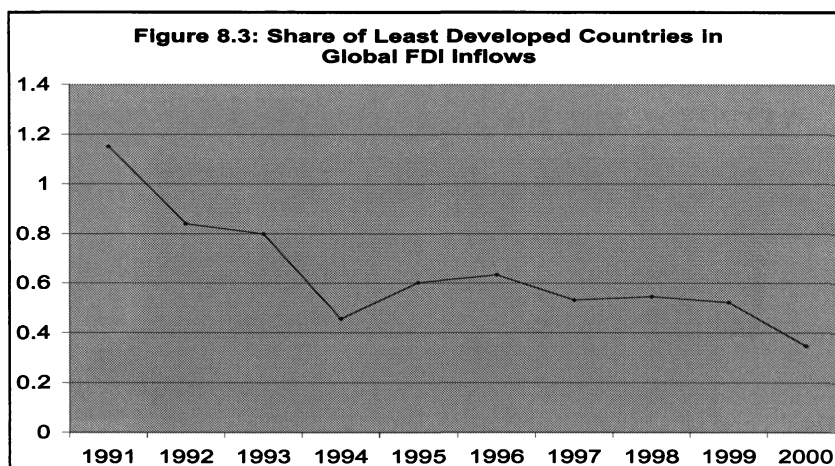


Figure 8.2: Share of Developing Countries in Global FDI Inflows in the 1990s

Source: based on Table 8.1

Growing Marginalisation of Poorer Countries

The shares of different regions also tend to mask the inter-country variations in relative importance as hosts of FDI. FDI inflows are highly concentrated in a handful of high and middle-income countries. Low-income and least developed countries remain marginalised in the distribution of FDI inflows. The share of 45 least developed countries as a group in global FDI inflows is negligible at 0.35 per cent and shows a declining trend over the 1991–2000 period (see Figure 8.3). Just ten most important hosts of FDI among developing countries account for over 80 per cent of all inflows received by developing countries in 1999. The concentration in the top ten recipients has increased from 66 per cent in the mid-1980s to over 80 per cent in the late 1990s.



Source: based on Table 8.1

The findings of empirical studies of the determinants of FDI inflows across countries suggest that these flows are driven by factors like country size, level of income or development, extent of urbanisation and availability of infrastructure, together with geographical and cultural proximity to home countries. Hence, relatively smaller, poorer and agrarian countries have limitations in tapping the resources of multinational enterprises (MNEs) for their industrialisation with policy liberalisation or through investment agreements as will be seen later (Kumar, 2002).

3 Developmental Impact of FDI on the Host Economies: A Selective Review of the Literature

FDI usually flows as a bundle of resources including, besides capital, production technology, organisational and managerial skills, marketing know-how and even market access through the marketing networks of multinational enterprises who undertake FDI. These skills tend to spill over to domestic enterprises in the host country.

Therefore, FDI can be expected to make a more than proportionate contribution to growth compared to domestic investment in the host country. There is now a body of literature that has analysed the effect of FDI on growth in an inter-country framework and another analysing knowledge spill-overs to domestic enterprises from MNEs (see, for example, De Melo, 1997; Kumar and Siddharthan, 1997; and Saggi, 2000 for recent reviews of the literature). However, the mixed findings reached by these studies on the role of FDI inflows in host country growth and on knowledge spill-overs from MNEs suggest that these relationships are not unequivocal. The primary consideration for expecting a more favourable effect of FDI on growth is externalities of MNE entry for domestic firms. The externalities, such as spill-overs, may not take place in some cases because of poor linkages with domestic enterprises or poor absorptive capacity. FDI projects vary in terms of generation of linkages for domestic enterprises. There is also a possibility of MNE entry affecting domestic enterprises adversely, given the market power of their proprietary assets such as superior technology, appeal of brand names and aggressive marketing techniques. Therefore, FDI may crowd out domestic investment and may thus be immiserising. Fry (1992), for instance, found FDI to have a significant negative effect on domestic investment and to be crowding it out. This effect varies across countries; in the Pacific basin countries FDI seems to have crowded-in domestic investment. Similarly, Agosin and Mayer (2000), analysing the effect of FDI inflows on investment rates in host countries over the period 1970–95, found that FDI crowds in domestic investment in Asian countries, crowds it out in Latin American countries, while in Africa the relationship is neutral. Evidence is also available on the adverse effect of foreign ownership on the productivity of domestic enterprises in developing countries.[1] A recent G-24 Working Paper by Gordon Hanson published by UNCTAD has also highlighted cases where FDI may have lowered host country welfare. A recent study by Maria Carkovic and Ross Levin of the University of Minnesota has found that FDI has no independent influence on the economic growth of host countries. Kumar and Pradhan (2002), in a recent quantitative study covering a sample of 107 developing countries in the 1980–99 period, corroborate that FDI appears to crowd out domestic investments in net terms in general, although some countries have experienced a favourable effect of FDI on domestic investments in net terms, suggesting a role for host country policies. They inferred, therefore, that policy flexibility is important for developing countries in benefiting from FDI.

Role of Government Policy and Performance Requirements: Experiences and Evidence

It is clear that the effect of FDI on domestic investments and growth depends very much on the nature or quality of the FDI. Certain types of FDI tend to have more favourable developmental externalities than others. In this context attention needs to paid by host countries to the quality of FDI inflows as well as to attracting greater

magnitudes of FDI. Recent work has shown that host country policies have an important bearing on the quality of FDI inflows received (Kumar, 2002). Governments have employed various measures to improve the overall quality of FDI inflows, including selective policies to target more desirable FDI inflows. East Asian countries like South Korea have, in the past, pushed FDI into high technology and export-oriented sectors with various policy instruments.

Many governments, in developed as well as developing countries, have imposed performance regulations to improve FDI quality. These include local content requirements on MNEs to intensify generation of local linkages or export obligations for expanding the contribution of FDI to expansion of manufactured exports of developing countries. The evidence available shows that developed countries used these performance requirements extensively until recently and continue to use them in different forms even now. The evidence suggests that these requirements have been generally effective in achieving their goals (see Kumar, 2003, for evidence from developed and developing countries). Different host governments have also used protectionist policies to encourage the tariff-jumping type of FDI inflows (see Caves, 1996 for a review of evidence). More recently, industrialised countries in the EU, for example, have used protectionist measures such as voluntary export restraints (VERs), quotas, screwdriver regulations, rules of origin and various anti-dumping measures to encourage foreign-based MNEs, especially from Japan, to increase the domestic content in their sales (Belderbos, 1997; Moran, 1998). Stringent rules of origin have also been adopted as a part of the North American Free Trade Agreement (NAFTA) to increase the domestic content of foreign enterprises' sales in the trade bloc. Some have employed incentives such as pioneer industry programmes to attract FDI in industries that have the potential to generate more favourable externalities for domestic investment (see UNCTAD, 1999, 2001, for examples). Similarly, because MNE entry through acquisition of domestic enterprises is likely to generate less favourable externalities for domestic investment than greenfield investments, some governments discourage acquisitions by foreign enterprises (Agosin and Mayer, 2000).

