5. Investment Trade Liberalisation

Introduction

Trade and investment liberalisation are centrepieces in the export promotion growth strategies of developing countries. However, the relationship between trade, investment and economic development is complex and controversial. Key issues include: (a) the location and protection of production facilities; (b) the contestation of domestic markets; and (c) the sovereign right of host governments to regulate foreign investment.

Globalisation and the rise of integrated international production has led to the dominance of the view that trade and investment are complementary and inextricably intertwined processes.

While privatisation and de-regulation are linked to International Monetary Fund (IMF) and World Bank economic reform programmes – and are seemingly unrelated to the operations of global trade rules – the removal of restrictions on foreign direct investment (FDI) is increasingly coming under the discipline of the multilateral trading system (MTS). In addition, a much broader and deeper treatment of investment can be found in the over 2,000 bilateral investment treaties (BITs) as well as in plurilateral and regional trade agreements.

The General Agreement on Tariffs and Trade (GATT) 1947 had few specific rules on investment. In earlier times, there was a perspective that investment was an alternative to trade. This could be the case, for example, if FDI led to full production of a good (replacing trade). In this framework, trade is also seen as less risky than FDI as it involves less sunk cost (UNCTAD, 2002). However, many governments from the North argued that GATT's obligation of national treatment (Article II.4) and non-discrimination (Article XI) applied to investment in some cases. Southern governments disagreed that the GATT had competence in the investment area and preferred bilateral approaches.

Globalisation and the rise of integrated international production has led to the dominance of the view that trade and investment are complementary and inextricably intertwined processes. Disciplines on investment are scattered throughout

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the World Trade Organization Agreements (WTOA). Trade and investment were explicitly included under GATT 1994 and these measures have been encapsulated as the agreement on Trade-Related Aspects of Investment Measures (TRIMs). Investment disciplines are also found in the GATS, the Agreement on Subsidies and Countervailing Measures (ASCM) and the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement. In addition, there is a Working Group on Trade and Investment. The GATS covers investment in services (commercial presence) while the ASCM applies to investment incentives that are subsidies (actionable and non-actionable). The latter obligated most countries to eliminate export subsidies (on goods) by 1 January 2003.

Critical factors in trade and investment liberalisation are:

- the privatisation of formerly state-controlled areas of the economy, including public services such as water and utilities;
- the de-regulation of labour and commodity markets;
- the elimination of restrictions on FDI.

Since foreign investment liberalisation, like trade liberalisation, is increasingly dependent on female labour, both have important implications for gender equality. At the same time, existing gender biases can affect the outcome of trade and foreign investment policies. This raises serious questions about the efficacy of such policies that ignore the underlying gender realities in an economy.

Investment in the Context of Economic Development and International Trade

Most often, investment is defined as a capital transaction in which the investor expects a return. It can therefore cover almost every kind of asset (excluding government grants and contractual arrangements for the supply of goods and services). Foreign investment refers to private lending or ownership purchase of bonds, stocks, use of patents or copyrights or ownership or control of equity in a physical entity in a foreign country. Foreign investment is further classified into two broad categories: foreign direct investment (FDI) and portfolio investment (see box 5.1).

A tea factory in Sri Lanka, where tea – along with rubber and coconuts – accounts for almost 41 per cent of export earnings

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Box 5.1 Types of Foreign Investment

Foreign direct investment (FDI): an investor based in one country acquires an asset in another country with the intent to manage that asset. The percentage of allowable foreign ownership varies from country to country. Historically, 10 per cent ownership by the investing firms has been an official definition of FDI for the US. Internationally, 10 per cent or above of ownership is accepted. However, the IMF also accepts ownership of less than 10 per cent plus an effective voice in management of the enterprise as FDI. According to the IMF, FDI is investment that reflects a lasting (long-term) interest in enterprises residing in another country. The definition of lasting and long-term may be time-based or the FDI can be based on degree of ownership and control. In the General Agreement on Trade in Services (GATS), FDI is referred to in terms of commercial presence.

Portfolio investment refers to investment in foreign stocks, bonds and other financial instruments (such as short-term bills of credit maturing in a year or less).

FDI may have undesirable impacts on poverty eradication and gender equality strategies, the environment, labour laws, working conditions and the overall area of economic development.

