

**MULTILATERAL AGREEMENT ON INVESTMENT  
STATE OF PLAY IN OCTOBER 1997**

**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT**

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## **FOREWORD**

The following is a selection of papers presented at the Symposium on the Multilateral Agreement on Investment, held in Cairo, Egypt, on 20-21 October 1997. The Symposium was organised by the OECD and the Egyptian Ministry of Foreign Affairs.

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## OPENING ADDRESS

H.E. Mr. Amre Moussa  
Minister for Foreign Affairs of Egypt

delivered by H.E. Ambassador Dawlat Hassan  
Deputy Assistant Foreign Minister for International Economic Affairs

Ladies and Gentlemen,

It gives me great pleasure to inaugurate and participate in the OECD's Symposium on the Multilateral Agreement on Investment. I also welcome our distinguished guests particularly Mrs. Shelton, Deputy Secretary General of the OECD, whose attendance together with all the delegates taking part in this meeting, gives us great pleasure.

I wish to thank the Organisation's Secretariat who have made the arrangements for this meeting in co-ordination with the Egyptian Foreign Ministry, who take pleasure in sponsoring its proceedings.

Before we elaborate on the scheduled topic, I seize the opportunity to commend the outreach policy adopted by the OECD with respect to non-member states, express my appreciation for Egypt-OECD growing relations and stress the interest we pay to continue our Cupertino within the framework of the emerging market economies forum and its activities. This forum is verily deemed as a place for enhancing our dialogue and exchanging views and experience with respect to all vital economic and social issues of common interest.

This symposium is being held as part of the OECD Secretariat's effort to introduce the latest developments concerning the Multilateral Agreement on Investment currently being negotiated by the OECD's 29 member states.

The Agreement deals with one of the most significant items on the international economic agenda and combines in a joint binding document three extremely important subjects, namely setting high standards for liberalisation of investment, protection of investment and a dispute settlement mechanism. Egypt, well aware of the vitality of such issues, has taken the initiative to call for the convening of a special symposium for the African countries in order to broaden their conception of the issues encompassed in the agreement.

It is widely recognised that foreign direct investment flows play an important role in the world economy. On the one hand, constitute one of the factors for achieving economic development due to their enormous potentials to boost national economies of recipient countries, facilitate the transfer of technology and management skills, develop human resources and increase job opportunities, and on the other hand, are very effective in countries' integration into the world economy under the recent global changes and the growing globalisation.

Recognising the increasing importance of foreign investments, many countries, especially the developing ones, have adopted national policies aiming at encouraging and attracting investments, most important of which are upgrading treatment standards in favour of foreign investors and eliminating barriers to investment. Relevant studies indicate that 95% of the amendments made to the foreign

investment organisational structures during 1991-1996 had been favouring liberalisation or granting investment incentives.

The application of these policies had been so effective that growth in foreign investment rates exceeded the growth rates of both world product and world trade. Total flows of direct foreign investments into all countries hit Billion dollars 315 in 1995 and billion dollars 350 in 1996 from Billion dollars 158 in 1991. Such increase is expected to continue well into the beginning of the next century.

At the same time, direct foreign investments in the developing countries increased from Billion dollars 41 in 1991 to Billion dollars 100 in 1995 and Billion dollars 129 in 1996. However, their distribution had been very uneven. In 1996 the southern and south eastern areas of Asia received almost two thirds of the investments allocated to the developing countries. Moreover, the Latin American countries made a remarkable breakthrough in attracting foreign investments which increased by 52%, compared with the previous year. The rate of foreign investment flows into the African countries has remained the least within the developing regions world-wide, despite the efforts locally exerted by most of the African countries for applying national macro-economic policies, carrying out structural reforms or adopting trade and investment large scale liberalisation policies. With some minor exceptions, we can safely say that the African countries are still marginalised in the world investment circle in spite of the huge potentials and capabilities the Continent possesses. Here I should stress the Continent's need for the international community's support in order to have Africa as a full partner in development and urge foreign investors to view Africa as a healthy investment location.

Allow me to briefly review the Egyptian experience. Overall economic reforms were initiated in 1991. The past two years have witnessed multiple efforts to accelerate such reforms, which positively affected the economic indicators, on top of which bringing down the deficit in the State's budget, reducing inflation and external indebtedness, stabilising the Egyptian pound exchange rate and making tangible resources of foreign currencies. Implementation of the privatisation programme was expedited in view of the growing demand on purchasing the companies' securities placed in the stock market. Furthermore, an ambitious programme to further the utilised areas of Egypt, which required the establishment of new urban areas in Sinai, the Red Sea, Eastern and Western Deserts, the Northern Coast and South of the Valley.

In connection with the development process, the laws affecting our economic life have been reconsidered and transactions and litigation procedures simplified as part of a comprehensive legal, legislative and administrative reform.

In line with internal economic reform a strategy of openness to the external world has been adopted, and a policy for attracting investments into the country has been followed.

Foreign investment laws and regulations in Egypt have recently been facilitated, especially with regard to registering the new investment projects. Guarantees are given to individual investors at low interest rates through international insurance companies. As a result, the whole world now views investment in Egypt through a more positive perspective, and the reports issued by international investment bodies have hailed Egypt's efforts to ease foreign investment procedures.

Globally, it is obvious that creating a foreign investment friendly environment under the accelerating liberalisation of economic systems has prompted countries to take certain organisational measures at bilateral and regional levels.

International forums have become more active trying to conclude an international framework regulating foreign investment. Here we mention in particular the work of the WTO's Trade and Investment Committee, the UNCTAD's Investment and Technology Committee and the Multilateral Agreement of OECD which is the topic of this meeting.

It was out of our keenness on following up the foreign investment issues that Egypt's Foreign Ministry took the initiative in setting up a national working group embracing the official bodies concerned, to follow up the negotiation process related to the said Agreement and take part in the meetings convoked by the OECD Secretariat to this effect, most recent of which the meeting held at OECD headquarters in September last during which the integrated draft of the Agreement was circulated. The document available explains the philosophical scope of the Agreement as a whole and allows a technical insight into its detailed provisions which covers a wide range of international economic relations including such new issues as privatisation and monopolies. The forward-looking scope and innovative dealing with some of the Agreement's articles show it different from any standing international agreements. On the other hand, this raises questions on the duplicated issues for which special agreements were made, such as TRIMs-TRIPs Agreements as well as the bilateral and regional agreements. How to harmonise all these agreements with each other remains a question to be answered ....

The context of the Agreement touches on highly complex issues. This, in my opinion, is what led to the disagreement among the OECD members and to postponing the settlement of the Agreement to 1998.

The situation is more complicated from the perspective of non-OECD member states, they are faced with an instrument whose significance cannot be ignored and whose reflections on future international transactions and effect on the sectors of production, services and financial market of all countries cannot be neglected, either those which will accede to the Agreement or not. Nevertheless, we are not playing a role in the drafting of the Agreement. It is true that the OECD Secretariat has made an effort to make the Agreement well known, but in our view all countries should have taken part in the negotiating process.

The developing countries, especially the African ones which direly need investment to pursue their economic development, do not have interest in this Agreement. However, they have queries and concerns, I hope this symposium will provide some answers to them by deepening the two sides' understanding through a free and objective dialogue.

In conclusion, I wish to stress that Egypt, a promising developing country encouraging and welcoming foreign investments, is not opposed to the creation of an international framework regulating the investment course, provided that it is just and balanced taking into account preserving the rights and interests of investors and investment recipient countries on equal footing. It should also secure their developing dimension into consideration and laying down the foundations necessary to forge ahead with the development process and respond to its requirements in accordance with the priorities and aims set by the recipient countries.

I thank all the participants and wish you success in your deliberations.

## **KEYNOTE ADDRESS**

**Ms. Joanna R. Shelton**  
**Deputy Secretary-General**  
**Organisation for Economic Co-operation and Development (OECD)**

### **Introduction**

I welcome this opportunity to discuss the Multilateral Agreement on Investment (MAI) with the countries of the African region. I would like to express my appreciation to our Egyptian hosts for taking the initiative in organising this Symposium. Egypt has made many structural reforms in its economic policy in recent years. One of the results is a re-orientation toward multilateral trade and investment disciplines. I understand that Egypt has an open mind on the MAI, an openness which is very much appreciated.

The negotiations on the MAI, which started in September 1995, are now in the final phase. The Ministers of the OECD expect to receive a final report in April next year stating that the negotiations have been concluded. In fact, this report was expected at their meeting in May this year, but they agreed to provide a little more time. Negotiators may have underestimated the complexity of the MAI. In addition, the work on putting together lists of proposed reservations proved to be a time-consuming affair for delegations. Given the wide scope of the MAI, many ministries and agencies had to be consulted about laws and policies that would be affected by this agreement.

But before going into the substance of the MAI, let us take a step back and talk about a basic question: why should there be multilateral rules for investment? Aren't all countries opening up to foreign investment unilaterally, convinced as they are that such investment brings economic benefits? This is what some countries have been asking us. Indeed, some of them said that they were receiving more foreign investment than they could cope with, so they were not interested in multilateral rules for the promotion and protection of investment. The recent financial storms that have raged through South-East Asia may have somewhat changed this thinking.

It is a fact that capital requirements to develop and improve the infrastructure in the so-called emerging economies will be immense. The World Bank estimates that for Asia alone, some 1.5 trillion dollars will be needed in the next 10 years. Public sources can only supply a fraction of that amount. We all know that official aid flows having been decreasing, and that is likely to continue for a while. So the bulk of these much needed capital flows will have to come from private investors. There is no doubt that these investors will prefer to go to those countries that adhere to a stable multilateral discipline containing guarantees for liberal and non-discriminatory treatment.

This applies not only to Asia but to Africa as well. Some African leaders have expressed frustration about the lack of investment flows into their countries. They say that they have done all the right things in terms of policies, but foreign investment remains low. But investors do not make decisions overnight, and it is easy to see why. Investment -- particularly direct investments, in plants, equipment or other fixed assets -- is a long-term commitment, which requires stable conditions and legal certainties. Adhering to the MAI will definitely help in persuading investors that these conditions exist, but it will not result in sudden inflows of foreign capital. Nevertheless, it is a fact that more and more firms in OECD countries are looking to Africa as an interesting place to invest. That is why your views on multilateral rules for investment, and the MAI, are particularly welcome.

## The nature of the MAI

So what is the MAI? The essential concept behind the MAI is that of non-discrimination. In an economically interdependent world, where countries actively compete for foreign investment, it makes no economic sense to treat foreign investors less favourably than domestic investors. Many of you will be familiar with the principle of national treatment through the many bilateral treaties on investment protection that have been concluded.

Unlike these bilateral treaties, the MAI widens the notion of national treatment to include the process of making of an investment. Or, to use MAI jargon, national treatment applies to the “pre-establishment” phase, as well as the “post-establishment” phase. Thus, the MAI is not only about protection, it is also about liberalisation. This has led to criticism that the MAI will take away the sovereign right of countries to adopt legislation with regard to foreign investors and that it would open the way for big multinationals to come in and do as they please.

Let me say very clearly that this is not the case. The MAI does not deprive Parties of their ability to pursue policies to ensure economic development or to set environmental rules or other domestic public policies. What the MAI does is to make sure that such policies or rules do not discriminate against foreign investors. National treatment, which is the core element of the MAI, means that foreign firms have the same rights and obligations as domestic investors. There are some specific exceptions to this rule, and that is in the area of dispute settlement. The investor, as defined in the MAI, will have the right to start proceedings before an international arbitration body. The main reason for this is to avoid that disputes end up in the political arena. This is the main feature in which the MAI differs from the only other multilateral instrument which includes the right to make investments: the General Agreement on Trade in Services (GATS). As you know, dispute settlement in the WTO is limited to state-state proceedings.

## The structure of the MAI

That is the basic nature of the MAI but now we face the question of what the MAI will look like. The Chairman of the Negotiating Group, Frans Engering of the Netherlands, likes to compare the MAI to a building, which includes: the foundation, the walls or the pillars, and the roof. These elements are all inter-related, and together they define the quality of the construction.

The **definition of investment** is the foundation: it supports the building. It is, quite literally, a fundamental point in the negotiations, and explains why the Negotiating Group started debating it from the very first moment, in September 1995. The definition not only determines the actual MAI disciplines, it also lays down the scope of dispute settlement.

There was an early consensus that the MAI should have a broad, asset-based definition, covering not only direct investment, but also portfolio investment. Tangible as well as intangible assets (such as intellectual property) should be covered. Translating that into generally acceptable language was not easy: it took until early this year to reach common ground.

There are still some outstanding questions, such as how intellectual property rights should be treated in the MAI, because they also are dealt with in other international agreements.

The **obligations** in the agreement are the pillars of the building. The most important pillars are the national treatment and most-favoured nation obligations. MFN is of course borrowed from trade



agreements, and it is equally relevant in the investment context. But there is more. Under the heading of “Special Topics”, we have looked at other policies that affect investors and which may call for rules in the MAI. Some of these issues are not new. Performance requirements, for example, are to a certain extent dealt with in the WTO Agreement on Trade-Related Investment Measures (TRIMS). But the MAI will go further to include trade in services, not just goods. We have also looked at all performance requirements, whether trade-related or not. There is agreement, for example, that an obligation to transfer technology in order to invest should not be allowed.

Other new features of the MAI are rules to allow investors to bring in key personnel, and obligations to provide national treatment in privatisation. The importance of non-discrimination in privatisation should not be underestimated. In many countries, governments still own or control large corporations. Private investors, foreign and domestic, are thus virtually excluded. Given the current trend of privatisation, the MAI would create equal rights for domestic and foreign investors to compete for the ownership of state enterprises. If ultimately accepted, this will reinforce the added value of the MAI. To avoid misunderstandings, it is important to emphasise that the MAI leaves unaffected the decision to privatise as such: that remains a sovereign decision of every individual country. But once the decision has been taken, its implementation will be subject to the rule of national treatment. The same principle, incidentally, would also apply to demonopolisation.

There is one new area where we may not be able to fulfil our original expectations: investment incentives. We may be able to apply national treatment and MFN obligations to this area, but probably not any other disciplines. This does not mean that the subject has been removed from the agenda forever. There is still the possibility of a future work programme on incentives.

It is of course very well that the MAI contains strong obligations, but if that provokes a large number of exceptions or reservations, this could undermine the strength of the pillars. This is a difficult dilemma: should the MAI have strong rules but allow many reservations, or should it be less ambitious in the rules and permit only few exceptions and reservations? Countries have not yet fully sorted this out, even though there has always been broad agreement that the MAI should set high standards in liberalisation and protection.

We now come to the part that keeps the whole structure together: the roof, or, in the case of the MAI, the **dispute settlement** system. Next to the traditional state-state proceedings, the MAI will also provide for investor-state dispute settlement. The detailed provisions on these proceedings have been worked out, but there are a number of important issues still to be solved. One example is the question: to what extent parties to a state-state dispute should be allowed to take countermeasures in case of non-compliance with an arbitral decision. Whatever the outcome, I believe the MAI will set high standards in the area of dispute settlement.

### **The contents of the MAI**

I do not intend to go into further detail about the MAI in its present phase of construction. Other speakers will do so later during this Symposium. Instead, I would like to concentrate on two issues that merit further discussion:

They are:

1. questions of labour and environment
2. accession by non-OECD countries

## ***Labour and environment***

An agreement as ambitious and extensive as the MAI cannot be silent about environment and labour issues. Political constituencies and Non-Governmental Organisations are judging the MAI on its potential effects on environmental and social policies. There is also a concern that the MAI should not negatively affect existing and future international environmental agreements.

It should be clear that the MAI does not interfere with national policies in these areas. All the MAI requires is that these policies apply to domestic and foreign investors alike, and that they are enforced in a non-discriminatory way. In other words, national treatment and non-discrimination are the key principles, here as in other areas of the treaty.

The idea of non-discrimination is also behind the proposed rule that governments should not lower environmental and social standards, as enshrined in national legislation, in order to attract foreign investors. This idea is now widely supported. It is also a provision contained in the North America Free Trade Agreement (NAFTA). It remains to be decided whether this rule should be binding and whether it should be subject to dispute settlement.