Another sphere where government intervention may be required to maximise gains from globalisation is in diffusion of knowledge brought in by foreign enterprises. An important channel of diffusion of knowledge brought in by MNEs in the host economy is vertical inter-firm linkages with domestic enterprises. The host governments could consider employing proactive measures that encourage foreign and local firms to deepen their local content as a number of countries, for example Singapore, Taiwan, Korea and Ireland, have done successfully (Battat *et al.*, 1996). The knowledge diffusion could also be accomplished by creating sub-national or sub-regional clusters of inter-related activities which facilitate spill-overs of knowledge through informal and social contacts among employees besides traditional buyer-seller links.

To sum up, FDI inflows may have widely diverging developmental effects on their

host countries, ranging from a highly favourable impact by bringing and diffusing new technologies and market access, besides the creation of output and jobs, to crowding out domestic investments and hence immiserising host economies. The literature emphasises the critical role played by host government policies, such as screening mechanisms and performance requirements, in maximising the contribution of FDI to their development and minimising negative effects. It follows from this that any attempt to curtail the policy space available to host governments for regulation of FDI is likely to have a bearing on the quality of the FDI.

4 Relevance of a Multilateral Framework on Investment: A Developing Country Perspective

As observed earlier, developed countries have constantly strived to secure more favourable conditions for investment by their enterprises worldwide by seeking liberalisation of investment regimes through bilateral and multilateral negotiations, given the North–South divide on the investment issue. They have resisted the attempts of developing countries to evolve binding codes of conduct for MNEs within the UNCTC and UNCTAD framework. Furthermore, they have strategically used multilateral trade negotiations to create a more favourable framework for FDI worldwide even though investment is more a development than a trade issue. Thus, despite the resistance of developing countries, the Final Act of the Uruguay Round included an Agreement on Trade Related Investment Measures. The TRIMs Agreement requires member countries to phase out performance requirements relating to trade, such as local content requirements and foreign exchange neutrality. The GATS provided a framework for liberalisation of trade in services including through cross-border commercial presence which is akin to FDI.

The TRIMs Agreement also provided for a review within five years of the operation of the Agreement and to 'consider whether the Agreement should be complemented with provisions on investment policy and competition policy'. However, without waiting for the mandated review of TRIMs, developed countries attempted to widen the scope of the multilateral regime on investment beyond what is covered in the agreements on TRIMs and GATS. One such attempt was the initiative to establish a Multilateral Agreement (MAI) under the aegis of OECD which was launched in 1995. The OECD negotiations on the MAI, however, could not be successfully concluded and were abandoned in 1998. The MAI negotiations failed because of the failure of OECD members to reach a consensus on the issue. However, even before the experience of MAI negotiations in OECD, an attempt was made to put the investment issue onto the WTO agenda at the first ministerial conference in Singapore, where the EU and Canada proposed the creation of a possible Multilateral Framework on Investment (MFI) under the auspices of the WTO. However, given the resistance of developing countries, a negotiating mandate could not be obtained; instead, a Working

Group on Trade and Investment was set up within the WTO to study the issue without a negotiating mandate.[2] Before the WGTI's study process could conclude its work and recommend the desirability, if any, of a MFI within WTO's ambit, the EU, with the support of other industrialised countries, pushed the investment issue for negotiation at the fourth ministerial conference of WTO held in Doha in November 2001. Despite the resistance of developing countries, who wanted to first complete the study process at the WGTI before agreeing to a negotiating mandate, the Doha Declaration provided for launch of negotiations on trade and investment after the fifth ministerial conference 'on the basis of a decision taken, by explicit consensus, at that session on the modalities of negotiations'.[3]

There is some ambiguity in the Doha mandate as to whether an explicit consensus will be needed to decide whether or not to launch the negotiations or whether explicit consensus is only required for deciding the modalities of negotiations, as discussed in the following section. A basic question before entering into any negotiation on an MFI is to determine to what extent there is a need for a new multilateral instrument on investment, and what its costs and benefits may be for developing country members. Against that backdrop, this paper assesses the relevance of MFI from a developing country perspective.

A GATT-type Framework on Investment Has No Conceptual Relevance

The attempt of developed countries to extend a GATT-type regime to investment based on national treatment and MFN is clearly misconceived conceptually, as well as in practice. There is a conceptual basis for trade liberalisation on the principle of comparative advantage where countries with different comparative advantages benefit from trading mutually. So developing countries trade their labour and raw material intensive goods with more knowledge and capital intensive goods produced by developed countries. On the other hand, FDI flows emerge because of differences in the levels of development and bundles of created assets. Indeed, international firm theory explains the 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 known brand names, access to cheaper sources of capital and accumulated experience of organising complex tasks.[4] From the start, therefore, MNE entrants enjoy an edge over local enterprises, if there are any, because of their monopolistic ownership advantages. The margin of the edge enjoyed by them is inversely related to the extent of development of local industrial capabilities and hence the level of development. It is particularly wide in low-income countries. It is no accident that 90 per cent of the global FDI stock is owned by the industrialised countries, with developing countries nearly always playing the role of host country for FDI flows.

Therefore, in contrast to the argument of the proponents of MFI, the *playing field is*

already tilted in favour of MNEs. When they enter a country MNEs are already far ahead of domestic enterprises in the potential host country; this is especially so in developing countries because of MNEs' monopolistic ownership of unique assets. 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 it is forced to compete with mighty global corporations under 'national treatment'.[5]

WTO Lacks Competence in Handling Investment

The inclusion of investment on the WTO agenda has also been justified on the grounds of the trade relatedness of investment. However, the trade-investment link, other than what is covered under TRIMs, is by no means straightforward. The bulk of FDI flows continue to be of a market-seeking (or tariff-jumping) type and actually substitute for trade. Therefore, after taking care of possible trade-distorting investment policies under the TRIMs Agreement, there is very little justification for including a full-fledged investment agreement in the multilateral 'trade' negotiations. FDI, like domestic investment, is a development and industrialisation issue rather than a trade issue. Bringing it onto the WTO agenda would unnecessarily divert the attention of the WTO from its main purpose, i.e. trade liberalisation. The 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 by the Singapore Meeting in 1996 has so far been unable to complete its work.

FDI Policy Needs to be Tuned to the Level of Development

It has been shown in the literature that countries at different levels of development receive different types of FDI (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 and investments in capital and intermediate goods industries in subsequent stages. Naturally, the need for a policy framework dealing with FDI depends upon the level of development. The one-size-fits-all approach to FDI policy inherent in the idea of the MFI in the WTO cannot serve the best interests of countries which are at different levels of development.

The Developmental Impact of FDI Depends on Host Country Policies

The evidence presented in Section 3 has shown that host government policies have played an important role in extracting benefits from FDI in developed and developing countries. The countries that pursued selective policies with respect to FDI, for instance, South Korea, Taiwan and China, among other south-east 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 which pursued more open policies, such as some Latin American countries. A multilateral regime takes away the ability of host governments to direct FDI in accordance with their development policy objectives and the overall 'quality' of any FDI inflows received is likely to suffer.

MFI is Unlikely to Expand the Magnitude of FDI Inflows

Proponents of a GATT-type MFI 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 gravity factors such as market size, income levels, the extent of urbanisation, geographical and cultural proximity to the major source countries of FDI and the quality of infrastructure. Policy factors play a relatively minor role at the margin, holding gravity factors constant (Contractor, 1990; Wheeler and Mody, 1992; Kumar, 2000a). After harmonisation of policy regimes across the world as proposed, the concentration of FDI in the industrialised countries may increase further. The irrelevance of government policy regimes 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. As observed earlier, 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 0.34 per cent in 2000. On the other hand, some countries which have a much more restrictive policy framework are able to attract sizeable inflows, for example China, which attracts over $40 billion worth of FDI inflows every year. Despite the fact that the USA and China do not even have a bilateral investment treaty, the USA is the most important source of FDI in China. The same is the case in Brazil. Therefore an MFI is unlikely to make any difference to the level of FDI inflows, while it has the potential to affect their quality.