Investment and economic growth

Conventional wisdom would argue that FDI is a potent ingredient in development because it allows for the transfer of technology and capital and is hence a catalyst for development. FDI can bring about:

- technology transfer;
- human resource development;
- increased production;
- efficiency in the use of national resources;
- improvement in the quality of production factors;
- forward and backward linkages with domestic enterprises;
- increased inflow of investment funds to the balance of payments.

All of these contributions are expected to lead to increases in exports, savings and investments and faster growth of output and employment. However, FDI may also have undesirable impacts on poverty eradication and gender equality strategies, the environment, labour laws, working conditions and the overall area of economic development. It may make little contribution to social product or capital formation if: (a) its predominant form is cross-border mergers and acquisitions (e.g. through privatisation); (b) there is over-reliance on artificial incentives (tax concessions and subsidies); and (c) there are inadequate human resources and an inappropriate infrastructure.

The empirical reality is that FDI is not automatically and unambiguously beneficial to development. Therefore, governments must:

- proactively work to ensure a balance between domestic and foreign investment;
- develop strategies at sectoral levels as well as macro-level policies to promote sustainability of the development process;

- introduce measures such as performance and technology transfer requirements;
- work to ensure positive spill-over and increase the linkages between local suppliers and FDI;
- ensure increased local application and development of leading edge industrial upgrading and extensive local linkage via technology transfer.

Box 5.2 Investment-related Trade Measures

Investment-related trade measures include:

- **local content requirements;**
- **incentives tied to exports;**
- **requiring foreign investors to purchase a certain quantity of components locally;**
- **requiring foreign companies to export products;**
- **requiring foreign companies to hire a certain percentage of local workers and managers;**
- **requiring foreign companies to share know how/new technology with the local workforce;**
- **restricting the import of components used in the production of goods;**
- **restricting foreign companies' access to foreign exchange.**

Research shows that it is only in this manner that a country can ensure that it does not simply become a site of assembly operations for transnational corporations (TNCs) and can guard against some of the inherently de-stabilising effects of FDI on the balance of payments.

Historically, governments have tried to secure economic development goals and to protect the balance of payments by regulating FDI through so-called 'investment-related trade measures' (see box 5.2). In today's environment, it is argued that these measures are directly or indirectly distorting to

FDI ... has significant development dimensions.

trade. Therefore, there is increasing pressure for greater and greater liberalisation of investment under the WTO. The idea behind this is to radically reduce or eliminate government measures that apply to foreign companies. Before examining this issue in more detail, it is important to highlight some of the interactions and inter-linkages between foreign investment and trade.

Foreign investment and trade

Foreign investment and trade have a reinforcing relationship and facilitate each other's growth. However, foreign investment is a more complicated issue than trade since it is subject to expropriation and compensation disputes, taxation payments and financial transfers. FDI in particular has significant development dimensions, including implications for trade, domestic savings, consumption, finance, technology, macroeconomic policy and strategic development policies at sectoral levels.

Overall, the interactions between foreign investment and trade may create a positive impact in terms of:

- increased production;
- increased trade flows;
- diversification of the composition of exports.

The degree to which FDI has a positive impact on trade depends on the motives of the investment – whether it is seeking:

- access to natural resources (a positive trade impact);
- access to markets and consumers (less of a positive impact);
- access to strategic assets such as research and development (not a common motive for attracting FDI in developing countries);
- the exploitation of the comparative advantage of a location, such as:

  a) cheaper labour or component outsourcing (mainly developing countries);

b) production of highly differentiated products adapted to the taste of local consumers (not common for developing countries) (UNCTAD, 2002).

Box 5.3 Trade and Foreign Capital Flows

Private and commercial capital inflows in the global economy increased from $25 billion to $227 billion between 1988 and 1998 (World Bank, 1999). The majority of this flow ($155 billion) came from FDI. Private debt flows (commercial bank lending, bond lending and short-term capital such as bills of credit) accounted for $58 billion and portfolio equity flows $14 billion. The distribution of capital flows, especially FDI, is highly skewed in favour of a few countries (Argentina, Brazil, Chile, China, Greece, Hungary, Indonesia, Malaysia, Mexico, Nigeria, Poland and Thailand). The distribution to low-income countries in the same period were $15.2 billion in total net private flows, $4.7 billion in international capital market (with portfolio equity flows of $0.4 billion) and $10.6 billion in FDI (World Bank, 1999). Very little flowed to sub-Saharan Africa (except Nigeria) where private capital flows made up less than 2 per cent of GDP (UNCTAD, 2000).