MAI negotiators are not ignoring the importance of good corporate behaviour, however. The issue of labour and environment is also dealt with in the OECD Guidelines for Multinational Enterprises. These Guidelines are recommendations to investors as to their responsibilities. There is wide support for associating these Guidelines with the MAI, in order to demonstrate that we expect investors to make a responsible use of their rights under the MAI.

## ***Accession by non-OECD countries***

This issue will be discussed more extensively tomorrow morning, but I would like to make some personal observations here. The OECD decided from the outset to keep other countries informed about the MAI. The objective was not only to provide information, but also to encourage other countries to accede to the MAI. For most OECD countries, it is very important that the MAI starts its life not as an agreement solely between OECD countries, but that it takes in a number of other countries as well. That is why a lot of time has been devoted to talking to non-OECD countries. This outreach is a parallel process, which takes place in Paris, in OECD capitals, and in the major regions of the world.

Several countries told us that were seriously considering acceding to the MAI. These countries (Argentina, Brazil, Chile, Hong Kong, China and Slovakia) have now been invited to become observers in the Negotiating Group).

Some of you may have participated in the Special Session for non-member countries which we organised in Paris just a month ago. Other conferences have been held in Asia, Latin-America and Eastern Europe and now in Cairo.

## **State of negotiations**

We are now entering the final stage of negotiations, and as is usually the case, it is the most difficult one. Practically all of the elements of the MAI are in place. The Negotiating Group is now focusing its efforts at two things:

1. negotiating the reservations that countries think they have to lodge to the various obligations, and

2. finding solutions for outstanding issues in the draft text of the MAI.

The negotiations about the reservations started early this year. Countries had been requested to table their proposed reservations, in order to get a first impression of the balance of commitments. The subsequent discussions (mostly bilateral) about these reservations were very useful in arriving at a common understanding about what should be listed. Countries have been revising their lists in the past few weeks, and new lists should be ready in time for the Negotiating Group meeting next week. More clarity about the reservations should help in finding solutions for most of the outstanding questions, such as general exceptions and the issue of privatisation and demonopolisation.

The final deadline for these negotiations is the OECD Ministerial Meeting of April 1998. But an important stock-taking will be necessary before then; a high-level meeting of the Negotiating Group is scheduled in early 1998. That meeting should provide guidance for solving the politically sensitive issues. Most of these have to do with questions of exceptions. Among them is the proposal by the European Union countries for a so-called Regional Economic Integration Organisation (REIO) clause. This is really an exception to the MFN rule. It would allow these countries to liberalise among themselves in certain areas without having to immediately grant this benefit to other MAI-partners.

Another difficult issue is cultural industries. Some countries say that their cultural policies imply that they must have complete freedom to legislate fully in this area, for example in the audio-visual sector.

A third and very important problem is to what extent countries can introduce new restrictions on national treatment. Most countries believe that once the MAI is signed, countries should be precluded from taking new reservations. This is the so-called standstill principle. Other countries want some flexibility on standstill, at least in some areas.

In summary, while much progress has been accomplished, a lot remains to be done. I hope that this Conference, like the previous ones, will provide the added benefit of your opinions and suggestions about the MAI as it stands today. We look forward to hearing your views and exchanging ideas over the next two days.

## FOREIGN DIRECT INVESTMENT TRENDS

**Dr. William Witherell<sup>1</sup>**  
**Director for Financial, Fiscal and Enterprise Affairs**  
**Organisation for Economic Co-operation and Development**

Good morning Ladies and Gentlemen.

I am pleased to have this opportunity to help set the context for your discussions on the MAI negotiations by presenting an overview of recent trends in foreign direct investment, with particular emphasis on investment flows from OECD countries and, to the extent available date permit, foreign direct investment in Africa. These data will suggest the increasingly important role foreign investment is playing and thus why the OECD believes the time has come to develop a comprehensive framework of multilateral rules which will facilitate the further development of these flows and the avoidance of international “frictions” in this area.

The OECD countries, of course, have long recognised that foreign direct investment is central to the process of international economic integration - or globalisation - fuelling development of advanced economies and developing countries alike. Foreign direct investment offers recipient countries the opportunity to upgrade productivity and competitiveness, benefit from the transfer of technical and managerial expertise, and promote integration into the international economy. And increased investment often leads to increased trade, creating a powerful engine of prosperity.

In recent years the critical role played by foreign direct investment has become more widely appreciated. A large and growing number of firms now view overseas expansion through direct investment as a necessity that will help them win markets and develop their competitiveness, rather than as a luxury reserved only for the largest firms. This growing awareness of the need to invest abroad is matched by an increasingly keen competition among host governments to attract firms. While there remains ample scope for further liberalisation in many countries, the changes represent a watershed in attitudes towards the participation of foreign-owned firms within the domestic economy. In the new environment characterised by liberalisation of trade and investment regimes and by privatisation, regulatory reform and demonopolisation of domestic industries, the potential gains from inward investment are more likely to be realised than ever before.

### **A. Global Trends in Direct Investment 1996**

Accordingly, in recent years, foreign direct investment has been growing rapidly, but there was a pause last year. Flows of direct investment to and from OECD countries fell slightly in 1996 from their peak in the previous year. Outflows from OECD countries totalled \$271 billion and inflows \$200 billion in 1996 (Table 1). In spite of the decline from the historic levels of 1995, the 1996 figures for flows were still the second highest on record (Chart 1). The global data recently published by UNCTAD, which add in foreign direct investment outflows from non-OECD countries, indicate that the global flows for 1996 slightly exceeded those for 1995. Particularly welcome was the dramatic increase by one third in the

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<sup>1</sup> The views expressed in these remarks in no way commit the OECD or its Member countries. A large part of these remarks draw heavily upon the “Special Feature” on direct investment trends, written by Mr. Stephen Thomsen, in the July 1997 edition of OECD Financial Market Trends.

inflows to developing countries in 1996.<sup>2</sup> The continued high levels of flows in recent years suggests that the process of globalisation brought about in part through international direct investment shows little sign of relenting. The trend towards globalisation is even more pronounced if one looks at cross-border mergers and acquisitions which have grown steadily throughout the 1990s and look set to continue at historic levels in 1997.

As a mixture of new investments and mergers and acquisitions, FDI is susceptible to the business cycle in both home and host countries. The long period of uninterrupted expansion of economic activities in many countries, particularly the United States, has no doubt provided a steady impetus to international direct investment. There are several long-term and inter-related elements behind the current trend towards globalisation, including continued liberalisation in both OECD and non-OECD countries, technological change and changing strategies of the world's largest firms towards a more aggressive expansion in markets in which they are under-represented or in which growth prospects are better.

Deregulation, demonopolisation, privatisation and the reform of trade and foreign investment regimes have been central to the high levels of international direct investment in the 1990s. The recent wave of international mergers among telecommunications and airline companies is testament to the tremendous impetus to FDI given by deregulation. An even greater impetus world-wide has come about through privatisation, with significant shares in, and sometimes control of, privatised firms going to foreign investors. According to OECD estimates, world-wide receipts from privatisations amounted to a record \$88 billion in 1996, of which \$68 billion came from OECD countries. In many countries, particularly in smaller OECD countries and in the developing world, the sale of public companies to foreign investors has been the primary source of inward investment in recent years.

In spite of cyclical downturns and barring any reversal of liberalisation measures, global FDI trends are to some extent self-perpetuating. As multinational enterprises (MNEs) expand their global presence, suppliers of goods and services -- such as components producers or banks -- often follow in their wake, sometimes at the explicit request of the client firm. Furthermore, when one firm invests abroad, its competitors often do the same even at the risk of aggravating excess capacity in a particular market. The global expansion of financial institutions and telecommunications firms also helps to reduce the costs of operating a global company, just as the MNE serves as a conduit for further trade and investment by reducing the informational barriers between countries.

Let's take a closer look at developments in 1996 (Table 1). The slight decline in OECD *outflows* in 1996 came about largely as a result of sharp declines in investment abroad by German, US and Swedish firms. Most other home countries maintained the same high levels of outward investment as in 1995. British firms invested a record amount abroad in 1996, confirming the position of the United Kingdom as the second greatest overseas investor after the United States. In yen terms, Japanese outflows grew for the third consecutive year at over 20 per cent, but remain at only one third the level of outflows in the peak year of 1990. Although US outflows fell in 1996, US firms were the most active foreign investors as they have been for the past six years and indeed throughout most of the post-war period. Since 1990, they have invested directly abroad over \$400 billion or over one quarter of total OECD outflows.

Looking at outflows by sector, US firms in most manufacturing industries invested significantly less abroad in 1996 than in 1995, while their investment in finance (excluding banking), insurance and property almost doubled. Much of the volatility in US outflows over time has come from investments in the financial and insurance sectors. For Japanese firms, both manufacturing and non-manufacturing

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2 UNCTAD Press Release: TAD/INF/2710, 10 July, 1997.

investments experienced a dramatic rise in flows in the late 1980s followed by an equally dramatic fall in the early 1990s. The difference between the two, however, is that manufacturing has quickly recovered, reaching a new high in 1995, while other sectors are still well below earlier levels.

The rise in Japanese manufacturing investment abroad over the past four years is a result of several forces, notably the appreciation of the yen, renewed growth at home and abroad, and the continuing need for Japanese firms to raise the share of overseas production to the levels found in other major home countries. Since 1994, Asia has been the favoured destination for FDI by Japanese manufacturing companies, followed closely by the United States. The rapid growth of Japanese investment into Europe which occurred in the late 1980s has since abated: inflows have averaged only \$2 billion in each of the past four years, compared to manufacturing investment by Japanese firms in Asia and the United States of \$8 billion each last year. The United Kingdom continues to receive the largest share of Japanese investment in Europe by a wide margin.

Global flows of direct investment are dominated by mergers and acquisitions (M&As) in value terms. In the United States, for example, acquisitions represented 85 per cent of foreign investment in 1995, with establishments contributing only 15 per cent. With the largest merger in 1996 worth over \$30 billion, the impact of cross-border M&As on total FDI flows is likely to grow in the future. By all accounts, mergers and acquisitions reached record levels in 1996. Much of this M&A activity involves two firms in the same market, particularly in those markets with a favourable business culture and a large and active stock market.

The forces behind the dramatic growth of mergers and acquisitions in the 1990s are sometimes specific to a particular industry or country, but many are general in nature. Through technological change and economic reforms which have occurred in virtually all countries over the past decade, including liberalisation of trade and investment policies, geographic and product markets are converging, and industries are consolidating in response. Many of the largest cross-border mergers have occurred in the telecommunications sector where formerly domestic companies are racing to achieve global reach as national monopolies are broken up and sold off. Similar motives are driving consolidation in air transport. Other general factors include economic growth, rising share prices and the desire of firms to shed affiliates in unrelated sectors.

## **B. International Direct Investment in the 1990s**

A review of developments in 1996 provides only a partial picture of trends in international direct investment. Direct investment tends to be even more volatile than other forms of investment, and it is therefore inappropriate to draw too strong conclusions based on only one year. This section reviews trends in the 1990s, a period in which OECD outflows have exceeded cumulative outflows of the previous three decades in nominal terms. Chart 2 shows the inflows of foreign direct investment by region.

By principal country and region, the United States remains the single largest host, but its relative share has declined substantially since 1987 when it took in roughly one half of inflows (Chart 2). As a group, the countries of the European Union have recently attracted more investment than the United States or any other region. Much of this investment has originated within Europe itself. Intra-EU investment took off in the second half of the 1980s and was encouraged by the moves towards a Single Market although global forces also played a role. Excluding intra-EU flows, Europe's position as a host falls behind both North America and Asia. Latin America and the developing countries of Asia have both received substantially more inward investment than in the 1980s. Although many countries in Asia have received copious inward investment in the 1990s, the spectacular growth in inflows into the region is in part due to the emergence of China. Direct investment flows to China now exceed those to all the rest of

developing Asia taken together. The rise of China in only a few years has, to a certain extent, induced a greater openness in the policies of those countries in the rest of Asia eager to attract inward investment.

Thus, although OECD Member countries invest substantially more outside of the OECD than they receive from those countries, they are also among the world's most active host countries. After falling throughout the 1990s, the OECD share of total global inflows grew in 1995 to reach 70 per cent, or roughly the same level as ten years ago. Table 2 shows cumulative inflows for individual countries during the 1990s. The United States has been the favoured location for direct investment in the 1990s in part by virtue of its sheer economic size. The top twenty locations are dominated by OECD member countries, which is not surprising given their weight in the world economy. For non-OECD countries, only China figures among the top ten. Thus, the United States and China have accounted for 30 per cent of global inflows in the 1990s, the top five countries for almost one half of total inflows and the top 10 countries for about two thirds of inflows.

Global flows are therefore focused on a small group of countries. While the uneven distribution of global FDI flows is likely to be of concern to those host countries not figuring near the top of the list in Table 2, there is not necessarily a direct relationship between the level of investment a country receives and the benefits which accrue from that investment. The benefits depend on the policy environment in which the investment is made, including trade and competition policy, and on the relationship between the size of the inward investment and total private investment in the host country.

Chart 3 shows FDI outflows by major home country or region since 1985. While the United States remains the single most important home country for multinational enterprises, firms from the European Union as a whole have invested more abroad. As with inflows, the largest share of this EU investment has remained within Western Europe. While intra-EU flows have continued at high levels throughout the 1990s, extra-EU outflows have been lower in the 1990s than in the late 1980s. As a result, European companies now invest roughly twice as much within the European Union as they do in the rest of the world. Outside of Europe, the United States is by far the favoured location, often involving acquisitions of American companies. A rising share of extra-EU outflows has gone to Eastern and Central Europe. Japanese outflows are also lower than earlier and are focused more on Asia and North America. The developing countries of Asia have emerged as a major source of investment, principally as a result of Hong Kong investment in China. Most of this investment remains within the region.

### **C. African Investment Trends**

How have the African economies fared during this period of strong global growth in foreign direct investment? The next two Tables (3 and 4) present data from two sources. Data collected by UNCTAD from the recipient or host countries are presented in Table 3. These data indicate that overall FDI flows into Africa ranged from \$5 to \$5.8 billion during the past three years<sup>3</sup>. While small compared to global flows (some 3.8% of the flows into developing countries in 1996), it is interesting to note that as a percentage of GDP Africa's FDI stock in 1995 was 13% which compares with 14% for Asia and 18% for Latin America and the Caribbean. Of course, these aggregate data cover up significantly different experiences among countries. Flows continue to be concentrated in Nigeria, Egypt, Morocco and Egypt with South Africa picking up. Indeed, when one looks at OECD investment data (Table 4) which are based on outflow data from the OECD countries, one sees a dramatic increase for South Africa in 1995, with the flows topping \$1 billion US (as compared with \$327 million in the UNCTAD figures). The next

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3 World Investment Report 1997, UNCTAD, Geneva, 1997.

to last line in this table tells the most important story. Over the 1985-1995 period Africa's share of direct investment flows from OECD countries has never exceeded 1.3 per cent and averaged 0.75 per cent. That is, the whole African continent has been receiving less than 1 per cent of direct investment over this 10 year period.

Thus it is evident that Africa has not shared in the rapid expansion of direct investment in developing countries in recent years. Part of the explanation is the small size of African markets. As I noted earlier the ratio of FDI stock to GDP is similar to that in Asia. But this reasoning is somewhat circular because had there been stronger foreign investment, GDP growth most likely would have been higher. As I expect we will learn during this conference, the African FDI story is considerably more complex, involving a wide range of macro-economic and governance issues, and the absence in many cases of an enabling environment for private sector and enterprise development. Some recent trends are promising -- a discernible economic recovery in the region, moves to liberalise investment and trade regimes and to increase regional co-operation, and some large scale privatisation programmes. Certainly acceding to the MAI or using it as a target for the design of investment regimes will not by itself be sufficient to assure a country of obtaining significantly higher investment flows; other policies directed at creating a broader enabling environment will be essential. But I do believe that in the intensely competitive global market for capital, countries that do not approach the investment regime standards of the MAI will loose out to others that do so, and the capital they are still able to attract will be priced at a premium.