No Symmetry between the Rights and Responsibilities of Foreign Investors is Proposed

Proponents of an MFI seek to protect only the rights of investors or corporations. Nothing is being proposed in terms of their obligations and responsibilities, and there are no provisions concerning protection of host country interests. FDI flows are generally undertaken by MNEs that command enormous resources and power as as a result of their gigantic and global scales of operation which are larger than the economies of many of the countries they operate in and which are growing faster than the size of many of these economies, as shown by UNCTAD's 2000 *World Investment Report*. This enormous power can be misused to pursue restrictive business practices.[6] Recognition of concerns about possible misuse of this power in private hands led the international community to launch several initiatives at the international level to curb it, such as

the United Nations Code of Conduct on TNCs in the 1970s that was also resisted by developed countries (Correa and Kumar, 2003). The glaring lack of a binding international regulation of the activities of international corporations has often been noted in the past decade. The Bhopal tragedy, where the MNC concerned sought to shirk the liability arising from the actions of its majority-owned subsidiary is a case in point. The practice of manipulation of transfer prices to shift funds across countries to evade taxes is also well-known. Furthermore, while there are attempts to curb the ability of host governments to impose performance obligations, the ability of corporations to impose restrictive clauses on their subsidiaries that are often trade distorting goes unregulated. 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 sub-national governmental entities); (b) governments of nations that are home to international corporations; and (c) international corporations themselves'.

Adequate Frameworks for Investment Protection and Dispute Settlement Exist

A general impression that is created by the protagonists is that an adequate framework for protection of investment and dispute settlement does not exist. This impression is completely flawed. There exists an elaborate framework for investment protection and dispute settlement at the bilateral as well as at multilateral levels. There is an extensive network of bilateral investment promotion and protection agreements or treaties (BIPAs or BITs) between different pairs of countries. By the end of 2001, 2096 such treaties had been signed by 174 countries. The bulk of these treaties were signed during the 1990s following the rapid growth of FDI flows. As many as 31 per cent of the treaties have been concluded between developed and developing countries and 45 per cent between developing countries.[7] Typically, these BITs provide protection and national treatment for investments that have been established in tune with the existing national regulations and policies. Hence, they provide flexibility to host countries to pursue their development policy, while at the same time giving a sense of security to foreign investors. It is much easier to conclude BITs than to establish a multilateral framework, as is clear from the fact that the OECD's negotiations for an MAI could not be concluded even though all the negotiating parties were developed countries.

Furthermore, multilateral instruments for protection and guarantee of international investments do exist. They include the 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 falls under the aegis of the World Bank and has provided a framework for dispute settlement since the mid-1960s. Other such bodies are the UN Committee on International Trade Law (UNCITRAL) and the International Chamber of Commerce (ICC) (Correa and Kumar, 2003).

Finally, contrary to the general impression created by the proponents of an MFI, bilateral investment treaties would still be needed, even with a multilateral agreement, just as the presence of GATT in trade in goods has not removed the need for bilateral trade agreements.

No Reciprocity with Labour Mobility

Capital and labour are two mobile factors of production. The proposed framework on investment proposes to liberalise capital movements without providing for labour mobility and hence would create asymmetry. The economic arguments for free movement of labour are no weaker than those for free movement of capital (Hoekman and Saggi, 2000). 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.' Regional blocs such as the EU and NAFTA that provide for free capital movement between member states generally also provide for labour mobility.

Evidence of the reluctance of developed countries to liberalise labour mobility is clear from the lack of commitments made by them in respect of Mode 4 in the GATS that covers movement of natural persons. Almost all of the market access commitments made by developed countries are subject to limitations such as an economic needs test or restricted to a specified proportion of the work force. Similarly, 83 per cent of commitments in respect of national treatment made by developed countries are also subject to limitations such as tax treatment or other discriminating treatment that is sometimes non-transparent. This situation prevails notwithstanding Article IV.1(c) of GATS, which covers 'the liberalisation of market access in sectors and modes of supply of export interest' to developing countries' (RIS, 2002). The restrictions on movement of natural persons across regions impose a cost on developed and developing economies far exceeding that of trade restrictions on goods. Winters *et al.* (2002) have estimated in the framework of a CGE model that an increase in developed countries' quotas for both skilled and unskilled temporary workers equivalent to just 3 per cent of their labour force would lead to over US$150 billion of welfare gains for developed and developing economies.

5 The Way forward for the Cancún Ministerial Conference

We have reviewed above the merit of various arguments in favour of a GATT-type multilateral framework on investment. It is clear that an MFI is justified on neither conceptual or policy grounds. The reduced flexibility to regulate FDI inflows in tune with their development policy objectives resulting from agreeing to a multilateral framework could lead to considerable loss of welfare in developing countries. While

the proposed MFI would reduce the policy space available to developing countries, it does not offer them anything in return. Neither they can expect more inflows of FDI nor any reciprocity in other sectors such as labour mobility. In view of this, developing countries resisted a negotiating mandate on investment at the Doha ministerial conference. However, developed countries, and especially the European Union, strongly pushed for a negotiating mandate. The final Doha Declaration provides as –follows:

> Relationship between trade and investment
> 20. Recognising the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade, and the need for enhanced technical assistance and capacity-building in this area as referred to in paragraph 21, *we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations*[8] (emphasis added).

Although the language of the Declaration talks of the need for a consensus on the modalities of negotiations, the Chairman's understanding and clarification that enabled the adoption of the Declaration at the Doha Ministerial suggests that the negotiating mandate would itself be subject to an explicit consensus:

> I would like to note that some delegations have requested clarification concerning paragraphs 20 ... of the draft declaration. Let me say that *with respect to the reference to an 'explicit consensus'* being needed, in these paragraphs, for a decision to be taken at the Fifth Session of the Ministerial Conference, *my understanding is that, at that session, a decision would indeed need to be taken by explicit consensus, before negotiations on trade and investment ... could proceed.*
>
> In my view, this would also give *each member the right to take a position on modalities that would prevent negotiations from proceeding after the Fifth Session* of the Ministerial Conference until that member is prepared to join in an explicit consensus (emphasis added).
>
> H. E. Youssef Hussain Kamal, Qatari Finance, Economy and Trade Minister, Chairman of Doha Ministerial Conference at the closing plenary session, 14 November 2001[9]

Going by the Chairman's understanding, the negotiating mandate on investment is yet to be obtained at the fifth ministerial conference scheduled to be held in Cancún in September 2003. In light of that, this section reviews the various options that developing countries can consider at the Cancún Ministerial in September 2003.