The interaction of investment and trade can also have a negative balance of payments effect if FDI is heavily reliant on large imports of capital and intermediate goods. Negative impacts of FDI are also linked to restrictive business practices and strategies of TNCs. These include cases where they target the domestic markets and/or foreign affiliates are subject to export restriction by parent firms and seek tariffs and other protection in the host country. The importance of FDI and TNCs is illustrated by the fact that:

- the 500 largest TNCs control about 70 per cent of world trade and 80 per cent of foreign investment;
- there are 800 free trade zones in 102 countries;

TRIMs ... focuses on measures that are seen to be distorting to trade in goods, prohibiting those that are seen as inconsistent with the basic provisions of GATT 1994.

- FDI has replaced Overseas Development Assistance (ODA) as the largest provider of financing for some countries;
- FDI in the 48 LDCs is very small and the level of concentration is higher than with ODA: the top ten FDI recipients accounted for 79 per cent of total FDI while ten recipients accounted for 32 per cent of ODA;
- most FDI originates from developed countries – only about 10 per cent came from developing countries (1990–94), mainly China, Malaysia, Republic of Korea, Singapore and Taiwan (Mehta, 1999).

Liberalised trade, which is promoted by eliminating restrictions on imports, privatisation and de-regulation, smoothes the way for inflows of foreign investment. However, it is also the case that trade restrictions may encourage FDI as a way of securing a marketing foothold (so-called 'tariff jumping').

The Agreement on Trade-Related Aspects of Investment Measures (TRIMs)

Governments try to control the inflow and outflow of foreign investment so as to increase the positive benefits and mitigate the negative effects. TRIMs covers governmental measures relating to investment that have direct effects on trade (see box 5.4). It focuses on measures that are seen to be distorting to trade in goods, prohibiting those that are seen as inconsistent with the basic provisions of GATT 1994. As such it specifies a minimum set of rules for the treatment of foreign investors.

Trade-related measures that are in contravention of obligations under the GATT 1994 (Articles III and XI) have to be phased out within a set period. This is two years for QUAD countries, five years for developing countries and seven years for LDCs. Review of TRIMs is part of the built-in agenda (which involves, among other commitments, new negotiations in major sectors such as services and agriculture). Article IX of the agreement mandates that the Council on trade in goods should review the operations of TRIMs and propose amendments. The Council should also to discuss whether TRIMs should be complemented with provisions addressing investment and competition policies.

Box 5.4 Foreign Investment Measures and TRIMs

The agreement on Trade-Related Aspects of Investment Measures (TRIMs) focuses on measures that are seen to be trade restricting or trade distorting.

Covered and prohibited under TRIMs:

- local content requirements in terms of value, volume or proportion;
- trade balancing requirements that link amount of imports to be created in local production to the amount of exports;
- foreign exchange restrictions that allow foreign exchange for the import of a product used in local production only up to a maximum level related to the foreign exchange inflow of the firm;
- restrictions on repatriation of dividends;
- ceilings on the equity holdings of foreign investors;
- export controls.

Not covered under TRIMs:

- minimum export requirements;
- technology transfer requirements;
- employment obligations;
- minimum equity requirements;
- export performance requirements;
- joint venture requirements;
- research and development requirements.

Countries are technically still able to use balance of payment measures.

Currently, even with the limited rules on investment, the TRIMs agreement constrains the ability of developing countries' governments to regulate FDI to promote development.

This is because of the prohibition against traditional and useful tools such as domestic or local content requirements on labour and inputs used in the production process. According to the South Centre (1999), such tools are necessary in LDCs for at least five reasons:

1. encouraging domestic activities in raw material and intermediate input sectors;
2. upgrading of inputs of production;
3. prevention of wastage of foreign exchange in the import of raw material and intermediate output;
4. ensuring linkages between domestic and foreign direct investment activities;
5. encouraging the development of local firms and entrepreneurship to ensure and promote development.