#### **D. Non-OECD Countries and the MAI**

As you know, the MAI is going to be a free-standing international treaty open for accession by any country willing and able to accept its obligations. It is the twenty-nine OECD Member countries and the European Commission who are carrying out the negotiations. The vast bulk of FDI originates within OECD countries and is destined for other markets within the OECD area -- some 85% of all outflows and 68% of inflows in recent years. Therefore, successful conclusion of the MAI negotiations will mean that a major portion of the world's investment flows will be covered by a comprehensive framework of international rules of the game.

But there are also a number of non-OECD countries that are important hosts, and in some cases also home countries, for foreign investment. The list of the top thirty host countries for foreign direct investment in the 1990's I discussed earlier (Table 2) includes six non-OECD countries from Asia: China, Malaysia, Singapore, Indonesia, Thailand, and Hong Kong (China), plus five Latin American countries (Argentina, Brazil, Columbia, Chile and Peru). Some of these non-OECD countries have relatively open, liberal investment regimes and should be able to accede to the disciplines of the MAI should they so wish. In addition, there are considerable number of other countries which rank lower in terms of their shares of global investment flows but which have open, liberal investment regimes. For this reason, it was decided that the MAI should be open to accession by interested non-OECD countries and on an equal footing with OECD Members, as will be discussed tomorrow. Each country will be able to negotiate its terms of accession, i.e. its own schedule of reservations. Adhesion of all parties to the basic rules of the agreement will be essential, but different levels of economic development can be reflected in individual country reservations, which might, in some cases, include transition periods.

The consultations we have held thus far with non-OECD countries suggest that a number of these countries may wish to join the MAI and for essentially the same reasons as OECD countries. Three reasons are most often mentioned:



-- First, signatories to the MAI can expect to attract more investment flows because the MAI will set a new internationally recognised standard of market access and legal security for potential investors. Participation in the MAI will undoubtedly be more effective in this regard than bilateral treaties, because the MAI will cover all phases of investment, including the entry and establishment phase, and stronger dispute settlement provisions.

-- Second, for countries whose domestic firms are undertaking investments abroad -- and this includes some African countries -- the agreement will offer market access guarantees and legal security in most of the world's major investment destinations. Although some benefits may flow automatically to non-MAI countries through the MFN provisions of the GATS and bilateral investment treaties, the scope of the MAI is much broader than these agreements. It includes all economic activity, including all manufacturing and natural resources as well as services.

-- Third, signing onto the MAI would give a country access to the "MAI Parties Group" which will facilitate the implementation and operation of the agreement. All countries will participate in the Parties' Group on an equal footing.

Less advanced developing countries will also have reasons for looking closely at the MAI. These countries probably have the greatest need for additional foreign capital, technology and know-how. Their governments need to do everything in their power to provide an attractive climate that can be harnessed durably for development purposes and to promote integration into the global economy. Even if less developed economies find they are not ready to accept the international commitments of the MAI, they should study its provisions as a reference tool for domestic policy reform. The MIA should also provide a reference for development assistance efforts and international programs to promote private sector development. Finally, the OECD would be well placed, in co-operation with other international organisations (UNCTAD, The World Bank ..), to assist countries to improve the climate for private investment in their economies.

Thank you.

**Table 1. Direct investment flows in OECD countries in \$US million**

	<i>Inflows</i>			<i>Outflows</i>		
	<b>1994</b>	<b>1995</b>	<b>1996 (p)</b>	<b>1994</b>	<b>1995</b>	<b>1996 (p)</b>
Australia	3 951	14 193	6 067	5 291	4 064	1 518
Austria	1 314	636	3 719	1 201	1 043	1 064
Belgium-Luxembourg	8 345	10 638	11 048	747	11 503	7 248
Canada	7 259	10 739	6 696	7 414	5 747	7 561
Czech Republic	869	2 562	972	120	37	26
Denmark	4 889	4 179	1 379	4 040	3 018	2 845
Finland	1 578	1 063	1 219	4 297	1 681	3 551
France *	10 975	13 357	14 383	10 896	10 694	17 734
Germany	1 548	12 050	-3 243	17 134	38 573	27 883
Greece	981	1 053	..	..	..	..
Hungary	1 144	4 453	1 631	49	43	10
Iceland	-	14	1	23	24	5
Ireland	422	621	1 736	..	..	..
Italy	2 236	4 817	3 454	5 109	5 732	5 476
Japan	888	41	222	17 938	22 628	23 468
Korea, Republic of	758	1 240	1 169	2 075	3 120	2 977
Mexico	10 972	6 963	5 598	..	..	..
Netherlands	7 345	10 766	3 317	17 088	12 412	9 991
New Zealand **	2 792	2 922	2 772	2 039	- 167	1 530
Norway (incl. reinv. earn.)	1 359	1 644	3 437	2 145	2 844	5 341
Poland	1 875	3 659	2 768	29	42	27
Portugal	1 254	695	608	283	689	771
Spain	9 428	6 256	6 638	3 897	3 529	3 370
Sweden	6 347	14 375	5 461	6 686	11 215	4 470
Switzerland	3 366	2 186	2 217	10 793	12 171	11 599
Turkey	637	935	558	78	163	291
United Kingdom	10 497	22 810	32 766	28 251	42 676	43 717
Unites States	49 760	60 236	83 950	54 465	95 509	88 304
<b>TOTAL OECD</b>	<b>152 788</b>	<b>215 103</b>	<b>200 543</b>	<b>202 087</b>	<b>288 989</b>	<b>270 777</b>

\* France - Break in series. As from 1996, data are based on a new methodology.

\*\* New Zealand - data for 1995 and 1996 are not balance date adjusted, year-ended March.

(p) Most data for 1996 are provisional.

Source: OECD - Directorate for Financial, Fiscal and Enterprise Affairs, Paris 1997.

Table 2

## TOTAL FDI INFLOWS BY PRINCIPAL HOST COUNTRY 1990-96

		US \$ million
1	<i>US</i>	327,074
2	China	158,462
3	<i>UK</i>	146,671
4	<i>France</i>	86,878
5	<i>Belgium-Luxembourg</i>	68,526
6	<i>Spain</i>	62,737
7	<i>Netherlands</i>	49,881
8	<i>Canada</i>	44,921
9	<i>Australia</i>	44,468
10	<i>Mexico</i>	40,222
11	Singapore	39,176
12	<i>Sweden</i>	38,188
13	Malaysia	31,967
14	<i>Italy</i>	26,534
15	Brazil	23,276
16	Argentina	22,409
17	<i>Germany</i>	21,663
18	Indonesia	20,773
19	<i>Denmark</i>	15,810
20	<i>New Zealand</i>	15,286
21	<i>Switzerland</i>	15,170
22	Thailand	14,238
23	<i>Hungary</i>	12,508
24	Hong Kong	11,639
25	<i>Portugal</i>	11,081
26	<i>Poland</i>	11,075
27	<i>Norway</i>	10,720
28	Chile	10,152
29	Colombia	9,814
30	Peru	9,540
	<b>World</b>	<b>1,627,825</b>

Notes: Definitions of FDI differ greatly across countries.

OECD countries are in italics.

Table 3

**FDI inflows into Africa**  
(\$ million)

	<b>1991</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>
<b>Africa</b>	<b>2 964</b>	<b>3 109</b>	<b>3 672</b>	<b>5 834</b>	<b>5 026</b>	<b>5 279</b>
<i>North Africa</i>	886	1 582	1 679	2 364	1 265	1 633
Egypt	253	459	493	1 256	598	740
Morocco	317	422	491	551	290	400
Tunisia	125	526	562	432	264	370
Other	191	175	133	125	113	123
<i>Other Africa</i>	2 078	1 527	1 993	3 470	3 761	3 646
Angola	665	288	302	340	300	290
Ghana	20	23	125	233	240	255
Nigeria	712	897	1 345	1 959	1 830	1 720
South Africa	212	- 42	- 19	338	327	330
Uganda	1	3	55	88	121	135
Tanzania	3	12	20	50	150	190
Other	465	346	165	462	793	726
<b>Middle East*</b>	<b>1 090</b>	<b>979</b>	<b>2 816</b>	<b>788</b>	<b>-1 648</b>	<b>777</b>
Saudi Arabia	160	- 79	1 369	350	-1 877	100
Yemen	583	714	897	11	- 218	100
Other	347	344	550	427	447	577

\* excludes Turkey

Source: UNCTAD

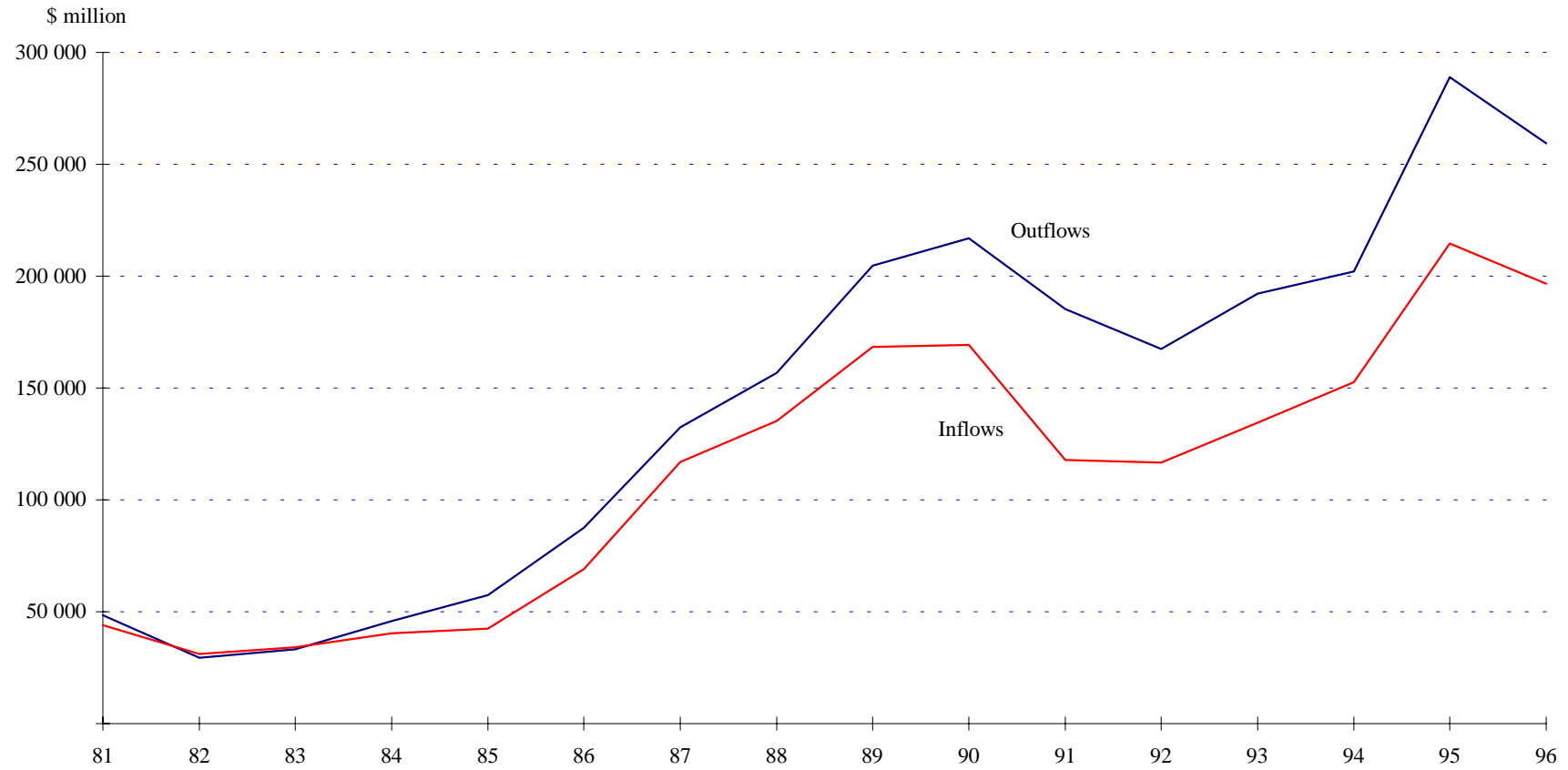
Table 4

**OECD Direct Investment Abroad: Outflows by destination***Million US dollars*

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
<b>AFRICA</b>	<b>404</b>	<b>815</b>	<b>673</b>	<b>347</b>	<b>2 496</b>	<b>744</b>	<b>2 182</b>	<b>1 417</b>	<b>2 915</b>	<b>1 526</b>	<b>2 829</b>
Algeria	4	0	2	0	0	0	10	54	10	119	95
Egypt	426	- 52	- 131	- 53	59	- 251	- 20	- 16	21	20	224
Libya	0	0	0	0	1	0	- 3	- 1	- 1	1	20
Morocco	9	18	16	- 6	15	30	71	71	185	239	11
South Africa	1	- 55	29	49	116	118	151	403	785	418	1 163
Other	- 35	903	756	357	2 305	847	1 973	905	1 915	729	1 317
<b>NEAR &amp; MIDDLE EAST</b>	<b>212</b>	<b>651</b>	<b>458</b>	<b>241</b>	<b>619</b>	<b>1 059</b>	<b>1 585</b>	<b>1 984</b>	<b>1 392</b>	<b>1 357</b>	<b>2 059</b>
Kuwait	0	0	0	0	0	- 1	0	0	0	36	19
Saudi Arabia	59	89	205	- 332	106	507	351	247	252	124	796
United Arab Emirates	4	1	8	194	4	- 5	81	175	246	1	156
Iran	0	- 20	2	14	- 1	0	530	16	208	- 250	282
Israel	128	- 96	158	82	12	- 73	133	570	314	197	378
Other	22	678	84	283	498	632	491	977	371	1 250	428
<b>WORLD</b>	<b>61 273</b>	<b>94 728</b>	<b>146 644</b>	<b>179 147</b>	<b>234 431</b>	<b>236 027</b>	<b>195 548</b>	<b>194 439</b>	<b>222 251</b>	<b>238 780</b>	<b>305 761</b>
<i>Shares of world total:</i>											
<b>AFRICA</b>	0.7%	0.9%	0.5%	0.2%	1.1%	0.3%	1.1%	0.7%	1.3%	0.6%	0.9%
<b>NEAR &amp; MIDDLE EAST</b>	0.3%	0.7%	0.3%	0.1%	0.3%	0.4%	0.8%	1.0%	0.6%	0.6%	0.7%