In the context of the Doha Mandate, developing countries have four possible options:

Most Preferred Option: Resist a Negotiating Mandate at Cancún

Keeping in mind the Chairman's clarification, it is still possible to resist a negotiating mandate on investment. For this to happen, a coalition of developing countries would be of critical importance. Developing countries will have to argue their case effectively. They could also draw attention to the practical problems involved in arriving at a consensus on the subject in the light of the OECD's MAI experience when a relatively homogeneous group of 29 OECD Member States failed to arrive at a consensus even after negotiations lasting over three years. Another attempt to evolve a multilateral framework on investment, the UN Code of Conduct on TNCs, similarly could not be concluded successfully, despite protracted negotiations lasting from 1977 to 1992. In a forum like the WTO, whose membership covers the entire spectrum of high-income, middle-income, low-income and least developed countries, the possibility of arriving at a consensus would appear to be abysmally low. The potential cost in terms of world development and welfare could be substantial, while the promise of gains is negligible. Instead, developing countries could seek a review of the reasons for the failure of the OECD's MAI and the lessons learnt from that experience as a part of the ongoing study process launched at the Singapore ministerial conference in the form of WGTI. This option would be by far the most desirable from a developing country point of view. But it would also be the most challenging to achieve given the developed countries' serious pursuit of an MFI. Yet it could be feasible, depending on the ability of developing countries to form a coalition on the issue.[10]

A Compromise Solution: A Multilateral Treaty on Investment Negotiated Outside the WTO

If developed countries persist with their demand for an MFI, a compromise solution could be a multilateral treaty on investment negotiated outside the Single Undertaking of the WTO. The objective of proponents of an MFI is 'to secure transparent, stable and predictable conditions' for cross-border investments, particularly FDI, that can be well served by a free-standing independent multilateral treaty on investment negotiated within the UN framework like many other international treaties, such as a the Law of the Sea, that have served their purpose well. An independent Multilateral Investment Treaty (MIT) could be modelled in large part on the Bilateral Investment Promotion and Protection Treaties (BIPAs) that provide protection for investments approved under the existing policies. It could also contain provisions on the obligations of investors among other provisions that are considered necessary. It could link itself with the existing institutional infrastructure on investment protection and settlement of investment disputes in the framework of ICSID, UNCITRAL, ICC and MIGA. Developing countries could argue that the WTO does not have the necessary expertise to deal with investment, which is a subject dealt by finance or industry ministries, rather than by trade diplomats. UNCTAD would probably be a more appropri-

ate forum, as it has inherited the UN Commission on TNCs. UNCTAD is also well placed to put a development dimension at the core of an MIT.

If there is an agreement to negotiate a treaty on investment outside the WTO, one alternative could be to resurrect the draft UN Code of Conduct on TNCs which could be adopted with minor amendments. The draft UN Code was negotiated in protracted negotiations over the 1977–1992 period. The draft code represents a balanced approach to a multilateral framework, setting out rights and obligations of investors and host governments (Correa and Kumar, 2003). The draft Code could not be adopted because of differences between developed and developing countries on its legal status and was abandoned in 1992. In view of the fact that considerable negotiating effort was spent in refining its different elements, its balanced treatment of host country, home country and investor interests, and its ability to provide a stable, predictable and transparent framework for FDI, it would serve the objective of both developed and developing countries very ably. It was negotiated within the negotiating platform of the UN Commission on TNCs which is currently serviced by UNCTAD. UNCTAD has the capability to provide a Secretariat for the Code and to service its implementation, given its work on investment.

The Last Resort: Negotiating a Development-friendly Multilateral Framework in the WTO

If a negotiating mandate on investment is unavoidable at the Cancún ministerial conference, then developing countries have to ensure that the framework contains adequate development provisions so that their development process is not disrupted and sufficient flexibility to pursue their developmental policy objectives is retained. This will be a big challenge and must be responded to by proactive preparation by the developing country negotiators in evolving a development-friendly MFI draft. In such a draft each and every element will have to be defined in such a manner that the concerns of developing countries are kept in mind. Some reflections on this are discussed in the following section.

6 Incorporating a 'Development Dimension' in a Possible MFI

If it is decided to negotiate a multilateral framework on investment within or outside the Single Undertaking, developing countries would have to reflect on different elements of such a framework from their perspective, including scope and definition, transparency, non-discrimination (national treatment and MFN) and development provisions. A basic consideration in the analysis that follows is the incorporation throughout a possible MFI of a 'developmental dimension'. Under this concept, the effects on development of various obligations should be systematically assessed in order to ensure that the overall impact of a possible agreement on development is pos-

itive, and that obligations with a likely negative effect are excluded or minimised. The Doha Declaration places heavy emphasis on the development provisions in Para 22 as follows:

> 22. In the period until the Fifth Session, further work in the Working Group on the Relationship Between Trade and Investment will focus on the clarification of: scope and definition; transparency; non-discrimination; modalities for pre-establishment commitments based on a GATS-type, *positive list approach; development provisions; exceptions and balance-of-payments safeguards*; consultation and the settlement of disputes between members. Any framework should reflect *in a balanced manner the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to* regulate in the public interest. The special development, trade and financial needs of developing and least developed countries should be taken into account as an integral part of any framework, which should enable members to undertake obligations and commitments commensurate with their individual needs and circumstances. ... (emphasis added).[11]

The challenge, therefore, before developing countries is to define different elements of an MFI in such a manner that their developmental concerns are taken care of. Given the different impact that an MFI may have on developed and developing countries, an MFI should allow for differential treatment with regard to developing countries (and LDCs), as generally permitted under GATT/WTO Agreements.

A crucial point in the negotiation of an MFI is how to achieve a balance between rights and obligations. In other words, a MFI should not only contain a set of restrictions on Members' policies, but it should also spell out clearly the obligations of investors. Most importantly, developing countries should retain flexibility in pursuing selective policies in tune with their development policy objectives and impose performance requirements on foreign investors.

Some considerations for designing a development-friendly framework are as follows:

Scope and Definition

It is important to clarify the implications of different criteria adopted for scope and definition from the perspective of host and home countries. Adoption of a broad scope and definition has obvious problems. For instance, a broad assets-based definition and all-encompassing sectoral coverage would limit governments' ability to regulate financial flows and manage financial crises. Given the frequency of crises in various parts of the world, international financial institutions such as the World Bank are advising caution on the part of the governments with respect to capital account liberalisation.[12]

Past experience suggests that if investment agreements have a broad and general scope, they are not able to keep in mind the specific conditions and interests of different countries. Hence there is need for exceptions. The experience of OECD's Multilateral Agreement on Investment is illustrative in this context as it had to be annexed with several hundred exceptions, despite the fact that the contracting parties were all highly developed OECD member countries. Although bilateral investment treaties adopt broad assets-based definitions, their scope is limited to investments undertaken in accordance with national laws and policies and their purpose is essentially protection. Similarly, investment treaties negotiated within regional integration arrangements (RIAs) such as EU and NAFTA are also generally broad in their coverage. However, the treatment accorded under these treaties is given on a discriminatory basis to the member states in the RIA only and these RIAs invariably cover mobility of all the goods and factors of production such as labour and capital.