Further Investment Liberalisation

Although some disciplines on investment have thus been incorporated into the WTO, overall they are limited in scope and lack coherence. Hence there has been a significant push towards greater investment liberalisation. Negotiations were underway on the infamous Multilateral Agreement on Investment (MIA), but these were later abandoned after strong objections from global civil society and some governments. Since then the EU and a few governments have been trying to reintroduce this into the WTO.

The debate has centred on nine main controversial areas:

1. the rights of investors;
2. non-discrimination (national treatment and Most Favoured Nation);
3. transparency (blanket, readily transferable);
4. obligations to provide information about regulatory measures – this can be very broad and cumbersome and the publication of information is difficult for the South (it incurs administrative charges and is costly to implement);

5. notification of home country measures that may affect investors;
6. expropriation and compensation;
7. taxation;
8. payments and financial transfer;
9. dispute settlement.

The debate is very politically charged, especially with the Mandate from the Doha Ministerial. This Mandate stated 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 . . . [W]e agree that negotiations will take place after the Fifth Session to be taken, by explicit consensus, at that session on modalities of negotiations". Doha has drastically changed the tenor of the debate from 'if' to 'when' multilateral discipline should be imposed on investment, and accelerated momentum toward investment negotiations. The Mandate states that further work "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 settlement of disputes between members".

Doha has drastically changed the tenor of the debate from 'if' to 'when' multilateral discipline should be imposed on investment, and accelerated momentum toward investment negotiations.

In this context, the role of the international financial institutions (IFIs) is critical as they impact on the day-to-day operations of policy in many developing countries. The World Bank and IMF – through their structural adjustment, stabilisation and pro-private sector programmes – have a strong interest in driving forward the process of trade liberalisation generally, and investment liberalisation in particular.

Gender Issues in Investment Liberalisation

Several gender concerns arise in the discussion of investment liberalisation. Some of the most important include:

- FDI's impact on the quantity and quality of female and male employment;

FDI's contribution to a rapidly accelerating climate of extreme de-regulation of labour markets ... [has] implications for women's health and morbidity.

- foreign investment's overall impact on the nature, size and growth potential of women-owned and women-operated small and medium-sized firms in host countries (through its impact on production, resource allocation and competition);
- FDI's contribution to a rapidly accelerating climate of extreme de-regulation of labour markets and the consequent implications for women's health and morbidity;
- corporate social responsibility in terms of the environment, social concerns, working conditions and the transfer of technology;
- performance requirements on FDI regarding technology transfer, the strengthening of domestic capabilities/linkages to domestic enterprises (especially small and medium-sized enterprises) and regional development promotion.

Other indirect impacts of FID on gender equality include its effect on:

- taxation/tax revenue and the implication for public expenditure and hence allocation to the social sector;
- the availability of different types of infrastructure (roads, electrification) and social services, e.g. if expenditures are switched away from providing agricultural feeder roads to projects that secure operating space and transportation for attracting FDI;
- the exchange rate and the balance of payments;
- the local investment/credit market if multinational corporations (MNCs) seek local funding.

Most studies on gender and FDI tend to concentrate on the employment dimension. A few explore the broader questions of resource allocation and exchange rate effects. Some of the emerging information is presented below.

Foreign investment and gendered employment patterns

FDI is generally expected to absorb labour, provide income and hence help to reduce poverty. However, there are issues about

the quality of employment (wages, working conditions, contribution to knowledge and skills upgrading) of male and female workers and managers. A recent study of trade and investment in Bangladesh showed that inflows of FDI and trade liberalisation did not significantly improve the factors that impact on poverty such as real wages and employment (Rahman and Bhattacharya, 2000). There was a decrease in the percentage of women in the household and the agricultural sector and a rising percentage of women working in manufacturing and services.

Women are still concentrated in a limited number of sectors, such as embroidery, textiles and clothing and in export-oriented assembly and manufacturing. It is estimated that of the 4 million employed world-wide in TNCs in the 1990s, women workers comprised 60–80 per cent (Tzannatos, 1998). However, the rise of subcontracting and domestic outwork is making these numbers more difficult to assess since MNCs connect via local intermediaries. The jobs women hold "in manufacturing in foreign affiliates and in enterprises linked to TNCs through non-equity arrangements have mainly been low skilled" (UNCTAD, 1999).