Source: OECD

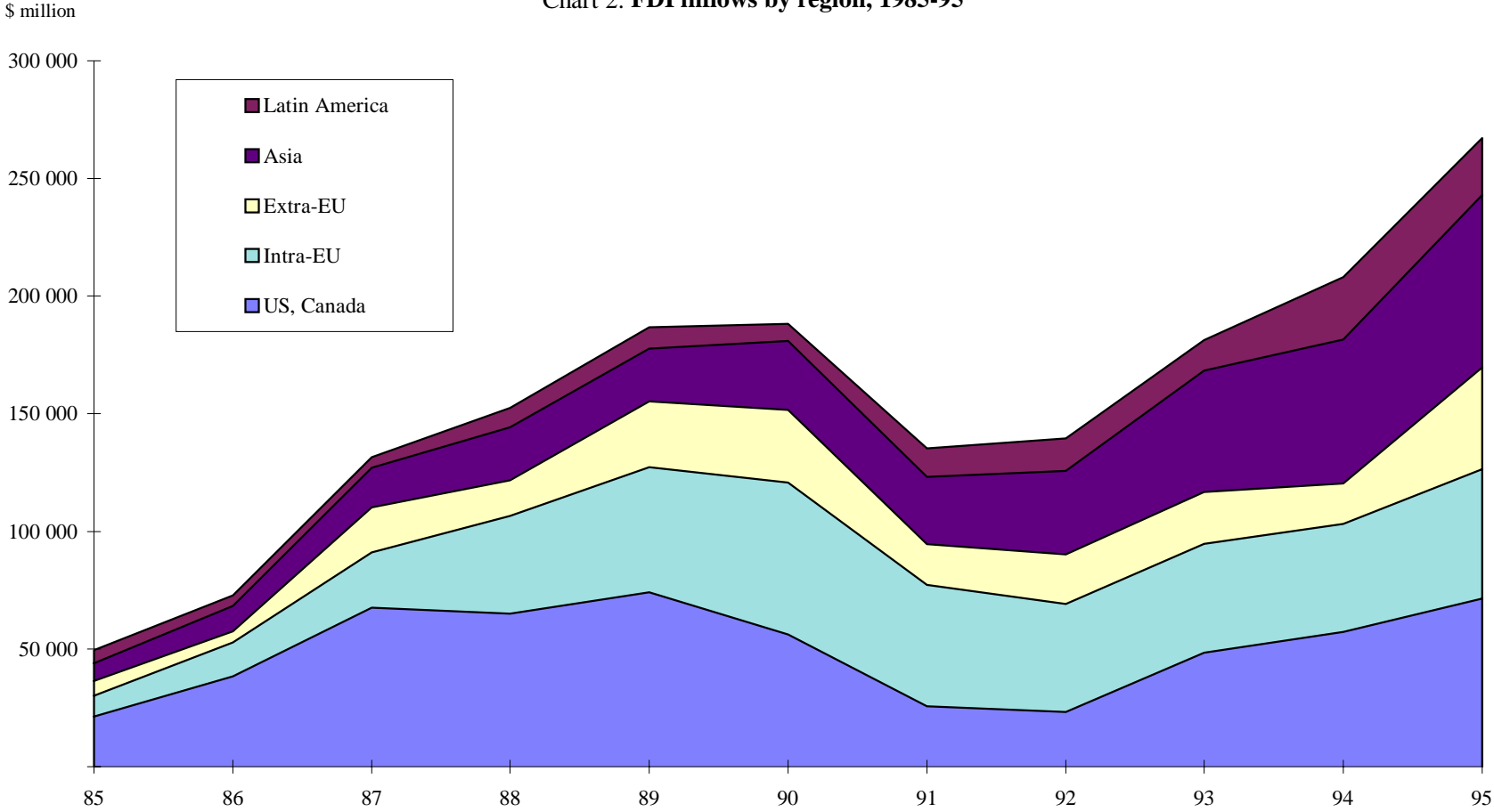
Chart 1. Total OECD FDI flows, 1981-96\*



\* Includes all 29 OECD Member countries for the entire period.

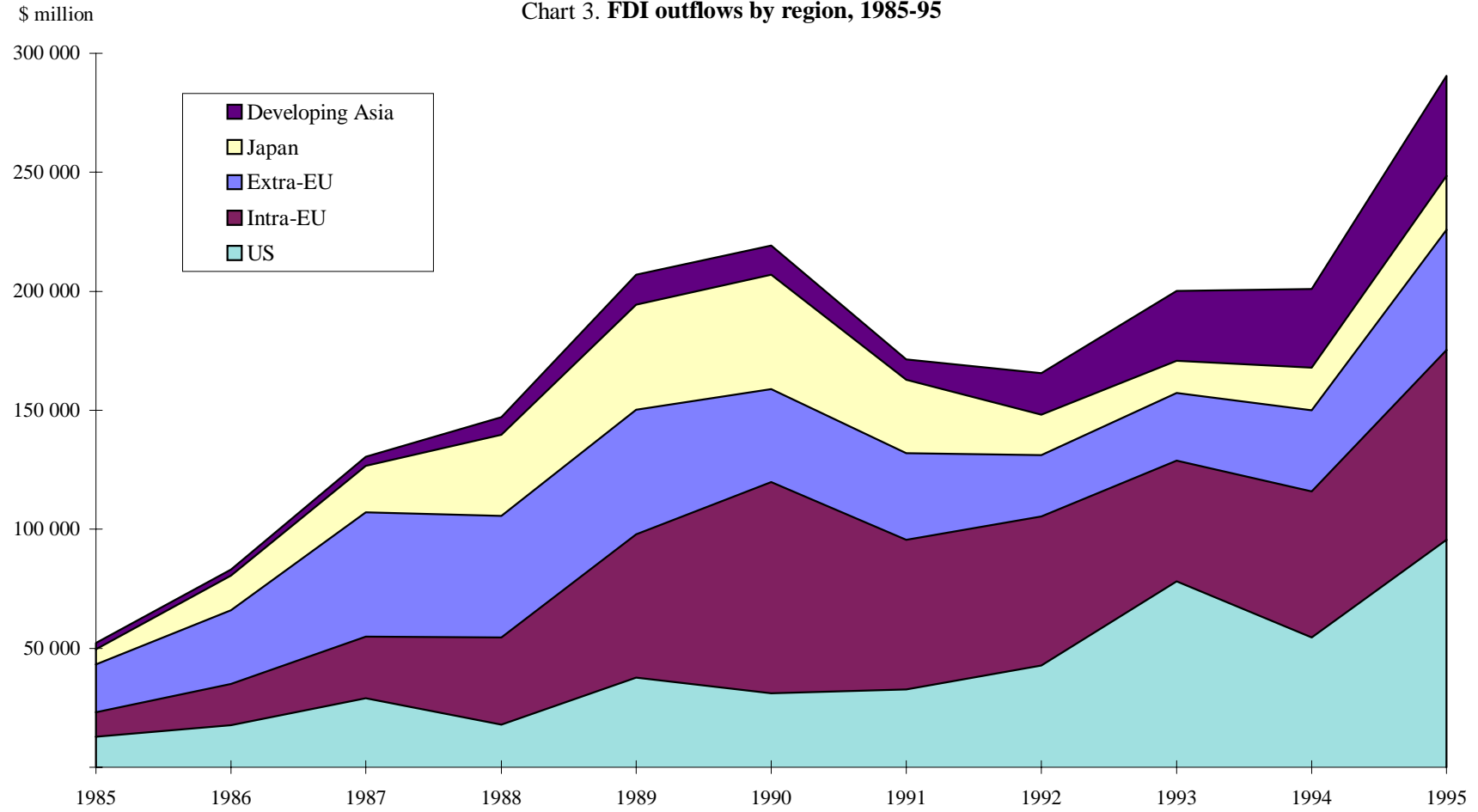
Source: *International Investment Statistics Yearbook 1996*, OECD

Chart 2. FDI inflows by region, 1985-95



Source: OECD, IMF, UNCTAD

Chart 3. FDI outflows by region, 1985-95



Source: OECD/IMF/UNCTAD



## Foreign Direct Investment and Development

Karl P. Sauvant<sup>1</sup>

Let me begin by underlining two points regarding the importance of foreign direct investment (FDI) that are particularly relevant for my presentation:<sup>2</sup>

1. FDI has become more important than trade for delivering goods and services to foreign markets: we know that, in 1994, world exports were \$5.0 trillion, and we estimate that sales by foreign affiliates were about \$6.4 trillion. In addition, we should note that about one-third of world exports are actually intra-firm exports, i.e., take place within the corporate systems of transnational corporations (TNCs), firms that control assets abroad.

2. FDI is not only a mechanism to deliver goods and services to foreign markets (and hence to link markets), it is also a mechanism to link national production systems. This, in its importance, is a fairly new phenomenon. It involves the international allocation of resources by firms on the one hand, and the utilization -- by the same firms -- of local factors of production on the other hand, in the framework of an increasingly sophisticated international intra-firm division of labour. The results are international corporate production systems, within which FDI, trade and technology flows are closely intertwined, partly as complements to each other, partly as substitutes for each other. I have already made reference to the fact that some one-third of world trade consists of intra-firm trade; I should add that some four-fifth of international technology transfers -- to the extent that they are reflected in royalty and fee payments -- are of an intra-firm nature as well.

The absolute and relative importance of FDI, and the emergence of an integrated international production system being built by TNCs in the broader context of globalization, naturally gives TNCs a role in the development process. This role varies, of course, across countries and industries. It is relatively more important in developing countries (as indicated by the share of FDI in gross domestic capital formation) and, in all countries, it is particularly important in key industries.

How does FDI contribute to growth and development?

The answer lies in the fact that FDI is a package that contains a number of tangible and intangible assets that are central to economic growth and development, namely, capital, technology, organizational and managerial practices, skills and access to international markets. Naturally, firms deploy these assets internationally in a manner that suits their own interests best, typically to improve their competitiveness. After all, firms are profit-making institutions, not development institutions.

How then, do countries benefit from FDI?

As far as host countries are concerned, the answer is fairly straight-forward: to the extent that TNCs bring, mobilize or upgrade capital, technology, organizational and managerial practices and skills, they broaden a country's input-base, and to the extent that they provide access to markets, they allow a country to

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  2. For an elaboration, see UNCTAD/ITE/ITT/5, *World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy*, (Geneva, UNCTAD, 1997), United Nations publication, Sales. No. E.97.II.D.10.

reap the benefits of economies of specialization as well as economies of scale in certain industries and they allow them to broaden the demand base. In that sense, FDI is like any investment, except that it often has the additional advantage of involving a number of other tangible and intangible assets that can be relatively scarce in host countries, especially developing host countries, and all of which are important for development.

This is not to say that development is not possible without FDI, or that FDI cannot have a negative impact in individual countries, e.g., where competition is stifled, certain restrictive business practices are employed or transfer prices are manipulated. This is also not to say that the same composition of the FDI package is of equal interest to all countries. For example, least developed countries may be more interested in the capital component of the FDI package, while middle-income countries may be more interested in the technology component. Similarly, export-oriented countries may be particularly interested in FDI that is geared towards the world market, and most countries are interested in the employment component. A number of countries therefore pursue various policies to attract especially those types of FDI that suit them best in terms of their own development objectives.

More generally speaking, countries are interested in maximizing the benefits they can derive from FDI.

A good part of these benefits accrue as a more-or-less normal by-product of the operations of TNCs, e.g., where they build or upgrade production capacities, create employment or establish backward linkages through which some of the TNC assets are passed on, for example, to sub-contractors.

In some cases, actual bargaining takes place between TNCs and governments, e.g., in the case of large natural resource or manufacturing projects. But given the competition among countries for FDI, and especially the competition for big projects, such bargaining these days more often than not takes the form of bargaining about how much incentives a prospective host government is prepared to offer.

Since we recently finished a major study on the role of fiscal, financial and other incentives in attracting FDI,<sup>3</sup> I cannot resist the temptation to elaborate a bit on this issue. There is widespread agreement among researchers, as well as executives of TNCs, that incentives offered to attract FDI do not determine, as a rule, the basic locational decisions of TNCs as far as regions and even countries are concerned because other factors are much more important. Typically, incentives are icing on the cake. Incentive competition for FDI can, therefore, easily lead to waste and, where it succeeds, distortions, thus leading to a sub-optimal allocation of resources. Governments would be well advised to review their FDI incentive schemes, with a view towards limiting certain excesses in incentive competition. Incidentally, we developed, in chapter VI of the World Investment Report 1995,<sup>4</sup> a few options as regards how this could be done.

But to return to the question of countries wishing to maximize the benefits that can be derived from FDI.

Today, the prevailing approach to do that is not through bargaining with individual firms. Rather, governments increasingly seek to create a favourable investment climate, including by trying to assure sound, stable and predictable macro-economic policies and regulatory frameworks, an environment conducive to

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3 UNCTAD, *Incentives and Foreign Direct Investment*. (New York and Geneva, 1996). Current Studies No. 30. United Nations publication. Sales No. E.96.II.A.6.

4 UNCTAD, *World Investment Report 1995: Transnational Corporations and Competitiveness*. (New York and Geneva, 1995). United Nations publication. Sales No. E.95.II.A.9.

international economic transactions, efficient administrations, a well educated workforce and modern infrastructure. The purpose of this approach is, obviously, to make it attractive for foreign firms to locate on your territory and for domestic firms to stay at home. In other words, the issue is increasingly not only to attract foreign investment but also to retain domestic investment.

More generally speaking, the issue is to influence the location of economic activities under conditions of liberalization and globalization, including the emergence of an international production system and fierce competition among states for internationally mobile assets. To be successful in this respect requires increasingly that governments create a favourable investment climate as defined earlier. For the logic of today's world economy is that, if the investment climate is not favourable (and some stickiness notwithstanding), firms can increasingly be expected to invest elsewhere -- or even to escape and migrate -- to climes that are more hospitable. Most governments do not find that desirable, presumably because it is better to have a cohort of viable -- i.e., internationally competitive -- firms located on their territories (and regardless of whether they are domestically or foreign owned) than to have fewer firms located on their territories. To put it differently, the assumption is: you can't milk a cow unless you have it.

This is not to say that governments stop seeking to maximise the benefits they derive from FDI. But their policies need to take into account the new parameters created by a liberalizing and globalizing world economy. Basically, that means that it is becoming more difficult for governments to impose certain requirements on firms (e.g., to conduct research and development or upgrade skills); rather governments need to make more efforts, need to be more pro-active, in terms of enticing firms to do more things that they find desirable. Obviously, the line between "imposing" and "enticing" is very fine and probably impossible to draw. In any event, more often than not, it is a matter of the right mix, reflecting, of course, also various economic attributes of the countries involved.

To give an example: most governments that today wish to attract R & D- intensive FDI cannot legislate that firms locate R & D facilities on their territories, or cannot legislate that existing facilities should be upgraded to undertake R & D. If they wish to attract R & D intensive FDI, they need, for example, to create science parks, make sure that their intellectual property rights legislation is strong, promote technological partnering among firms, and strengthen the technical skills of their workforce.

Thus, governments do have an important pro-active role to play in order to increase the contribution that FDI can make to development. But this role needs to be carefully calibrated, and formulated in full awareness of the constraints created by a liberalizing and globalizing world economy. As the specific configuration of these constraints varies from country to country and from industry to industry, it is a true challenge for policy makers to find the proper policy mix that makes their countries attractive for foreign and domestic investment and lets their countries benefit as much as possible from this investment.

## THE BENEFITS OF FOREIGN DIRECT INVESTMENT

Adrian Otten, WTO Secretariat<sup>1</sup>

National economies are increasingly knit together by interdependent and interacting networks of trade, investment and information flows. This phenomenon is often referred to as "globalization". Each element in this process depends on the other elements. For example, foreign investment and trade are increasingly complementary aspects of the international organisation of the production and supply of goods and services, by which the value-added chain is divided up and located in those countries where the stage in question can be most efficiently undertaken. Information flows through electronic means, such as the Internet, are on the one hand vital for the operation of multinational companies and provide new ways by which services can be delivered to markets. On the other hand, as seen in the recent WTO negotiations on basic telecommunications, foreign direct investment can play a crucial role in the establishment of the basic infrastructure for such information flows.

All this means that the potential availability of capital, technology, managerial and marketing skills and information flows to host countries is at unprecedented levels. This creates huge opportunities for developing countries for "catching up" through the harnessing of such flows; but it also carries with it a challenge, which is perceived as being particularly acute for Africa, namely that of avoiding marginalization in an increasingly integrated world economy.

In these remarks, I would like to say a few words about activities in the World Trade Organization, in particular about the way in which the interdependence of trade and investment issues is already reflected in WTO provisions and about the activities of the new Working Group on the Relationship between Trade and Investment. I will then share with you some of the main points which emerged from the Working Group's consideration at its meeting earlier this month of the relationship between investment and economic development.

### Investment and Existing WTO Rules

When the multilateral trading system, as embodied in the GATT, was established after the last World War, it dealt only with the cross-border transactions in goods. However, as it has developed and particularly in its recent transformation into the World Trade Organization, this "traditional" concept of trade has been extended to cover not only services as well as goods but also important aspects of the treatment of foreign companies operating in the territories of WTO Members - the issue at the heart of investment policy.