Considerations for defining the Scope and Coverage of the Framework from a Development Perspective:

i) Restrict the Scope to FDI

In the present context, it is important to keep in mind the mandate of the Doha Declaration that suggests, in paragraph 20, that the focus is on 'long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade'. Thus the mandate clearly limits the scope of the possible MFI to 'long-term cross-border investments particularly foreign direct investments'. It is important to focus on FDI because these are essentially long-term in nature. In the WGTI meetings, Japan was one of the countries that argued for the need to restrict the scope of MFI to FDI.[13]

ii) Majority Ownership is the Only Objective Criteria for Defining FDI

FDI is distinguished from foreign portfolio investments in that ownership is accompanied by management control. Therefore, there is a need to define a threshold of equity ownership that ensures management control and hence can be used to distinguish FDI from all other types of foreign investment. Different levels of equity ownership are used in different countries for defining a controlling stake. For example, the IMF considers 10 per cent equity ownership to be adequate for exercising control, some institutions (for example the Reserve Bank of India) use 25 per cent ownership as sufficient and in some countries the figure is set at 33 per cent. However, all these criteria are arbitrary in nature. Indeed, the proportion of ownership necessary for exercising effective control over an enterprise depends on how the rest of the share holding is dispersed. Majority ownership is the only objectively defined threshold because only the majority shareholder is able to take all the important decisions. Hence, majority ownership could be employed to define FDI. GATS, CARICOM and the

Statute of a 'European Company' have adopted the majority ownership rule in their definitions of a controlling stake.[14]

iii) Limit the Coverage to Export-oriented FDI that Contributes to Trade Expansion
Furthermore, the Doha Declaration focuses on 'foreign direct investment that will contribute to the expansion of trade'. Clearly, the focus is on investments that contribute to the expansion of trade and eventually to development, rather than on all cross-border investments. There are certain types of foreign direct investments that contribute to trade expansion more than other investments. While the bulk of foreign direct investment flows continues essentially to be seeking the domestic markets in the host countries and generally substitute trade, export-platform investments undertaken by multinational enterprises as a part of their restructuring of production according to international differences in factor costs have contributed significantly to the expansion of world trade over the past three decades. Export-oriented foreign direct investments have helped the east and south-east Asian countries to rapidly build their manufacturing export capabilities. Therefore, these investments can contribute to the expansion of trade as well as expediting the development of the host countries. The literature suggests that export-oriented foreign direct investment is a special type of foreign direct investment and is determined by different factors (Kumar, 1994; 1998). Therefore, in view of the language of paragraph 22 of the Doha Declaration, it is worthwhile to argue a case for limiting the scope of possible MFI to export-oriented FDI and not all cross-border investments.

iv) Limit the Coverage to Greenfield Investments that contribute to growth
FDI's developmental impact on the host country also depends on whether it takes the form of a greenfield investment or acquisition of an existing enterprise (Brownfield). UNCTAD's studies suggest that 'the potential of an adverse effect is greater in the case or M & As than in the case of greenfield investment'.[15] It may be argued that greenfield investment has a greater potential for contributing to the expansion of trade by making a contribution to manufacturing and export capabilities than through acquisition of existing enterprises. Therefore, developing countries may wish to exclude acquisitions of existing enterprises from the scope of a possible MFI.

Transparency: Seeking a Symmetric Framework

In an effort to attract FDI, developing countries are themselves moving towards making their investment policy regimes more transparent. It is not clear whether binding rules on transparency are necessary. APEC's approach to Non-binding Investment Principles may be adequate. Keeping in mind the generally life-long relationship that they entail, governments are more cautious in dealing with investments, and especially with FDI, than trade. The WTO Secretariat has observed that transparency provisions in existing bilateral and regional investment treaties – where they exist – are

generally less detailed and prescriptive than similar requirements in the WTO'.[16] While transparency with respect to an FDI policy framework might be unexceptional, some of the procedures for processing and evaluating proposals might not be made transparent in the public interest. The exceptions of where keeping information confidential is in the public interest need to be provided.

In dealing with foreign investors, governments of developing and least developed countries often experience an information asymmetry, i.e. availability of little information about the background and track record of the investors in other countries with respect to corporate social responsibility, their involvement in bribery and corruption and restrictive business practices. The recent cases of Enron, Anderson and Xerox are cases in point. In this context, the MFI should provide for transparency on the background and track record of corporations and other investors. Investors and home governments must accept obligations to share information on their involvement in questionable dealings. The MFI could also provide for the creation of a centralised online database recording cases of fraud, bribery and corruption, transfer pricing manipulations and questionable dealings, and other cases of violation of national laws from different host countries in respect of foreign investors. Such a database will be particularly useful for governments, especially in smaller and poorer countries with limited resources to verify the credentials of foreign investors.

National Treatment in Post-establishment Phase: Retaining the Policy Flexibility

As argued earlier, MNC affiliates enjoy several monopolistic advantages such as globally known brand names, proprietary superior technology, captive access to resources and talent; they face different opportunities and pursue different objective functions compared to national enterprises. The margin of the edge enjoyed by them may be particularly wide in poorer developing countries. In low-income countries, because of a wide technology gap, not only may knowledge spill-overs fail to take place, but the foreign entry may sometimes crowd domestic enterprises out and hence lower host country welfare (Correa and Kumar, 2003).

Therefore, in contrast to the argument of the proponents of MFI, the *playing field is already tilted in favour of* MNCs. When they enter a country, MNCs are already far ahead of domestic enterprises in the potential host country, especially if it is a developing county, because of their monopolistic ownership of unique assets. 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 mighty global corporations under 'national treatment'.

Given the differences in corporate strategy and decision-making, and the special advantages of MNCs, host governments in developing countries often need to adopt

policies supporting and nurturing domestic 'infant enterprises' or small and medium enterprises from foreign competition, either through selective policies towards FDI or through measures favouring domestic enterprises. Given the scarcity of public funds that may be committed through tax exemptions or subsidies to promote development-related activities (such as research and development, employment and adding local value), governments in developing countries may need to limit the granting of incentives to national firms or to a certain category thereof, for instance, small and medium enterprises. Discriminatory support measures favouring domestic enterprises in strategic industries are quite common even in the developed world. A well-known example is SEMATECH, a consortium of computer chip manufacturers that has excluded foreign participation and has received substantial subsidies from the US government.[17]

The recognition of national treatment as a general principle in an MFI would prevent any future change in legislation aimed at providing advantages to nationals, which are not available to foreign investors. The Doha Declaration indicates that any framework should '*take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest* ...' (emphasis added).[18]

To protect flexibility for developing countries, granting of national treatment in the post-establishment phase may be structured on the basis of a GATS-type positive list approach which is more development friendly and could be subject to such limitations as were considered necessary. The GATS-type approach leaves to the Members the possibility of determining in which sectors the national treatment standard will be applicable. National treatment, therefore, is not unconditionally and automatically applicable (as in other WTO Agreements) but is subject to the prior decision of the respective Member who prepares its own 'positive list' of sectors where it is ready to give concessions.

d) National Treatment in Pre-establishment Phase: Exclude any Commitments

Currently, WTO Member States can apply measures aiming at screening FDI inflows, either in particular sectors or across the board, in order to admit those projects that are consistent with their development needs. Since the objectives sought by host countries (such as the building up of domestic industrial and technological capabilities, the development of SMEs, the protection of the environment and the development of particular regions) may vary significantly, the criteria to assess investment proposals are also likely to differ among countries.