A textile factory in the Philippines

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MNCs in electronics and EPZs are very footloose due to the intensity of international competition, production and trade cycles in garments and electronics and low penalties for high labour turnover.

Product mix is key to determining the sex ratios of employees. For example, while electronics and garment manufacturing employ mostly women, more industrial sectors employ more male labour. There are also differences in terms of marital status, with younger women found in electronics, and older and married women in textiles and garments. Garments and light assembly seem to be more prone to subcontracting and homeworking than electronics. MNCs in electronics, and EPZs are very footloose due to the intensity of international competition, production and trade cycles in garments and electronics, and low penalties for high labour turnover. Even when MNCs are stable, they are able to effectively utilise the threat of moving to strengthen and maintain their bargaining power.

In addition, there are concerns about the health and safety of the work and the burden of social reproduction and paid work. Such concerns arise whether women are engaged in the formal sector or in subcontracting and homeworking. Women's wages may also have little effect on their overall level of economic empowerment if the family structure and household dynamics are such that they do not control the income that they earn. These factors may also be a constraint on women's ability to take up paid work. In patriarchal family structures they may only be available for homework that must be engaged in side by side with housework. Different types of households (whether patriarchal, female-headed or bargaining) lead to different reservation wages in MNCs.

Foreign investment, production, resource allocation and gender

Foreign investment is an important component in export promotion growth strategies of developing countries. Privatisation of state-owned entities, de-regulation of labour and commodity markets and the elimination of restrictions are critical for attracting FDI. While the intent is to increase the level of competition and decrease the level of protection, such a policy agenda often translates into adverse consequences for local small and medium-sized businesses that may not be able to compete with the big well-endowed MNCs. This has serious implications for women entrepreneurs, including micro-enterprise, especially in the areas of agriculture and craft.

At the meso-level there are issues of transaction costs, imperfect information, gender biases, market inter-linkages and asymmetry of property rights. Thus, for example, the expansion of investment opportunities due to the infusion of foreign investment may not be available to women entrepreneurs due to gender biases that lock women either into or out of particular markets.

Privatisation of the services sector is a particularly strong pull factor for FDI in Latin America and the Caribbean. This trend will be reinforced by the GATS. The critical issue here is the availability and affordability of safe water and health care and adequate education and training.

Given women's responsibility for social reproduction, and gender bias in accessing credit, declining purchasing power results in an increasing burden on them to secure alternative food sources as well as generate additional income.

Foreign investment, exchange rate effects and gender

The economic effects of both trade and investment work through macro-policy and exchange rate policy. The link between foreign capital inflow and the real economy of the host country operates via a two-way transmission mechanism: the exchange rate and the interest rate. It may be either growth inducing or growth stagnating. Capital account surplus and positive capital inflow are both associated with pressure on the exchange rate. These may or may not be exacerbated by the actions of the central bank to either keep the exchange rate stable by controlling domestic liquidity and/or resort to measures such as raising the domestic interest rate. This has important consequences for domestic investment. Either way there are adverse effects on employment and purchasing power (and hence distributional consequences for different groups in the society). Particular effects are likely to be deep, traumatic and longer lasting for the marginalised and the poor who have few resources to offset such economic shocks. Women tend to be predominant in these groups.

Given women's responsibility for social reproduction, gender bias in accessing credit and declining purchasing power results in an increasing burden on them to secure alternative food sources as well as generate additional income. Raising interest rates is likely to crowd out female entrepreneurs seeking credit for initiating or expanding businesses. The literature on structural adjustment provides ample evidence in this regard. Other areas where foreign investment policy may have

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some strong effect for women include under the TRIPS agreement (see Chapter 6). This has both trade and investment implications that may have negative impacts on women in their multiple roles as farmers, healers, and developers and conveyors of traditional knowledge and technology.

The implications for gender of further investment liberalisation

The discussion of a more comprehensive approach to investment within the WTO is not without significant but underrecognised gender dimensions. Any greatly expanded investment agreement, such as an MIA, would obligate governments to change tax and company laws to remove existing favourable treatment of local firms and to create favourable conditions for foreign investment (South Centre, 1999). In this context, important issues include the right to regulate national treatment/subsidies and corporate social responsibility.