The main ways in which investment matters are treated in existing WTO rules are summarised below. It is important to bear in mind that these rules are multilateral (the WTO has 132 Member governments with an additional 29 in the process of negotiating accession), binding and subject to a functioning state-to-state dispute settlement procedure.

#### (i) General Agreement on Trade in Services (GATS)

The GATS defines trade in services to cover not only the cross-frontier movement of services but also the supply of services by a foreign company through a local commercial presence, i.e. through foreign investment. By treating investment as one element of trade in services, the GATS addresses not only the

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terms and conditions on which a foreign investor may enter a market, but also the conditions under which it will operate in the post-establishment phase. It does this through:

- certain rules of general application, the most important of which is most-favoured-nation treatment;
- obligations on national treatment and market access which are a function of national schedules of specific commitments annexed to the Agreement. The extent of these national schedules varies considerably from country to country. Those of developing countries are generally more limited, but some have taken the opportunity to provide a secure and transparent environment for foreign service suppliers over a broad range of sectors.

The GATS is conceived of as a framework for progressive liberalisation, through successive rounds of negotiations, the first of which must begin before the year 2000. In addition, two major pieces of unfinished business left over from the Uruguay Round have been and will be the subject of negotiations this year:

- basic telecommunications: an agreement liberalising trade and investment was concluded in February this year. Important not only for foreign investment in this sector but also for foreign investment generally, through lowering the cost of telecommunications;
- financial services: negotiations to be completed by the end of this year.

(ii) Intellectual Property

Modern investment treaties generally treat the intellectual property of foreign investors as a form of asset subject to the rules of the agreement. Under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), each WTO Member is required to accord in its own territory the protection required by that Agreement to the intellectual property of the companies and natural persons of other Members. Generally, developing countries have until 2000 and least developed countries to 2006 until bring themselves into conformity with TRIPS obligations, although many are doing so more quickly in recognition of the more favourable environment for foreign investment that this will provide.

(iii) Agreement on Trade-Related Investment Measures (TRIMs Agreement)

The TRIMs Agreement prohibits certain types of requirements on investors, in particular local content and trade-balancing requirements. It provides for a transition period for the phasing-out of pre-existing such requirements (until the beginning of the year 2000 in the case of developing countries and 2002 for least developed countries).

The Agreement also provides for a review by the year 2000 which will consider if the Agreement should be complemented with provisions on investment policy and competition policy.

(iv) Other WTO Rules Related to Investment

- The provisions of the Agreement on Subsidies and Countervailing Measures as they apply to investment incentives.

- The provisions of the plurilateral Agreement on Government Procurement which prohibit discrimination in government procurement against locally established suppliers on the basis of their degree of foreign affiliation.
- The provisions of the GATS on the movement of natural persons, including the temporary entrance of business visitors and intra-company transfers of key personnel.

#### Working Group on the Relationship between Trade and Investment

It is no secret that some Members of the WTO feel that, given the increasing interdependence of trade and investment, it would be in the common interest of members of the international community to negotiate a multilateral framework of rules in the WTO on investment, while some other WTO Members are not convinced. Most Members are disposed to consider this issue, but feel that further exploratory work is necessary before taking a decision. The decision taken at the first WTO Ministerial Conference, held in Singapore last December, to establish a working group to examine the relationship between trade and investment reflects this view. The WTO is thus addressing the question of additional rule-making in the area of investment in a cautious and step-by-step manner. The Singapore mandate explicitly states that the work of the Negotiating Group shall not prejudice whether negotiations shall be initiated in the future and that any decision to launch negotiations will require a consensus decision among WTO Members. The Singapore mandate further requires the Group to cooperate with UNCTAD and other intergovernmental organisations, in particular to ensure that the developing dimension is taken fully into account.

The Working Group, which is chaired by Ambassador Krirk-Krai Jirapaet of Thailand, has held two meetings so far, one in July and one earlier this month. A further meeting will be held on 8-9 December. A work programme has been established in the form of a checklist of issues (copy attached), structured in four clusters. At present the Working Group is examining clusters I - III, which concern respectively the implications of the relationship between trade and investment for development and economic growth; the economic relationship between trade and investment; and stocktaking and analysis of existing international instruments and activities regarding trade and investment. The fourth cluster is directed to consideration of issues that will have to be treated in the Group's report concerning future work in the WTO. The Group is required to report at the end of next year to the WTO General Council, which will decide at that time how the work should proceed.

#### Investment and Development

At the Working Group's meeting earlier this month, the relationship between investment and development was discussed on the basis of substantial papers presented by five intergovernmental organisations which have been active in this field (UNCTAD, OECD, World Bank, IMF and UNIDO). In addition, the WTO Secretariat provided a paper on the relationship between trade and foreign direct investment. It was striking that each of these papers painted a broadly similar picture. While the contribution of FDI to capital formation can be quite significant, the most important benefit was generally held to take the form of intangible assets transferred by investors, in particular technology and managerial, marketing and other skills. Other important benefits that were identified that foreign direct investment, depending on its type, can bring include the promotion of local entrepreneurship and business through backward and forward linkages, the enhancing of access to foreign markets through the distribution networks of multinational enterprises and through facilitating exports by domestic firms, the promotion of competition on the domestic market, and the modernisation of basic infrastructural services such as in the areas of finance and telecommunications. In regard to the effect of foreign direct investment on the balance of payments, the situation of course varies according to the type of FDI, but the overall situation that emerges from the studies

is that FDI is generally associated with an expansion of home country exports and can play an important role in their diversification.

Finally, several of the studies presented addressed the policy environment that would be most conducive to attracting FDI and realising benefits from it. These include political and macro-economic stability, open and stable trade and investment regimes, improvements in transport and telecommunications infrastructure, adequate protection of property rights and a predictable institutional environment without excessive red tape. An important condition identified for enhancing the benefits from being involved in global production systems is ensuring a higher degree of competition in host country markets through appropriate trade, investment, regulatory and competition policies. From an international trade point of view, it is important to note the strong conclusion that emerges from the various studies that open trade regimes are conducive not only to attracting more FDI but also to reaping greater benefits from it than are closed trade regimes.

CHECKLIST OF ISSUES SUGGESTED FOR STUDYNon-Paper by the ChairRevision

It was widely recognised that the Working Group's work programme should be open, non-prejudicial and capable of evolution as the work proceeds. It was also emphasised that all elements, not only category I, should be permeated by the development dimension. Particular attention should be paid to the situation of least-developed countries. In pursuing the items of its work programme, the Working Group should avoid unnecessary duplication of work done in UNCTAD and other organisations.

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I. Implications of the relationship between trade and investment for development and economic growth, including:

- economic parameters relating to macroeconomic stability, such as domestic savings, fiscal position and the balance of payments;
- industrialisation, privatisation, employment, income and wealth distribution, competitiveness, transfer of technology and managerial skills;
- domestic conditions of competition and market structures.

In this work, the Working Group should seek to benefit from the experience of Members at different stages of development and take account of recent trends in foreign investment flows and of the relationship between different kinds of foreign investment.

II. The economic relationship between trade and investment:

- the degree of correlation between trade and investment flows;
- the determinants of the relationship between trade and investment;
- the impact of business strategies, practices and decision-making on trade and investment, including through case studies;
- the relationship between the mobility of capital and the mobility of labour;



- the impact of trade policies and measures on investment flows, including the effect of the growing number of bilateral and regional arrangements;
- the impact of investment policies and measures on trade;
- country experiences regarding national investment policies, including investment incentives and disincentives;
- the relationship between foreign investment and competition policy.

III. Stocktaking and analysis of existing international instruments and activities regarding trade and investment:

- existing WTO provisions;
- bilateral, regional, plurilateral and multilateral agreements and initiatives;
- implications for trade and investment flows of existing international instruments.

IV. On the basis of the work above:<sup>2</sup>

- identification of common features and differences, including overlaps and possible conflicts, as well as possible gaps in existing international instruments;
- advantages and disadvantages of entering into bilateral, regional and multilateral rules on investment, including from a development perspective;
- the rights and obligations of home and host countries and of investors and host countries;
- the relationship between existing and possible future international co-operation on investment policy and existing and possible future international co-operation on competition policy.

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<sup>2</sup> The question of the timing of work under section IV was the subject of a decision taken by the Working Group at its meeting of 2-3 June 1997.

## SCOPE AND DEFINITION OF THE MAI

Olivier Ferrand<sup>1</sup>

The general presentation made by Joanna Shelton, Deputy Secretary-General of the OECD, in her opening speech clearly demonstrated that the Multilateral Agreement on Investment is an ambitious instrument. I assume any negotiator must be tempted to describe his creation in such terms; however, the MAI *really* is an ambitious agreement.

The text of the MAI is not yet in final form. Technical details and some political choices are still outstanding, but the main elements of its scope of application are now in place.

I propose to examine these elements with you, demonstrating their ambitious nature and, at the same time, emphasizing their limits: the MAI is a high-standard agreement, but it is also a reasonable agreement which ought to enable those countries which so wish, whatever their degree of development and however open their economies, to comply with the obligations incumbent on them under the MAI.

### 1. THE MAI, AN AMBITIOUS AGREEMENT

The MAI is ambitious by virtue of both its scope, the obligations to which it gives rise and its dispute-settlement mechanisms.

#### 1.1. Ambitious in scope

Firstly, the scope of application of the MAI is very broad in that it covers **all economic sectors**. At the WTO, with the GATT and GATS agreements, negotiations were “*bottom up*”: only those sectors expressly mentioned come within the scope of application of the agreements and sectors not mentioned are free from any obligations. With the MAI, on the other hand, a “*top down*” approach has been adopted. This means that all sectors are by definition included in the agreement, and only the introduction of a specific national reservation can enable a Contracting Party to suspend the application of the agreement to a particular sector that it wishes to protect. The MAI is therefore a horizontal treaty, in contrast to the sectoral approach used today at the WTO.

Secondly, the scope of application of the MAI is very broad in that it covers **all forms of investment**. An investor is defined as any natural or legal person of a Contracting Party. For the MAI an investor can be anyone, and it is difficult to imagine a broader definition. What is more, investment is also given a very extensive meaning. It covers, and I quote “any kind of asset owned or controlled, directly or indirectly, by an investor”. In practice, this means that the MAI goes beyond the traditional concept of *foreign direct investment* (establishment of branches and subsidiaries, acquisition of permanent holdings in local companies, purchase of tangible assets). It also comprises *portfolio investment* (i.e. equity participation for investment purposes), *financial investment* (bonds, debentures, loans) and *intangible property*. *New forms of investment* likely to emerge in the future will also be covered by the MAI, and it will be able to adapt to the changing nature of international investment as a result of its definition of investment in the form of an open list. Lastly, the agreement does not only encompass international investment: some of its obligations also relate to *domestic investment*.

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1. Direction du Trésor - Ministry of Economy and Finance (France)

Thirdly, the scope of application of the MAI is very broad in that it covers **all stages of investment**. To quote once again, it includes “the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposition” of investments.

Lastly, the scope of the MAI is broad in that it covers **all types of measure that a Contracting Party may take to restrict freedom to invest**. It covers all types of normative instrument: laws, regulations, judicial decisions, and international treaties. It applies to all levels of government, both national and subnational. For any given level of government, it includes both government authorities and legally independent agencies to which those authorities have delegated their prerogatives.

Such extensive scope of application is consistent with the MAI’s main objective, namely to make the existing system of bilateral investment protection agreements into a multilateral one. Bilateral treaties do indeed have a similar scope of application. Moreover, within a multilateral framework, the situation is not an entirely new one, since a similar approach was adopted with the Energy Charter Treaty.

### **1.2.. Ambitious obligations**

First, the MAI establishes a number of **general rules concerning the liberalisation of investment**. These are classic rules in the field of trade and international investment, but their wording in the MAI is very general in scope. The rules are three in number:

- the Most Favoured Nation clause: each Contracting Party shall grant the investors of another Contracting Party treatment no less favourable than that which it grants investors of any other Contracting Party or a non-Contracting Party;

- the national treatment clause: each Contracting Party shall grant treatment no less favourable than that which it grants its domestic investors;

- the transparency clause: each Contracting Party shall undertake to publish all the normative texts applicable to investors, and also to make public any policies not set down in any texts.

Second, the MAI develops a number of **specific rules concerning the liberalisation of investment**. These are the “special topics”, which are to be discussed in detail during session 3 at the end of the afternoon.

Last, the MAI has established a number of **rules on investment protection**. These include, in particular, the general treatment clause, the banning of expropriation without compensation, and the freedom of transfer of payments. These rules will be analysed by Dr. Joachim Karl in the next presentation.

### **1.3. An ambitious dispute settlement mechanism**

The major innovation in the MAI is doubtless to be found in this area. The agreement contains the classic machinery for settling disputes between countries, but it also contains a novel procedure for settling disputes between investors and countries: any Contracting Party investor, whether a legal entity or a natural person, will be able to take his dispute directly to the MAI panel. This important question will be tackled tomorrow by Ambassador Marino Baldi.

## **2. THE MAI, A REASONABLE AGREEMENT**

Total and unconditional liberalisation of international investment could lead to economic destabilisation and would have been counterproductive. The MAI negotiators thus established limits to both its scope of application and its obligations.

### **2.1. The limits to the MAI's scope of application**

The first such limits concern the **definition of investment itself**. In this connection, work is still under way to determine the appropriate treatment of *indirect investment*. Numerous delegations are in fact in favour of excluding from the scope of the MAI investments by a subsidiary or branch established in a non-Member country. Other possible "carve-outs" relate to *public debt, real estate and licences*.

The second set of limits has to do with **making the MAI compatible with the other international agreements covering investment**.

As regards bilateral investment protection treaties the situation is relatively straightforward. In the case of a bilateral treaty which predates the entry into force of the MAI, any provision not in accordance with the latter must be the subject of a specific reservation, failing which it will lose all effect if it is out of line, or be extended to all MAI signatories if it is a more favourable liberalisation or protective measure. There is therefore no obligation to align and multilateralise the existing bilateral treaties in the MAI, which significantly limits its scope of application.

As regards multilateral treaties, the situation is far more complex. An initial difficulty has to do with the *specific multilateral agreements* covering precise sectors. The principle is that the MAI, as a broad-ranging agreement covering all sectors of the economy, must neither be intended to nor have the effect of calling in question the technical provisions of these specific agreements. Consideration is thus being given to limiting the scope of application of the MAI with regard to intellectual property rights, so as to avoid any possible conflict with existing international agreements in this area (TRIPS in the WTO, WIPO).

The other difficulty stems from the link-up with *WTO agreements*, particularly GATS. In theory, the scope of application of the MAI and the GATS is mutually exclusive: the former deals with investment and the latter with trade. In practice, the two agreements partially overlap. If reference is made to the nomenclature of service provision as defined in the GATS, it will be seen that mode 3 (establishment of commercial presence) is, as such, an investment for the MAI. Moreover, mode 4 (transborder movements of natural persons) is partially included in the MAI under the special heading of key personnel. Lastly, even mode 1 (transborder services) and mode 2 (consumption abroad), which would appear to be the most trade-specific, probably come within the scope of the MAI when they relate to assets rather than consumable goods.

In areas where there is duplication, certain MAI obligations will undoubtedly be stricter than those in the GATS. Detailed examination is not yet terminated but this does emerge clearly from the general tenor of the MAI, which is indeed broader in scope. Its provisions are also more elaborate. As we have just seen, the MAI goes beyond the general principles of liberalisation of investment (national treatment, most favoured nation clause, transparency) to include specific liberalisation principles (performance requirements, enterprise behaviour, key personnel) and also obligations regarding the protection of high-level investment.

This leads to a major difficulty. Owing to the MFN clause in the GATS, Parties to the MAI, all of whom are WTO members, will automatically have to extend all additional liberalisation commitments they assume under the MAI to all other members of the WTO. They will thus have to grant advantages “free of charge”, without obtaining anything in return. This shortcoming of the multilateral architecture is a source of concern for OECD Members and we are looking closely into how it can be appropriately remedied.