In view of the great variation in the quality or developmental impact of different FDI proposals on the host country's economy and in the light of possible adverse impact on domestic enterprises and host country welfare, as observed earlier, host governments may wish to protect domestic 'infant enterprises' or small and medium enterprises from foreign competition through selective policies towards FDI. Host

governments may also impose, subject to the TRIMS Agreement, performance requirements on foreign entrants to regulate their operations in tune with their development policy objectives. The policy flexibility of governments of developing countries to pursue a selective policy towards FDI and impose performance requirements is very crucial and needs to be retained in any multilateral framework. The Doha Declaration provides for such flexibility and suggests due regard for development policy; it preserves their right to '... take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest'.[19]

The application of the national treatment principle for pre-establishment would limit host countries' freedom to exclude or restrict foreign investment in specified sectors or activities, stipulate domestic ownership requirements and adopt other permissible performance measures at the entry of FDI. Pre-establishment national treatment is not provided under bilateral investment treaties, except for a few treaties signed by the USA. Investment agreements as a part of regional integration arrangements (RIA) agreements like NAFTA provide for pre-establishment national treatment. But these are limited to partners on a reciprocal basis and also include full labour mobility alongside capital mobility. MFI, on the other hand, is limited to only capital mobility and not labour mobility.

Therefore, developing countries should resist the national treatment obligation for pre-establishment stage to retain the policy flexibility.

The proponents of MFI argue that a GATS-type approach to pre-establishment national treatment commitment allow adequate policy space to developing countries.[20] In principle, the GATS approach provides the flexibility. However, the experience of GATS suggests that developed countries bring pressure on developing countries to make commitments in the sectors that are of particular interest to them.

(e) Most-Favoured-Nation: Building Exceptions for Ethnic Investors

The extension of the MFN treatment to investment may be seen as a logical requirement in a multilateral system. It may affect, however, the special treatment conferred by many developing countries to 'ethnic overseas investors', in spite of their being permanent residents in or citizens of other countries. Therefore, exceptions for a differential treatment for ethnic overseas investors may be retained in a possible MFI.

(f) Development Provisions

Developing countries seek FDI as a resource for their industrialisation and development. FDI is supposed to bring to its host country a number of valuable resources for development, such as capital, technology, managerial and marketing skills, and sometimes market access in the case of export-oriented FDI. The knowledge and technologies brought in may be diffused through the host economy and hence be more productive. However, not all FDI brings with it such resources and as is evident from the literature cited in Section 3, FDI may even reduce host country welfare by crowding

out FDI. The evidence also shows the critical importance of host government policies such as performance requirements in maximising the benefits of FDI and minimising possible adverse effects. Hence, host governments – developed as well as developing – have generally employed policies that bring the operations of MNCs into consonance with the host country's developmental goals.

i) Flexibility to Impose Performance Requirements

Under special and differential treatment provisions, developing countries should seek flexibility to pursue policies that help them in exploiting the resources of MNCs for their development more effectively. These include policies such as performance requirements. Performance requirements may be employed to increase the depth of the involvement of MNCs' operations with the host economy and enhance their vertical linkages (such as local content requirements), to moderate the adverse effect of FDI on the balance of payments of the host country (such as export performance requirements or foreign exchange neutrality requirements), and to put in place domestic equity or joint venture requirements to facilitate absorption of technology transferred by MNCs, and training and transfer of technology requirements. The evidence available has shown that developed and developing countries have extensively employed these performance requirements and they have helped the host governments in achieving their development policy objectives (Kumar, 2003).

Some of these performance requirements, such as local content requirements and foreign exchange neutrality requirements, have been phased out as per the obligations of TRIMs Agreements . Others can still be applied. A number of developing countries have sought extensions to the phase-out period for implementation of commitments under TRIMs.[21] In cases where developing countries agree to negotiate an MFI, they can seek an abrogation of the TRIMs Agreement as the MFI will subsume all the necessary elements for dealing with investment.

ii) Exceptions in Government Procurement

Government procurement has been extensively used, in developed and developing countries, to promote the development of local industries by means of preferential treatment in terms of prices or other conditions of supply. From a developmental perspective, a possible MFI should be flexible enough to permit the use of public purchasing power as an instrument to promote the development of local firms.[22]

iii) Balance of Payments Safeguards

Safeguards should be built into the possible MFI for periods of balance of payments difficulties faced by developing countries. BIPAs have sometimes incorporated provisions for temporary suspension of remittances of profits and dividends and repatriation of disinvestments proceeds by companies in periods of balance of payments difficulties faced by host countries. Such provisions could be built into an MFI as well.

iv) A Special and Differential Treatment based on Objectively Defined Criterion for Development

The special and differential provisions for developing countries should be based on the level of development rather than additional transition years. For example, the provisions and policy flexibility could be linked to developing countries reaching a threshold of per capita manufacturing value added (MVA per capita). In this way the concept of graduation is built into as countries crossing the development threshold will cease to enjoy special and differential treatment. As in the case of the Agreement on Subsidies and Countervailing Measures (SCM), a threshold level could be defined, of MVA per capita, keeping in mind the world average of per capita MVA of US$1000 (MVA accounting for roughly 20 per cent of GDP and with an average per capita income for the world of US$5000 in 2000). A country should retain the policy flexibility that it deems desirable to pursue its development policy objectives so long as it has not crossed the threshold of US$1000 of MVA per capita. In this way the SDT will be based on an objective criteria will also introduce a concept of graduation. The countries below the MVA threshold should have complete freedom to apply performance requirements and other policies to maximise the contribution of FDI to their development.

(g) Balancing the Host Country and Home Country Interests

The Doha Declaration indicates the need to balance the interests of host and home countries. However, no indication has been made on how to balance the interests of developed and developing countries. A balancing of interest between all the stakeholders could be ensured with rights and obligations of all the stakeholders and by ensuring a symmetry between capital and labour mobility. China, Cuba, India, Kenya, Pakistan and Zimbabwe have made a joint submission to the WGTI on Investors' and Home Governments' Obligations.[23]

i) Seeking Binding Investors' Obligations

The proponents of the MFI have been seeking rights of foreign investors which the host country governments should commit to provide. However, nothing has been said about the obligations of the investors or the home countries. Any multilateral framework on investment has to be a balanced one defining the rights and responsibilities of all the actors involved. The Doha Declaration indicates the need for a balanced framework covering host and home country interests.

FDI is generally undertaken by TNCs. Given the massive economic power and resources that they command and their operations spreading around the globe, it is difficult for host governments to regulate their conduct. In view of their objective of global profit maximisation, there could be conflict of interests between their objectives and the development policy objectives of host countries and they could indulge in restrictive business practices, manipulation of transfer prices and other anti-competitive or corrupt practices. A number of cases of corporate misconduct have

been reported from different parts of the world involving some of the largest TNCs. National regulations have obvious limitations in regulating the operations of TNCs which cover the globe, although countries like the USA have adopted regulations covering operations conducted outside their national boundaries such as the Foreign Corrupt Practices Act and anti-trust regulations.[24]

Recognising the limitations of host governments in regulating the activities of TNCs, the international community has made several attempts to establish international norms of conduct for TNCs. These include the OECD's Guidelines of 1976, the ILO's Tripartite Declaration, UNCTAD's Multilaterally Agreed Set of Principles on Restrictive Business Practices and Draft Code of Conduct on International Transfer of Technology, among others (Correa and Kumar, 2003). The most ambitious and comprehensive of such attempts was the initiative to try to establish a UN Code of Conduct on TNCs, a draft of which was developed in lengthy negotiations during 1977–1992. The draft TNCs Code (abandoned in 1992) provided for a number of obligations to be complied with by foreign investors. During the period since the late 1990s, there has been a big trend towards consolidation and restructuring in the corporate world through mergers and acquisitions. These mergers and acquisitions have further increased concentration in larger corporations and, hence, their market and political power.