Right to regulate

The special and differential component of any investment provisions must be premised on the right of governments to regulate in the public interest. Because of investment's critical relationship to trade and development, safeguard provisions (such as transfer of payments, protection against import surges and balance of payments safeguards) are necessary but not sufficient to preserve the right to regulate. Governments must have full control to determine, develop and enforce disciplines with regard to economic, social, environmental and administrative regulations in favour of economic development and social and gender equality objectives.

This is particularly important for the medium- and long-term interests of women workers, entrepreneurs and farmers. Specific and special programmes may be necessary within the context of industrial policy to protect their health, livelihood and sustainability of income.

National treatment/subsidies

The issue of national treatment could pose serious drawbacks for women's empowerment in terms of the cooling effect on subsidies or grants set aside for local, women-owned businesses

An informal school in Pakistan for children who sew footballs

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(which tend to dominate the micro- and small business sector). Such subsidies or grants may violate WTO rules unless such benefits could also be extended to foreign investors. Governments are also likely to be deterred from instituting programmes that they would have put in place as part of gender mainstreaming commitments.

Corporate social responsibility (CSR)

Corporate social responsibility (CSR) is critical to any discussion on national, regional and international investment rules in the context of development and trade. A gender-sensitive approach to CSR must be a central part of discussions in both: (a) the traditional areas of development obligations, social and labour standards and consumer protection; and (b) the emerging areas of corporate governance, ethical business standards and human rights.

One starting point is a gender analysis of the already existing set of non-binding rules. These include the OECD Guidelines for Multinational Enterprises (MNEs), the ILO Tripartite Declaration of Principles concerning MNEs and Social Policy, the UN Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices and the Global Compact of the United Nations Secretary-General. From the vantage point of gender and social equality, it is important to determine how much attention is paid to the occupational health and safety of workers,

gender equality, environmental protection and overall sustainable development. In addition, CSR should also promote the transfer of technology and linkages with small and medium-sized domestic enterprises.

Pointers for Further Discussion

Investment and its regulation at the multilateral level is quite a controversial area. Some developing countries and development, gender and social activists are gravely concerned about the overall effect of rules that would attempt to impose a single model for investment to cover all countries regardless of their levels of development. This concern is even more acute in terms of the issue of men's and women's roles and contribution to investment, trade and development. This chapter has attempted a simple sketch of the possible terrain and the scope of discussion and policy interventions that could be undertaken in approaching investment discussion in the MTS from a gender perspective. The questions posed in box 5.5 and the guidelines and recommendations in Chapter 7 are meant to provoke more and deeper thinking on this issue.

Box 5.5 Key Questions for Gender and Investment

1. **What are the scope and opportunities for women to move into managerial and middle-level jobs in the trade and FDI sector?**
2. **To what extent does gender play a role in the level and structure of investment by industries and activities in the country?**
3. **What are the employment and human resource development issues of trade and investment in terms of men and women? What are the income-generating activities of men and women that arise directly or indirectly from trade and foreign investment? How sustainable are these and what mechanisms are needed to ensure sustainability?**

Box 5.5 **(continued)**

4. What is the quality (in terms of wages, working conditions and skills development) that trade and FDI provide to men and women?

5. In terms of non-equity arrangements (licensing, franchising and subcontracting), what is the difference in the ability of male-owned *versus* female-owned firms to participate? Which gender dominates, in what type of arrangement? What are the particular gender constraints to accessing each type of arrangement?

6. How are male and female businesses able to participate in the supply and distribution chain of MNCs? Are these established and what degree of co-ordination, technical and financial assistance are needed by men's and women's businesses to effectively participate in them?

7. What are the capabilities of domestic firms, in particular women-owned firms, to benefit from the 'spill-over' effect of the presence of MNCs? What is the most effective and gender-sensitive role of government in facilitating this process?

8. To what degree are women gaining high-level managerial positions in MNCs?

9. What are the gender impacts of the costs and benefits of investment incentives (fiscal and financial) for attracting FDI?

10. What are the possible gender consequences of the application of the national treatment principle to investment?