## **2.2. The limits to obligations under the MAI**

An initial type of limit to MAI obligations meets the need to allow for the specific features of certain sectors. The limits concerned are **vertical limits** and two sectors are concerned in practice:

-- the financial services sector is covered, but the rules applied to it are less demanding than the normal rules in the agreement. In particular, restrictions on freedom to invest are permitted on prudential grounds, while the obligation of transparency is qualified since, if fully applied, it might interfere with the necessary confidentiality peculiar to certain financial information;

-- taxation comes closer to a total “carve out”. At this stage of the negotiations only a limited transparency clause and a clause prohibiting extreme cases where financial measures amount to expropriation are envisaged. Numerous delegations consider that taxation is a world on its own and that bilateral double taxation conventions are the most appropriate instrument in this field.

The second type of limit to the MAI obligations relates to **horizontal limits**. These encompass what the MAI wording refers to as “general exceptions” and “safeguard clauses”:

-- A general exception is a provision enabling a Contracting Party to take measures contrary to the Treaty on a permanent basis. The “national security clause” in the MAI thus authorises Contracting Parties to take any steps necessary to protect their vital security interests or in the performance of their obligations under the United Nations Charter for purposes of maintaining international peace and security. A general exception in respect of public order is also included in the MAI. Some delegations have also proposed a general exception for culture.

-- A safeguard clause is a provision enabling Contracting Parties temporarily to suspend application of certain disciplines in the agreement. The MAI contains such a safeguard clause to cover serious balance-of-payments and external financial difficulties of a Member State. Recourse to this clause is subject to review by the Parties Group and the IMF.

The last type of limit to the MAI obligations is the most important and relates to **national limits**. A country may exempt from MAI rules any sector it deems in need of protection by introducing, as an annex to the agreement, a national reserve along these lines. The list of reserves system thus provides a “refuge” for the legislation on investment of any country which is a signatory to the agreement, and allows the MAI to be adapted to the differing degrees of development and market openness of the signatories.

To conclude, I do hope the dry technicality of what I have said has not discouraged you too much. I have to admit that the complexity of the MAI does sometimes leave one a little pensive. But this is no doubt the price to be paid for its being so ambitious.

However, were only three of my ideas to impress themselves on your minds, I would propose the following:

-- firstly, the scope of application of the MAI is very broad and is part of the general approach to a high standard agreement;

-- secondly, some limits have nevertheless been included, enabling MAI rules to be fully adapted to Member countries' differing degrees of development and openness, so that any country can benefit from its membership of the MAI.

-- thirdly, the MAI is intended to be compatible with multilateral agreements on investment questions, and especially the WTO agreements, and every effort is being made to ensure that it does not impose obligations on the Contracting Parties which would conflict with their obligations under those agreements.

Thank you for your kind attention.

# PROTECTION OF INVESTORS AND INVESTMENT

Dr. Joachim Karl<sup>1</sup>

## I. Introduction

The MAI chapter on investment protection is almost complete. The latest draft contains the following elements:

- general treatment of the investor and the investment;
- expropriation and compensation;
- protection from strife;
- transfer of funds;
- subrogation;
- protection of existing investment;

Discussions are going on of whether to include a provision protecting the investor rights arising from individual contracts that have been concluded between an investor and the host country. Furthermore, a final decision still has to be made on how the MAI provisions on investment protection relate to the respective rules in other agreements, e.g. the bilateral investment protection agreements.

In general, the draft text has many similarities with the well-known investment protection provisions in hundreds of bilateral investment protection agreements. This is no surprise because it was never the intention of the negotiating partners to „re-invent the wheel“. However, we sometimes wished to put into it some more spokes in order to strengthen the whole vehicle.

I should now like to introduce the main results concerning the various draft provisions. In doing so, I shall concentrate on those issues where a final agreement could not have been achieved so far.

## II. The MAI Provisions on Investment Protection

### 1. General Treatment

According to this introductory article, investments shall receive fair and equitable treatment as well as full and constant protection and security. Treatment must in no case be less favourable than that required by international law.

We then tried to be more specific about what this obligation means. We agreed that both the operation and the management, maintenance, use, enjoyment or disposal of an investment shall be protected. However, it is still open whether with regard to these activities, only unreasonable **and** discriminatory state measures shall be prohibited, or whether it is sufficient that these measures are **either** unreasonable **or** discriminatory. Those, who support the cumulative approach argue that it would go too far to prohibit measures that are only „unreasonable“ - given the vagueness of this term. In view of the others, it would be too restrictive to cover only „discriminatory“ measures because a host country may severely

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interfere with the activities of an investor without a discrimination necessarily having to take place.

## 2. Expropriation and Compensation

It was not very difficult to come to an agreement with regard to the core provisions of this article. An expropriation, or any other measures having equivalent effect, whether directly or indirectly, is only permitted if it is

- for a purpose which is in the public interest,
- non-discriminatory,
- against payment of prompt, adequate and effective compensation, and
- in accordance with due process of law.

In addition, the article defines the meaning of the terms „prompt, adequate and effective“ and „due process“.

a) There is agreement on the following elements:

- „prompt“ means without delay;
- „adequate“ means that compensation must be equivalent to the fair market value immediately before the expropriation took place, without any deduction due to the fact that the pending expropriation became publicly known in advance;
- „effective“ means that compensation shall be fully realisable and freely transferable;
- „due process of law“ includes the right of an investor to have its case reviewed by a judicial authority or any other independent body in the host country.

b) With regard to the following issue, the discussions were more difficult:

- The question came up as to what compensation the investor can claim in case that payment has been delayed. It was agreed that the host country has to pay interest at a commercial rate established on a market basis for the currency of payment from the date of expropriation until the date of actual payment. However, it was unclear whether we would need an additional provision according to which the host country would also bear the exchange-rate risk in case of a delay. This means that in case of a devaluation of the host country's currency between the time of expropriation and the time of actual payment, the host country would have to compensate the investor for this devaluation as well. After lengthy discussions the large majority supports the idea that the MAI should not contain an explicit provision on the subject. However, an interpretative statement would be added to the text according to which „adequate“ compensation includes compensation for devaluation losses.



### 3. **Protection from Strife**

This provision deals with the situation where an investor suffers losses in the host country due to war, any other armed conflict, state of emergency or similar events. In principle, the host country shall not be obliged to pay compensation in such cases. Rather, the MAI stipulates that **if** the host government decides to pay compensation, the principles of national treatment and most-favoured nation treatment shall apply. However, there are two situations where there will be an obligation to compensate: First, in the case that the armed forces of the host country requisition the property of the investor. Second, in the case that the armed forces of the host country destroy the property as long as this demolition was not required by the necessity of the situation. Compensation in such cases has to be prompt, adequate and effective.

### 4. **Transfer of Funds**

This article states that all payments into and out of the host country that are related to an investment may be freely transferred without delay at the market rate of exchange prevailing on the date of transfer. The provision contains an open-ended list of what kind of payments are included (e.g., the initial capital, returns, compensation, proceeds from the sale or liquidation of the investment, earnings and other remuneration of personnel).

There is agreement that the freedom of transfer does not impede a contracting party to, inter alia, protect the satisfaction of judgements in civil, administrative and criminal proceedings.

A few issues could not be resolved so far:

- a) After long debates, there is now an emerging consensus that the MAI shall contain such a provision. The reason is that the MAI uses a broad definition of the term „investment“; which does not only cover foreign **direct** investment. Given the huge quantity of other forms of investments, such as portfolio investments and their volatility, there is a strong feeling that a safeguard clause is needed. However, there is agreement that transfer restrictions should be allowed only in exceptional circumstances, in particular in a serious balance-of-payments crisis. Any restriction has to be in conformity with the obligations of the host country under the IMF Agreement. Furthermore, any restriction shall be temporary, and subject to review every six months.
- b) Second, a final decision has not yet been taken with regard to the currency in which transfers may be made. The majority supports a provision, according to which transfers may be made in a freely convertible currency, and where this term will then be defined. Two options for such a definition are currently discussed. While the first alternative defines a „freely convertible currency“ as one which is widely traded in international foreign exchange markets and widely used in international transactions, the second option refers to such a currency which is, in fact, widely used to make payments for international transactions and is widely traded in the principle exchange markets.

- c) Third, it still has to be decided whether a clause is needed dealing with the situation where there is no market rate of exchange. It has been suggested that in such a situation, the rate to be used shall be the most recent exchange rate for conversion of currencies into Special Drawing Rights.

## 5. **Subrogation**

All delegations accept the principle that if the home government compensates an investor with regard to a loss it has occurred in the host country, the former country enters into all the rights and claims that the investor had vis-à-vis the host country.

Two issues are still under consideration: First, a few delegations believe that the provision should make it clear that it deals only with compensation for **non-commercial** risks. Second, one delegation has serious difficulties to allow the home country of the compensated investor to proceed - as the latter's successor in rem - under the rules of investor-state-arbitration.

## 6. **Protection of Existing Investments**

Delegations agree in principle that the MAI should cover investments, irrespective of whether they have been made before or after entry into force of the Agreement. Some delegations would like to add a provision to the effect that the MAI does not apply to claims arising out of events which have occurred, or to claims that have been settled, prior to its entry into force.

Furthermore, some delegations suggested yet another addition according to which a change in the form in which assets are invested does not affect their character as investments.

## 7. **Protection of Investor Rights arising from individual contracts between the Host Country and the Investor**

Discussions are going on as to whether the MAI should contain a provision according to which each contracting party shall respect any other obligation it has undertaken individual investment contract with a specific investor. As a consequence, a breach of such an investment contract would amount to a violation of the MAI.

At the moment, there are three options on the table: First, the MAI would not contain such a provision at all; second, only the MAI dispute settlement mechanism would be available in case that there is an alleged breach of the contract; third, the MAI would contain a so-called „respect clause“, including the possibility to have recourse to the MAI dispute settlement mechanism. The main difference between the first and the second option on the one hand, and the third option on the other hand, would be that only in the latter case, the breach of the investment a contract by the host country would always amount to a violation of the MAI. Consequently , the investor and its home country would be entitled to the remedies that the MAI provides in such a case.

## 8. **Relationship to other Sources of Protection**

The Negotiating Group still has to decide whether the MAI should include an article that if the domestic law of a contracting party or any other obligation under international law provides for a more favourable treatment for the investor than the MAI does, the former shall, to the extent that it is more favourable, prevail over the present Agreement. Currently, most delegations think that Article 30 para. 3 of the Vienna Convention on the Law of Treaties already takes care of this issue. Article 30 para. 3 states that if two subsequent treaties deal with the same subject matter, the former treaty shall only apply to the extent that it is compatible with the latter agreement. The question is whether this provision makes it sufficiently clear that the investor shall get the more favourable treatment.

## EXCEPTIONS, DEROGATIONS AND NATIONAL RESERVATIONS

Marinus Sikkel<sup>1</sup>

The MAI has a very wide scope and has very strong obligations regarding the investments falling within that scope. This raises the question whether it is desirable and feasible to enforce under all circumstances and for all Contracting Parties those obligations.

There may well be circumstances that call for a temporary or permanent possibility to derogate from the MAI principles. It may well be warranted to take into account that the levels of development of the Contracting Parties can be widely different.

Realising that, in order to achieve a high level Agreement it is necessary to provide for some flexibility, the negotiators have foreseen six types of provisions which will enable the signatories to derogate from the principles of the agreement:

- 1) Certain **limitations in the definition**.
- 2) **General exceptions** under which States would have the possibility to take the measures necessary to ensure compliance with certain general objectives.
- 3) The definition of investment is very broad and therefore covers most elements of the balance of payments. Accordingly, a **temporary derogation** clause in case of serious problems with the balance of payments could be inserted.
- 4) **Prudential measures** which give the Contracting Parties the possibility to ensure the integrity and stability of their financial system.
- 5) **Taxation** is generally not covered by the MAI. A so-called carve-out/ carve-in approach is followed.
- 6) **National reservations**. States will have to disclose all non-conforming measures which they maintain at the time the MAI is signed or at the time they join. Clearly, the final negotiating phase will focus on such a list and seek to establish commitments which are as open as possible.

### DEFINITION

Although a working hypothesis for the definition is established, further work is necessary on the issues of indirect investment, intellectual property, concessions, public debt and real estate. E.g. many delegations are not in favour of covering investments made through affiliates established in a non-MAI country. In the field of IPR's conflicts with existing international Treaties on this subject must be avoided.

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## GENERAL EXCEPTIONS

Such exceptions could be granted for reasons of national security and maintenance of international peace. The question of a “cultural exception” intended to protect linguistic and cultural diversity is also under discussion. Some countries believe that a reference to public order is necessary to allow countries to take exceptional measures based on this principle.

Some of the elements under discussion with regard to this article are the following:

- It has been proposed that the general exceptions provisions not be applicable to all of the obligations under the agreement. The question is whether certain obligations of the agreement are considered so central to investor protection, for example compensation in case of expropriation, that a provision should limit the right of a Contracting Party to invoke this Article for actions that would be inconsistent with its obligation to pay compensation in the case of an expropriation.
- Should the provisions regarding protection of essential security interests be self-judging?
- Recent agreements like the NAFTA, the ECT, the GATS, and the Shipbuilding agreement do not define essential security interests but provide elements clarifying the purpose of the provision. Should the list of such elements be open or closed?
- An anti-abuse-clause could be added to this article. However a good faith obligation already exists in international law and there are concerns that by restating it in the agreement, we may create a different standard. Some delegations thought it might be useful to follow the ECT (Article 24) and GATS (Article XIV) provisions that public order or other general exceptions must not constitute a disguised restriction or that they are invoked without proper justification.

## BALANCE OF PAYMENTS CLAUSE

OECD Member countries are strongly attached to the freedom of investment and capital movements more generally as well as to the right of investors to freely make payments and transfers in connection with current and capital transactions. They have traditionally discouraged resource to exchange restrictions and capital controls as a means of solving balance-of-payments problems, stressing that they should not be a substitute for appropriate adjustment policies. Nevertheless, it is noted that there are considerable differences of scope between the classical BIT's and the MAI. Especially since the MAI will also cover portfolio investments it may be considered that there could exist exceptional circumstances in which a country should have the flexibility to introduce restrictions for a temporary period if this can allow the country to buy time until appropriate policy measures take hold. This may be especially important in the context of adjustment policies adopted with IMF support.

## PRUDENTIAL MEASURES

- “1. Notwithstanding any other provisions of the Agreement, a Contracting Party shall not be prevented from taking prudential measures with respect to financial services, including measures for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by an enterprise providing financial services, or to ensure the integrity and stability of its financial system.
2. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Contracting Party’s commitments or obligations under the Agreement.”

The proposed Article applies to measures taken with respect to financial services. Given the coverage of the MAI, the Article will apply to measures affecting investors and their investments in the financial services area and not all aspects of international trade in financial services. The proposed text recognises the right of a Party to take prudential measures which do not conform with National Treatment, MFN and the other provisions of the Agreement, provided that the measures are not used as a means of avoiding Party’s commitments and obligations.

Several questions are under consideration, such as the question whether the exercise of a Party’s right to take prudential measures which do not conform with the provisions of the Agreement should be subject to the dispute settlement mechanism of the MAI, or whether financial services expertise should be required for any arbitration panel for disputes on issues relevant to financial services.

## TAXATION

Taxation is a vital point in foreign investment decisions. Foreign investors attach primary importance to fair fiscal treatment. Logically, therefore, the non-discrimination rule in the MAI should extend to fiscal treatment. But in reality, things are not that simple. Fiscal experts have identified a number of problems that would arise if the MAI were in its entirety to apply to taxation. Their primary concern is that strong obligations on national treatment, non-discrimination and most-favoured nation treatment, as envisaged in the MAI, could conflict with obligations contained in the many bilateral agreements on the avoidance of double taxation. Although these agreements are also based on the non-discrimination principle, this does not necessarily mean that a foreign investor is always taxed identically to a local firm.