Some of these obligations and others that could be appropriately considered for incorporation in a possible MFI include:

- In terms of general principles, foreign investors would respect the national sovereignty of host governments and the right of each state to regulate, monitor and determine the role such corporations may play in economic and social development and to limit the extent of their involvement in specific sectors; agree not to interfere in the internal affairs of the host country and intergovernmental relations; adhere to economic goals and development objectives, policies and priorities, and work seriously towards making a positive contribution to the achievement of broad developmental objectives; adhere to socio-cultural objectives and values, and avoid practices, products or services that may have detrimental effects; and abstain from corrupt practices.
- Making a contribution to the strengthening of the scientific and technological capacities of developing countries
- Contributing to the technical and managerial training of nationals of host states and giving priority to the employment of local personnel at all levels;
- Refraining from imposing restrictive clauses in technology transfer contracts with their affiliates and licensees that prevent absorption and assimilation of technology transferred;[25]

- Refraining from imposing conditions on their overseas affiliates that restrict the sourcing of equipment, spares, raw material and services to affiliates' sources;
- Contributing to the promotion and diversification of exports and to increased utilisation of goods, services and other resources available locally;
- Not imposing restrictions on overseas affiliates regarding their exports either by limiting their quantity or destination;
- Co-operating with host governments in periods of balance of payments crisis by delaying remittances of profits and by phasing out divestment proceeds;
- Desisting from engaging in short-term financial operations or intra-corporate transfers in a manner that would increase currency instability and balance of payments difficulties;
- Prohibiting the imposition of restrictions on affiliates regarding the sourcing of their purchases and on their exports;
- Applying fair pricing policies in intra-corporate trade and curbing transfer pricing manipulations;
- Paying due regard to international standards of consumer protection;[26]
- Adopting fair employment practices, providing a safe and healthy working environment, paying remuneration to workers that provides them with an adequate standard of living and recognising their right to join organisations of their own choice without previous authorisation, eliminating discrimination unrelated to individual's ability to perform his/her job and protecting children from economic exploitation;[27]
- Taking steps to protect environment and rehabilitate it when there is damage;
- Accepting that they should disclose financial as well as non-financial information on the structure, policies and activities of the TNC as a whole, as well as that of the local affiliate.[28]

ii) Seeking Provisions for Transfer of Technology by Investors

For developing countries and LDCs, access to foreign technology is a critical issue which has not so far been adequately addressed in WTO Agreements. There are limitations in national regulations in effecting technology transfer from MNCs, as is clear from the evidence that is available.[29] As mentioned, an attempt was made in the 1980s to establish an International Code of Conduct on Transfer of Technology under the auspices of UNCTAD, but these negotiations have failed.

If an MFI is to be negotiated, an important target for developing countries may be

to include provisions relating to transfer of technology, so as to ensure that foreign investment effectively contributes to the technological development of the host country. Issues to be considered in this framework include:

- Requirements of transfer of technology as a condition for entry or operation of a foreign investment;
- Obligations to train and employ local personnel;
- Performance requirements related to a given level or value of research and development;
- Restraints on the TNCs from imposing restrictions on their overseas affiliates that adversely affect the process of absorption of technology and diversify sources of capital equipment and services;
- Measures to attract FDI in research and development activities;
- Grant of subsidies and tax benefits in developed countries to promote the transfer of technology (including associated equipment) to developing countries and LDCs.[30]

iii) Dealing with Market Power and Restrictive Business Practices of MNEs

Concern about the market power of MNEs and possible abuse of it has attracted the attention of the international community. MNEs have been found to have engaged in a number of anti-competitive arrangements with other firms. These include horizontal international marketing and price-fixing cartels, vertical international distribution systems established by MNEs for the sale of their products and the use of joint ventures with other firms.[31] National competition policy may have limitations in dealing with the abuse of market power by MNE affiliates which have operations crossing national boundaries. As observed earlier, these concerns led to the adoption of the Set of Multilaterally Agreed Equitable Principles and Rules for Control of Restrictive Business Practices drawn up under the auspices of UNCTAD in 1980. The set provides for collaboration between governments and puts in place an international mechanism to facilitate control of RBPs. Enterprises are obliged to refrain from RBPs defined to include price fixing, collusive tendering, market or customer allocation arrangements, allocation of sales or production quota, concerted refusal to deal or supplies to potential importers and collective denial of access to an arrangement. The enterprises are also required to refrain from abuse of market power in the form of predatory behaviour, discriminatory pricing or terms, joint ventures, mergers and acquisitions, and refusal to deal. It also facilitates appropriate action at multilateral level. However, the set is not a binding instrument. Effective regulation of RBPs and other anti-competitive practices through binding provisions should form an integral part of the MFI if it is negotiated.

iv) Seeking Binding Home Country Obligations

In a balanced framework, the home governments should also accept some obligations. Home governments' policies do influence the behaviour of TNCs originating in their territories. Some home governments, for example the USA, have asserted their power to restrict exports of goods by the overseas subsidiaries of US enterprises. Home governments must accept an obligation not to impose such trade or investment-related restrictions on the overseas affiliates of corporations based in their territories. They should also undertake to provide information regarding the involvement of TNCs in any questionable dealings and other information on their background that may be useful for the host government at the time of approval. The home governments should also co-operate with host governments in controlling restrictive business practices, transfer-pricing manipulation and in recovery of the liabilities of TNCs resulting from their misconduct in host countries.

v) Seeking Commitment on Labour Mobility

MFI is a framework for liberalisation of capital flows and will benefit developed countries. Developing countries could seek a reciprocity in the form of a multilateral framework for the liberalisation of labour flows. This would make it a balanced framework. As observed earlier, the restrictions on the movement of natural persons are imposing substantial costs in terms of world welfare. Facilitation of labour mobility would yield substantial efficiency gains benefiting both home, as well as host, countries.[32]

vi) An International Discipline on Incentives

A number of investment incentives are granted by developed and some developing countries as a part of their industrial, technological and other policies. It has been demonstrated that these incentives distort investment patterns in favour of developed countries, as developing countries are at a disadvantage in trying to provide matching incentives. Because of the prisoners' dilemma inherent in investment incentives competition, an international discipline to limit investment-distorting incentives would maximise the collective welfare of the participating countries. Such a discipline should form a part of an MFI. However, exceptions allowing developing countries and LDCs to use such incentives to promote such policy objectives as industrial development and regional development of backward regions have to be built into such a discipline.

vii) A Cautious Approach to Investor Protection

Standards relating to investor protection, such as general treatment, compensation in cases of expropriation, protection from strife, free transfer of payments and subrogation are generally contained in bilateral investment treaties and regional agreements on investment. Those standards are by and large accepted and established in bilateral and regional treaties. The implications of a possible inclusion of those standards in an

MFI will largely depend upon the scope of the adopted definition (particularly important with regard to the free transfer of payments) and on the extent to which protection would be an absolute standard, or subject to a 'contractual approach' as suggested above, that is, to compliance by the concerned investor with the host country's laws and regulations.