After considerable debate the conclusion tends to go in the following direction:

- ◆ the Contracting Parties recognise the importance of the principles of non-discriminatory treatment in taxation. They refer in that respect to the extensive network of agreements for the avoidance of double taxation and their efforts to expand that network;
- ◆ as a general rule the MAI will not apply to fiscal measures, except for expropriation and transparency;
- ◆ respect for these principles will play a role in the accession process.

## STANDSTILL AND THE LISTING OF COUNTRY SPECIFIC RESERVATIONS

The MAI aims to ensure a high minimum standard of treatment for investors and their investments, including National Treatment and MFN treatment. These standards apply to all the Contracting Parties alike.

However it is recognised that there are major differences in the level of economic development between the OECD member States. It is also recognised that some of them have a long tradition of openness to foreign investors while others are relatively newcomers in this respect.

To take these differences into account it will be possible to lodge country specific reservations which will allow individual countries to maintain certain non-conforming measures they already have at the time of coming into force of the MAI. Standstill would result from the prohibition of new or more restrictive exceptions to this minimum standard of treatment. Standstill would not apply, however, to any general exceptions (e.g. national security) or to any temporary derogations (e.g. balance of payments) that might be allowed under the MAI.

For those matters where Contracting Parties are ready to commit to standstill:

- a) each Contracting Party should list all existing non-conforming measures that it wishes to maintain in an Annex of the Agreement;
- b) the reservations should describe, in the most precise terms possible, the nature and scope of the non-conforming measures. This would ensure that the scope of the reservations is not broader than these measures and, thus, that the reservations are not of a “precautionary” nature;
- c) no additional non-conforming measures could be introduced; and
- d) an amendment to a non-conforming measure would be permitted provided it did not decrease the conformity of the measure.

Of course, if the MAI obligations were expanded, (a) - (d) would come into play again with respect to the new or enlarged obligations.

Further discussion is needed on the question of country specific reservations in certain sensitive sectors and new economic activities that may emerge in the future. Some delegations suggested flexibility could be achieved by separate annexes to the Agreement for the listing of country specific reservations in these areas. For sectors, sub-sectors or activities mentioned in this annex it would be allowed to introduce new or more restrictive non-conforming measures.

You will not be surprised to learn that a very important element of the negotiations at present is the examination of the lists of reservations tabled by the negotiating parties. Achieving a balance of commitments has always been one of the core targets of the negotiations. That such a balance does not imply identical obligations for all Parties, regardless of their level of development and experience with foreign investments will greatly contribute to the possibilities for all countries to participate in the MAI.

## TEMPORARY STAY AND WORK OF INVESTORS AND KEY PERSONNEL

Enery Quinones, OECD Secretariat<sup>1 2</sup>

From the beginning, the topic of 'key personnel' was both an important but highly controversial one. The business sector has stressed the importance of being able to bring into a country, personnel which they believe essential for running their investments in a profitable way. Business also sees the possibility to move key personnel as an indicator of a liberal business climate in host countries. This, however, often runs into a country's immigration and labour laws and policies and thus makes the issue a highly sensitive one.

The problem resides mainly in the political weight of labour market policies under the pressure of persistent mass unemployment in some OECD-countries and of migration. Labour ministries are closely monitored by Parliaments which often adopt restrictive short term measures against unemployment. The political support for a generous treatment of foreigners as a way to improve growth potential in a longer perspective is not always assured. Nevertheless the draft text of the MAI does contain a basic agreement on the movement of investors and key personnel which you will find reproduced in the Consolidated Text. The square brackets indicate where there are still remaining open questions which reflect this domestic policy issue rather than diverging views of negotiating countries.

Negotiators looked at previous agreements having key personnel provisions, such as the GATS and the Energy Charter Treaty. These agreements established a general precedence of domestic labour market rules and combined this with either a best efforts clause or a partial exemption from the application of national rules. The latter solution offers stronger rights to foreign business and was therefore adopted by the MAI-negotiators.

The key personnel article in its present shape thus combines two basic elements:

-- a provision with a 'chapeau', subjecting the movement of key personnel to national laws, regulations and procedures affecting the entry, stay and work of natural persons. It provides that Contracting Parties shall grant temporary entry, stay and authorisation to work to investors committing a substantial amount of capital or to their employees in their capacity of executive, manager or specialists who are essential to the enterprise. The grant of temporary entry and stay - not the authorisation to work - is extended to spouses and minor children.

-- a second paragraph, not subject to the chapeau sets out that entry, stay and authorisation to work may not be denied for reasons relating to labour market or other economic needs tests or numerical restrictions. With regard to these two measures, national legislation does not precede over the MAI. Other restrictions of national labour laws which continue to be applicable and are not affected by this clause are for example health, safety or criminal law considerations.

It is the view of negotiators that such a coexistence of national labour market rules and a more liberal access for foreign investors and their staff takes care of political concerns with regard to

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2 This article has been adapted from a presentation by Mr. Michael Grau made at the MAI Symposium in Korea, April 1997..



unemployment and establishes at the same time new legal rights for investors to which the relevant MAI-disciplines, mainly dispute settlement, can be applied.

In this context it is important that the negotiating parties share the assumption that any further problem of compatibility with national legislation must be addressed by legislative means at home or by country specific reservations and not by further negotiating the key personnel clause. As has become clear during the negotiations, labour market tests and also numerical restrictions will, at least in an initial phase of application of the MAI, occur in many cases, mostly with regard to specialists. The countries concerned accepted that they have to notify these measures upon accession in the form of a country specific reservation.

Negotiators are still considering whether to introduce an anti-abuse clause to try to strengthen the investors rights further: This would provide that a Contracting party shall not invoke national laws as a means of evading its obligations under this article. An alternative option would be the inclusion of a general anti-abuse clause into the MAI, outside the key-personnel-article and valid for the entire agreement although it is not very clear whether this is really legally necessary.

Apart from the anti-abuse clause, two more elements inside the draft MAI-clause continue to pose difficulties. The Negotiating group has been asked for further guidance on these:

-- whether to include a one-year previous employment requirement. There are diverging opinions among negotiating parties. Some say that the investor must retain the possibility of hiring specialised staff when he enters a new market or develops and sells a new product. Others fear that without the requirement of previous employment the risk of abuse would be excessive. This is still bracketed text and there are good economic reasons for not including such language.

-- there continues to be a controversy about whether only nationals of another contracting party or also foreigners residing permanently within its territory shall be entitled to enjoy the rights offered with regard to key personnel. Negotiators have agreed to consider that at least for the purposes of investors, nationals and permanent residents should be covered. They are reflecting further on the inclusion of permanent residents as concerns the categories of executive, manager, and specialist.

The idea to give investors the right to hire foreigners already holding valid permits and documentation in the host country and to not apply national employment quotas to them was originally a bracketed option within the key personnel article. Agreement has now been reached to include such a provision into the MAI outside the key personnel article.

The following issues have now also been settled and are part of the key personnel provisions:

-- **The substantial amount of capital requirement:** This is a complement to the definition of investors for the specific use of this article: The investor has to commit a substantial amount of capital to the enterprise enjoying the right to employ key personnel. There is no definition of what is meant by "substantial amount of capital. An example often cited is that of street trade. Those traders shall not enjoy MAI-privileges but remain subject to ordinary migration and labour legislation.

-- **National governments retain the right to periodically verify the continued eligibility of key personnel.**

-- There is a **no binding obligation to grant authorisation to work to spouses of key personnel**. MAI parties are encouraged to make a best efforts to grant such authorisations but are under no legal obligations to do so.

#### About definitions

There is a distinction between the investor himself and key personnel - The latter are Executives, Managers and Specialists. The specialist, as the most controversial case, is, according to the draft article, somebody who possesses knowledge at an advanced level of expertise and who may be required to possess specific or proprietary knowledge of the enterprises product, service, research equipment, techniques, or management.

#### A final word

While it is relatively certain that the MAI will not go further at this stage as concerns the key personnel provisions, it is still to be decided whether future rounds of negotiations may result in stronger provisions. The general use of inscribing topics as part of future negotiations (after the MAI has been completed and ratified) is known as the concept of a “built-in agenda” and is one which is very much linked to the whole area of special topics, which my other colleagues will speak about. This question is still being negotiated.

## PRIVATISATION AND MONOPOLIES

Huh, Noh-Choong<sup>1</sup>

### I. INTRODUCTION

Mr. Chairman, distinguished guests, ladies and gentlemen,

It is a great honour and pleasure to be with you today to discuss “Setting New Disciplines in the MAI - Privatisation and Monopolies”. I am grateful to the OECD for providing me with this opportunity.

The treatment of investors and their investment in the MAI lies in the basic obligations of National Treatment(NT) and Most Favoured Nation Treatment(MFN). These obligations also hold special meaning in the treatment of investors during privatisation and monopolies.

However, during the early stages of MAI negotiations, the Negotiating Group decided that basic requirements would be insufficient to guarantee non-discriminatory treatment for investors in the areas of privatisation and monopolies. Thus, these two areas have been discussed separately in the MAI, as special topics.

I would now like you to join me in looking through the points raised during the discussions on privatisation and monopolies up to the present time, based on the draft text of the MAI.

### II. Privatisation

In a large number of countries, governments are engaged in an on-going process of transferring ownership and control of firms to the private sector. Privatisation has been identified as an important subject for the MAI. It is an area where the MAI could break new ground since current OECD rules do not fully cover this subject.

The definition of privatisation in the draft text is “the sale or other disposal by a Contracting Party of its equity interest in, or the assets of, a state enterprise or government entity.” It may take effect in one single operation or be spread over time in tranches.

The starting point for the draft provisions on privatisation is that any decision on privatisation remains in the hands of the government. It would be misleading to construe the MAI as imposing an obligation on a Contracting Party to privatise. Governments would also remain sovereign on the method in which they carry out an actual privatisation operation. These could include, among others, public offerings in domestic and international markets and direct sales to investors.

In the current draft text, the applicability of the MAI principle of non-discrimination in the area of privatisation is confirmed. Once a publicly owned enterprise, or a part of such an enterprise, is offered to private investors, the rules on national and most favoured nation treatment would apply -- both to initial and subsequent sales associated with the privatisation operation. Therefore, foreign investors should possess equal rights in the acquisition of government-held assets as domestic investors.

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An issue of heated debate is linked to specific privatisation rules on the ownership or control of privatised assets. The so-called “special shares agreements”, such as the retention of “golden shares”, management/employee buy-outs, special schemes for the public, choice of a particular category of buyers, obligations impending on shareholders requiring the maintenance of their shares for a certain period of time and other similar arrangements, could violate NT/MFN obligations. This would happen whenever they discriminate between investors, whether explicitly or not, granting preferential treatment to some shareholders, whether de facto or de jure.

For many delegations, such “special shares arrangements” should not be considered inconsistent with NT/MFN treatment, unless they explicitly or intentionally discriminate against foreign investors. Others have said that, these special schemes would result in discrimination and should, therefore, be prohibited under the MAI. If this latter approach were to be adopted, reservations would have to be lodged whenever the privatisation program or a specific privatisation transaction entails such arrangements. In turn, this has led some delegations to raise the need for precautionary reservations.

Taking this into account, the importance of the obligation of transparency in the privatisation process, specific transparency obligations were included, separate from the existing general transparency rule. Under the terms of this obligation, a Contracting Party should make all the conditions and procedures relating to a specific case of a privatisation, publicly available.

This can be ensured by giving any information relevant to the privatisation process, such as clearly defined bidding procedures, selection criteria for evaluating bids and financial statements on the company to be privatised. However, the draft article does not specify the information that should be made available. Rather, that is left at the discretion of the Contracting Party concerned.

### III. MONOPOLIES

It is obvious that little room would exist for other investors, in a situation where a monopoly exists be they foreign or domestic, to conduct business. The MAI will not change that. There is, however, broad agreement that government-designated monopolies should be covered by the MAI to ensure that these entities do not treat foreign investors less favourably than national enterprises.

The right of government to create, allow or maintain monopolies could not be challenged under the MAI. Views on whether this principle should be expressly stated or not tend to differ. Some delegations consider that this right should be made explicit for the sake of clarity and certainty. Other delegations, however, insist that it could give rise to questions regarding the obligations on expropriation and compensation and possible market access provisions in the MAI.

It is generally agreed that any government-designated monopoly should act in a manner that is consistent with the MAI obligations on NT and MFN treatment, in its exercising of delegated regulatory powers linked with a monopoly good or service.

This consensus has led to three sub-rules in the present draft text on monopolies. First, a general provision was made, according to which Contracting Parties would have to ensure that covered monopolies do not act in a manner that is inconsistent with the obligations of the agreement. Second, monopolies are required to provide non-discriminatory treatment to investors of other parties to the agreement and their investments in their sales of the monopoly good or service in the relevant market.

Third, monopolies, or monopsonies, are required to provide non-discriminatory treatment in their purchase of the monopoly good or service (with the exception of government procurement).

Furthermore, it has been proposed that Contracting Parties should ensure that monopolies do not use their positions to engage in anti-competitive practices, including through the discriminatory provision of the monopoly good or service, cross-subsidisation or predatory conduct, in non-monopolised markets. I believe some delegations are in favour of such a provision. Others, however, feel that it enters too far into the field of competition policy to be suitable for inclusion in an investment agreement such as the MAI.

Concern has been expressed by some delegations, on demonopolisation, in particular on whether the principle of stand-still would apply in these cases. In fact, some countries might need to lodge new reservations, despite a general agreement on the avoidance of introduction of new reservations after the entry into force of the MAI, because demonopolisation has the effect of extending the obligations under the Agreement to a new area.

Some delegations have suggested that investor-state dispute settlement should not apply under the monopoly provisions. Objections have been raised on such a fragmentation of the dispute settlement system.

#### IV. CONCLUDING REMARKS

As mentioned previously, it is not the intention of the MAI to take away from contracting parties their rights on designation of monopolies, demonopolisation, and privatisation. Rather, the MAI aims to ensure that foreign investors are given NT and MFN treatment from contracting parties in the areas of designation of monopolies, demonopolisation, and privatisation. And to ensure that monopolies do not act against the obligations of the MAI.

I would like to reiterate once again, so as to affirm the fact that the right to decide upon the designation of monopolies, demonopolisation, and privatisation lies solely with the contracting parties.

The MAI stands by the guaranteeing of foreign investors participation in the designation of monopolies, demonopolisation, and privatisation. However, there have been arguments for the right by contracting parties to make policy decisions that discriminate against foreign investors.

As politically sensitive issues, it is difficult to address privatisation and monopolies merely from an economic perspective. Therefore, I hope that the ideas and suggestions by the non-member countries present today can also be reflected in the discussion process of the MAI.

Thank you for your kind attention.

## PERFORMANCE REQUIREMENTS AND INVESTMENT INCENTIVES

Motohiko Kato<sup>1</sup>

### A. Performance requirements

Performance requirements is one of the special topics we are dealing with in the MAI negotiations. You are all aware that it is an important issue.

We can define performance requirements as requirements which governments impose on the performance of investors or enterprises. The goal of these requirements is to secure perceived economic benefits for the country as a whole or for a specific region. However, we must be aware that performance requirements can interfere in the decision-making process within each enterprise. This can lead to market distortions or inefficiencies.

MAI rules on non-discrimination are not sufficiently able to prevent these distortions. As a result, it has been agreed during our negotiations that MAI should prohibit some of these requirements - and apply them to investments from both contracting parties and non-contracting parties.

The aim of the MAI is to go further than existing rules set up by the WTO, TRIMS or NAFTA. This goal can be reached by extending the rules to the field of services, and to performance requirements which distort investment flows even if the investment in question is not related to international trade.

Today, the MAI's work on performance requirements has advanced to the stage of a draft article.

The article is likely to generally prohibit roughly twelve specific performance requirements. Although its length and content remain to be decided, the prohibition will clearly extend to areas such as export and local content requirements.

It is important to note, however, that not all requirements will be prohibited in all circumstances. The article will therefore include provisions to permit performance requirements when the investor receives an advantage - for example, an investment incentive. Requirements falling into this category also include those related to technology transfer, location of headquarters and exclusive supply from a certain facility to certain markets.