The right to initiate a dispute should be limited to Member States as currently provided under applicable rules for dispute settlement. Investor-to-state disputes would not acceptable in an MFI negotiated in the WTO framework.

Furthermore, there is a need to adopt a cautious and restrictive definition of expropriation or takings in the light of evidence on litigation brought by affiliates of US corporations against the Canadian government under Chapter 11 of NAFTA seeking compensation for government regulations and actions affecting the business prospects of companies as amounting to regulatory takings. For instance, the United Parcel Service (UPS) has sued the Canadian government under Chapter 11 of NAFTA for $230 million over what it alleges is unfair cross-subsidisation by Canada Post of its Xpresspost and Priority Courier operations.[33] Regulatory actions of host governments taken in pursuit of their development policy goals and of environmental and social objectives which are in the broad public interest should be specifically excluded from the scope of expropriation or regulatory takings.

7 Concluding Remarks

This paper has reviewed the options open to developing countries on investment at the Cancún ministerial conference of the WTO which will decide whether or not to launch negotiations on a multilateral framework for investment. Given the high opportunity cost of policy flexibility in the process of development and no reciprocity or gains even in the form of higher inflows of FDI, the most prudent option for developing countries would be to resist a negotiating mandate on investment at Cancún. In view of the clarificatory statement by the Chairman of the Doha ministerial conference that led to the adoption of the Declaration, this may still be possible. However, it will require effective co-ordination among developing countries and their ability to put up a strong coalition against the negotiating mandate.

A compromise solution could be to negotiate a multilateral treaty on investment on the lines of bilateral treaties outside the WTO. Better still would be to resurrect the UN Code of Conduct on TNCs, a draft of which still exists and which could be adopted as a binding UN instrument. The draft UN Code provides a multilateral framework balancing host country, investor and home country interests and could serve the purpose of the protagonists of the MFI very well.

If a negotiating mandate at the fifth meeting is unavoidable, then efforts should be made to ensure that developing countries' concerns are built into each element of the

proposed framework. This paper has outlined different elements of a possible MFI which captures the development dimension to aid the preparations of developing countries for negotiations. This is to be secured by limiting the scope of the MFI to trade-oriented FDI, resisting commitments on pre-establishment national treatment and adopting a GATS-type approach for post-establishment commitments, providing for flexibility to pursue selective policy and impose performance requirements by developing countries, incorporating investors' obligations and home country obligations, providing for transfer of technology, control of RBPs and competition policy, in order to balance the interests of the host and home countries. In this way, developing countries will be able to minimise the damage that an MFI has the potential to cause in terms of its effects on their development.

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Notes

1 See Brian Aitken and Ann E. Harrison (1999), pp. 605–18.
2 See Singapore Ministerial Declaration, WT/MIN((96)/DEC dated 18 December 1996.
3 See Doha Ministerial Declaration adopted on 14 November 2001, WT/MIN(01)/DEC/1.
4 See Dunning (1993) and Caves (1996) for expositions of theoretical approaches to FDI.
5 See Kumar (2001).
6 There have been several revelations of 'sensational abuses of international corporate power. The most prominent of these is the involvement of ITT in US plans to overthrow the government of Salvador Allende in Chile and the efforts of US copper companies, nationalised by his government, to hinder Chile's economic planning through a campaign of economic disruption. The Chilean case was closely examined by the US Senate Sub-Committee on Multinationals. Its investigations confirmed the fears of those who believed that US corporations were a threat to the sovereignty of host states. The Chilean investigations were followed by hearings concerning alleged corruption on the part of US firms operating abroad, particularly in the arms industry. The findings of these hearings reinforced the view that US business abroad was a power that had to be controlled, and that the USA itself had a duty to check abuses by its own corporations. This resulted in the passage of the Foreign Corrupt Business Practices Act in 1977 (quoted from in Peter Muchlinsky (1999), pp. 6–7).
7 UNCTAD (2002), TD/COM.2/EM.11/2 8 May 2002.
8 http://www.wto.org/english/tratop_e/dda_e/dohaexplained_e.htm#investment. Emphasis added.
9 http://www.wto.org/english/thewto_e/minist_e/min01_e/min01_chair_speaking_e.htm#clarification
10 Several developing countries continue to resist a negotiating mandate on investment at the Fifth Ministerial. For instance, ambassadors from Kenya, Uganda and India at a Seminar on the Nature and Implications of a WTO Investment Agreement held in Geneva on 20 March 2003, clearly argued against a WTO framework on investment besides representatives of over 40 NGOs. For more details see: http://www.tradeobservatory.org/library/uploadedfiles/No_Investment_Negotiations_at_the_WTO.pdf
11 http://www.wto.org/english/tratop_e/dda_e/dohaexplained_e.htm#investment
12 See, for instance, World Bank, 1999: 146.
13 See Paper submitted by Japan at WGTI, WT/WGTI/W/111, April 2002.
14 See UNCTAD/ITE/IIT/11; 1999a: 41–3.
15 UNCTAD, 1999, 2000: 171.
16 WTO, Working Group on Trade and Investment Transparency, WT/WGTI/W/109, 2002, A Note by the Secretariat.
17 Moran (1996: 431).
18 Para 22 of the Doha Declaration.
19 Doha Ministerial Declaration, para. 22.
20 See Concept Paper on Policy Space for Development by EC and its Member States, WT/WGTI/W/154, 7 April 2003.
21 See Correa and Kumar (2003) for details.
22 In contrast, the draft MAI did not affect the right of a state to establish or maintain state (or private) monopolies, but prevented discrimination against foreign investors with regard to the sale of goods and services made by a monopoly, as well as with respect to its purchase of goods and services from third parties, except to the extent that the purchase were not made with a view to commercial resale or for use in the production of goods and services for commercial sale.
23 See WT/WGTI/W/152, 19 November 2003.
24 See Muchlinsky (1999, chapter 6) for an analysis of the limitations of national regulation on TNCs given their operations transcending the national boundaries.
25 See Kumar (1985) for evidence on restrictive clauses included in technology transfer contracts signed by TNCs.
26 The Working Group on Transnational Corporations of the UN Sub-Commission on Human Rights is deliberating on the Responsibilities of Transnational Corporations to Human Rights. A significant part of the obligation of TNCs being discussed relates to consumer protection. TNCs are required to ensure the safety and quality of the goods and services they provide and not to produce, market or advertise potentially harmful products. The enforcement mechanisms and appropriate sanctions in case of non-observance of obligations by TNCs is also being debated. See http://www.unhchr.ch/html/menu2/2/sc.htmas for more details. Also *Times of India*, 4 August 2002.
27 Such obligations are being debated by the TNCs Working Group of the UN Sub-Commission on Human Rights, op.cit.

28 The European Commission already has Directives on the reporting and disclosure requirements requiring consolidated accounts. See Muchlinsky (1999, chapter 10).
29 See Muchlinsky (1999), p. 447, describing Nigerian experience with transfer technology regulation that has been largely ignored by foreign and local investors when entering into technology licensing contracts.
30 The establishment of this type of incentives may require appropriate adjustments to the Agreement on Subsidies and Countervailing Measures. It should also be noted that under article 66.2 of the TRIPs Agreement, developed countries are bound to provide incentives domestically to promote the transfer of technology to LDCs.
31 See Muchlinsky (1999: p. 387).
32 See Winters *et al.*, 2002.