Another exception, which is still under discussion, is environmentally-motivated. This exception has been proposed so that countries can take the necessary measures to secure compliance with national laws or regulations, protect animal and plant life and health, and to conserve living or non-living exhaustible natural resources.

Finally, the article will also make exceptions for some performance requirements in the context of export promotion and preferential tariffs or quota programmes. Other proposed exceptions include foreign aid programmes and government procurement.

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1. First Secretary, Economic and Scientific Affairs and Trade, Permanent Delegation of Japan to OECD

## **B. Investment Incentives**

The question of investment incentives is another important issue.

Most countries currently promote foreign direct investment in an active way. In recent years, investment regimes have been considerably liberalised. In consequence, there has been increased competition between countries for foreign direct investment.

Governments that seek to attract investment are usually willing to offer advantages to investors. Many governments are eager to attract investment to their countries. As a result, they are frequently subjected to costly competition with each other over specific investments.

In the MAI negotiations, there is a clear split between countries: While some influential OECD countries maintain that the MAI should not seek to discipline investment incentives, a number of other countries are quite willing to create rules which would do so.

The first group of countries see investment incentives as a legitimate and useful policy tool which can be used to promote economic development through new investment. In this context, certain countries are opposed to specific incentive rules in the MAI. They contend that applying national and most-favoured-nation treatment would be sufficient and that it would still constitute a step ahead from the current situation.

The second group of countries believe that disciplines on investment incentives should be an important part of MAI. A number of proposals have been made regarding possible options for disciplines, although they have not yet been discussed in-depth. Such options include banning so-called positive discrimination and trying to limit the magnitude of certain investment incentives. Some parties argue that disciplines should be accompanied by more elaborate rules than have been envisaged by MAI, namely on notification and transparency, and perhaps on consultations.

Any discipline going beyond national and most-favoured-nation treatment must clearly define incentives. A number of proposals for such a definition have been made throughout the negotiations. They range from a detailed definition which is based on the WTO approach of defining subsidies, to more modest and more general definitions.

Opponents to disciplines have argued that it would be premature to introduce these disciplines in MAI, because they might duplicate or take away from existing and future WTO obligations in the field of subsidies.

Moreover, many countries feel that tax incentives should be excluded from MAI, like other tax measures. Since tax measures are probably the most common type of incentive, several countries question the effectiveness of any discipline not covering them.

## THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES

Ambassador Kjell Lillerud<sup>1</sup>

History, purpose, and treatment of areas such as environment and labour, and association with the MAI.

### Introduction:

The OECD Guidelines for Multinational Enterprises constitute one of four elements in the Declaration on International Investment and Multinational Enterprises which the OECD member states adopted in 1976. They are thus one important part of an overall package of instruments designed to address key issues for international co-operation in the investment area.

The Guidelines establish voluntary standards of conduct for multinational enterprises, and they represent the collective expectation of OECD governments as to the behaviour of such enterprises.

The other three elements of the Declaration are:

- a) a *National Treatment Instrument* providing that OECD members should treat foreign-controlled enterprises operating in their territories no less favourably than domestic enterprises in like situations;
- b) an *instrument on Investment Incentives and Disincentives* that encourages transparency and provides for consultation and review;
- c) an *instrument on Conflicting Requirements* designed to avoid or minimise the imposition by OECD governments of conflicting requirements on multinational enterprises and to provide a forum for consultation.

The Declaration is essentially a political undertaking, but it is supported by various legally binding Decisions of the OECD Council that provide for active follow up procedures covering all the four elements of the Declaration. The Declaration is one of several important points of departure for the negotiations of a comprehensive treaty like the MAI. That is why the Guidelines for Multinational Enterprises are highly relevant when we address MAI rights and responsibilities.

### History and Purpose

Looking back to 1976, when the Guidelines were introduced, we see a rather different scene than the one prevailing today. The general economic situation was very different, and so was the environment for international direct investment and multinational enterprises. Such enterprises were often the focus of widespread and critical attention in many countries, and many regarded them as excessively large and powerful, and in some respects beyond the authority of the individual sovereign state.

Multinationals were accused of using their power disruptively. Typical concerns included the abuse of dominant market positions, a lack of commitment to the host economy or insufficient integration in the domestic business environment. Many were also concerned about the stability of their operations and decisions taken on the basis of global corporate strategies not necessarily linked to the local situation. All

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the concerns, whether real or not, explain why the Guidelines for Multinational Enterprises came into being in 1976. They were part of the OECD response to the concerns that had arisen in the field of international investment and multinational enterprises.

In 1976 the Guidelines represented a very innovative instrument, being the first internationally agreed framework for co-operation in the field of international direct investment and multinational enterprises which was also accepted and supported by business and labour. The Guidelines have served as reference points for work on similar instruments in, for instance, the UN and the ILO.

Since 1976 perceptions of and attitudes towards multinational enterprises have evolved considerably, not least in the OECD countries. Many factors are responsible for this development, and much of it can be linked to trends in international direct investment and the experience with and performance of multinational enterprises. International investment has grown considerably and it has become much more diverse. Greater diversity, and the growing number of actors in international direct investment has diffused many previous concerns.

The Guidelines themselves have also contributed to changed attitudes by providing a common frame of reference, and by assisting multinational enterprises to ensure that their operations and activity are compatible with the expectations of host countries.

Of course, issues and difficulties still arise from the activities of individual multinational enterprises. Multinational, like domestic companies, still close activities or make other changes in their operations which may pose difficulties for labour or for host governments. Concern still arise when key decisions affecting the foreign located subsidiary are taken elsewhere, when there are difficulties in having access to those responsible for decision making, or when the parent company places restrictions or limitations on certain of the activities of the foreign located subsidiary.

As multinational enterprises organise their operations beyond the national framework there is always scope for abuse of concentrations of economic power and for conflicts with national policy objectives.

The common aim of the OECD members is to encourage the positive contributions which multinational enterprises can make to economic and social progress, and to minimise and resolve the difficulties which may arise from their operations. One important purpose of the Guidelines is thus, inter alia, to respond to the transnational character of such enterprises by furthering increased co-operation among countries in which the enterprises operate.

As mentioned earlier, the Guidelines are voluntary and, consequently, not legally enforceable. This does not, however, imply less commitment by OECD governments to encourage their observance. The rationale is that internationally agreed guidelines can help prevent misunderstandings and build an atmosphere of confidence and predictability between business, labour and governments. Alongside with national laws, the Guidelines form part of a legal infrastructure which promotes responsible behaviour by Multinational Enterprises.

### Coverage

The Guidelines are divided into separate chapters which cover the range of activities by multinational enterprises. These chapters deal with: general policies, information disclosure, competition, financing, taxation, employment and industrial relations, environment and science and technology. I will refrain from going into all these chapters, and, as the heading of this presentation indicates, concentrate on labour and environment.

### Labour: employment and industrial relations

The chapter on employment and industrial relations encourages enterprises to respect employees' rights to representation, refrain from unfair influence in labour negotiations or during organising campaigns, and to negotiate constructively on employment conditions.

The chapter contains some rather specific recommendations on these issues, and they should all be seen in conjunction with the prevailing laws, regulations and labour relations and employment practices in each country where enterprises operate.

As indicated earlier, it is significant that the Guidelines are supported by both business and labour in the OECD area. For the TUAC (Trade Union Advisory Committee) there is no doubt that the chapter on employment and industrial relations is important in this respect.

### Environment

The chapter on environment was introduced into the Guidelines and adopted by the OECD Council in 1991, in response to the ever increasing public awareness and concern with the protection of the environment. It should be noted that concerns about the protection of the environment are of a general nature and are not, therefore, limited to the actions by enterprises. Actions by governments are equally important. Furthermore, the dealing with environment in the Guidelines should not be seen as singling out multinational enterprises for special attention. Both domestic and multinational enterprises are subject to the same expectations with respect to their conduct whenever the Guidelines are relevant to both.

Nevertheless, multinational enterprises are often in the forefront in terms of action relevant to the environment, for example through technological knowledge, and it is therefore logical that they are urged to take due account of the need to protect the environment and to avoid environmentally related health problems in their operations. As in the field of labour relations, any action by multinationals shall be within the framework of laws, regulations and administrative practices in the countries in which they operate.

### Association with the MAI

As I mentioned earlier, the Guidelines being one of the important points of departure for the MAI-negotiations, it is to be expected that their association or linkage with the MAI has become an issue in the debate. And an important one.

There is not yet any "single OECD" view on how to associate the Guidelines with the MAI. But there seems to be a clear emerging view that;

- a) the voluntary status of the Guidelines should be preserved,
- b) the Guidelines should be unambiguously reaffirmed in the context of finalising the MAI,
- c) there is a need to revise and update the Guidelines, but only after the finalization of MAI,
- d) non-OECD-countries joining the MAI will be required to take on a similar commitment in relation to the Guidelines as OECD members.

There are various technicalities to sort out before we reach consensus on these issues, and you will get a picture of the situation by looking at Chapter X in the draft Consolidated Text.

The interesting question here, of course, is whether you see that inclusion of the Guidelines in the MAI will have any impact on your Government's overall assessment of whether they should join the Agreement. Will inclusion of the Guidelines facilitate accession or not? Or will it not make any difference

at all. Quite opposite views are voiced within the OECD circle in this regard. Those sceptical towards the Guidelines would argue that a requirement to sign up the Guidelines would deter non-OECD countries from joining the MAI. Others, feeling that the Guidelines represent an important, albeit political, influence on the behaviour of multinational enterprises, would argue that the non-OECD countries could see political and economic advantage in having the Guidelines in operation in their countries. It would be very interesting to hear your own views on this.

## **EMPLOYMENT AND INDUSTRIAL RELATIONS (Extract from Guidelines)**

Enterprises should, within the framework of law, regulations and prevailing labour relations and employment practices, in each of the countries in which they operate:

1. Respect the right of their employees to be represented by trade unions and other bona fide organisations of employees, and engage in constructive negotiations, either individually or through employers' associations, with such employee organisations with a view to reaching agreements on employment conditions, which should include provisions for dealing with disputes arising over the interpretation of such agreements, and for ensuring mutually respected rights and responsibilities;
2. a) Provide such facilities to representatives of the employees as may be necessary to assist in the development of effective collective agreements;  
b) Provide to representatives of employees information which is needed for meaningful negotiations on conditions of employment;
3. Provide to representatives of employees where this accords with local law and practice, information which enables them to obtain a true and fair view of the performance of the entity or, where appropriate, the enterprise as a whole;
4. Observe standards of employment and industrial relations not less favourable than those observed by comparable employers in the host country;
5. In their operations, to the greatest extent practicable, utilise, train and prepare for upgrading members of the local labour force in co-operation with representatives of their employees and, where appropriate, the relevant governmental authorities;
6. In considering changes in their operations which would have major effects upon the livelihood of their employees, in particular in the case of the closure of an entity involving collective lay-offs or dismissals, provide reasonable notice of such changes to representatives of their employees, and where appropriate to the relevant governmental authorities and co-operate with the employee representatives and appropriate governmental authorities so as to mitigate to the maximum extent practicable adverse effects;
7. Implement their employment policies including hiring, discharge, pay, promotion and training without discrimination unless selectivity in respect of employee characteristics is in furtherance of established governmental policies which specifically promote greater equality of employment opportunity;
8. In the context of bona fide negotiations with representatives of employees on conditions of employment, or while employees are exercising a right to organise, not threaten to utilise a capacity to transfer the whole or part of an operating unit from the country concerned nor transfer employees from the enterprises' component entities in other countries in order to influence unfairly those negotiations or to hinder the exercise of a right to organise;

9. Enable authorised representatives of their employees to conduct negotiations on collective bargaining or labour management relations issues with representatives of management who are authorised to take decisions on the matters under negotiation.

## **ENVIRONMENTAL PROTECTION**

Enterprises should, within the framework of laws, regulations and administrative practices in the countries in which they operate, and recalling the provisions of paragraph 9 of the Introduction to the Guidelines that, inter alia, multinational and domestic enterprises are subject to the same expectations in respect of their conduct whenever the Guidelines are relevant to both, take due account of the need to protect the environment and avoid creating environmentally related health problems. In particular, enterprises, whether multinational or domestic, should:

1. Assess, and take into account in decision making, foreseeable environmental and environmentally related health consequences of their activities, including siting decisions, impact on indigenous natural resources and foreseeable environmental and environmentally related health risks of products as well as from the generation, transport and disposal of waste;
2. Co-operate with competent authorities, inter alia, by providing adequate and timely information regarding the potential impacts on the environment and environmentally related health aspects of all their activities and by providing the relevant expertise available in the enterprise as a whole;
3. Take appropriate measures in their operations to minimise the risk of accidents and damage to health and the environment, and to co-operate in mitigating adverse effects, in particular:
  - a) by selecting and adopting those technologies and practices which are compatible with these objectives;
  - b) by introducing a system of environmental protection at the level of the enterprise as a whole including, where appropriate, the use of environmental auditing;
  - c) by enabling their component entities to be adequately equipped, especially by providing them with adequate knowledge and assistance;
  - d) by implementing education and training programmes for their employees;
  - e) by preparing contingency plans; and
  - f) by supporting, in an appropriate manner, public information and community awareness programmes.

## INSTITUTIONAL ISSUES AND ACCESSION TO THE MAI

Nick Griffiths<sup>1</sup>

### I. Legal Framework

If the negotiation is completed as planned, OECD Ministers will sign the MAI in April next year. At the same time, Ministers will also sign a Final Act. The main purpose of this Act will be to provide a formal basis for the preparatory work before the MAI enters into force.

The Final Act will probably name a target date for entry into force, perhaps between one and two years later. The final decision, however, is likely to be left to the signatories, probably on similar lines to the mechanism used for the WTO.

### II. Institutions: the Preparatory Group and the Parties Group

The Final Act will establish a Preparatory Group with all signatories as members. This Group will operate until the MAI comes into force. One of its main tasks will be to handle applications to join by non-OECD members. Successful applicants would be entitled to participate in the Group on the same terms as OECD members. As well as this task, the Group will also be responsible for the setting up of administrative arrangements, secretariat, budget, etc.

The Parties Group will come into operation when the MAI comes into force. There is still some uncertainty about its character. Some see the MAI as simply a framework of rights and obligations together with a procedure for settlement of disputes. The Parties Group would therefore concentrate on the important task of handling new accessions. Others see the Parties Group as a new institution to act as a forum for debate and for carrying forward a wider policy agenda. In practice, it is probable that its character will evolve to suit the actual future needs of MAI members.

The decision-making rules for the Parties Group are likely to be based on consensus as much as possible, although most delegations recognise the need for some flexibility, particularly on procedural issues. A decision-making process similar to that used in the WTO is being considered. It is not yet clear whether decisions on accessions will be based on consensus, or on some form of majority vote.

### III. Accession

The draft Article in the MAI Consolidated Text dealing with the Preparatory Group gives the Group the power to:

- conduct discussions with non-signatories to the Final Act.
- conduct discussions with interested non-signatories to the Final Act and make decisions on their eligibility to become a Signatory to the Agreement.

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1. First Secretary, Trade and Investment, Permanent Delegation of the United Kingdom to OECD

The draft Article on accessions reads as follows:

1. This agreement shall be open for accession by any State, regional economic integration organisation, and any separate customs territory which possesses full autonomy in the conduct of matters covered by this agreement, which is willing and able to undertake its obligations on terms agreed between it and the Parties acting through the Parties Group.
2. Decisions on accession shall be taken by the Parties Group.
3. Accession shall take effect thirty days from the date of deposit of the instruments of accession with the Depositary.

Non-OECD members will thus have the option either of joining the MAI as original signatories before it enters into force, or of acceding to the MAI after it enters into force. There is unlikely to be much procedural difference between the two, but original signatories would have the advantage of being able to participate in the Preparatory Group. The process of accession will be the same for all, including any OECD Members who were not original signatories. The basic requirement for signing the Agreement will be the country's willingness and ability to accept the core obligations of the MAI. Each country, whether an OECD Member or not, will be able to negotiate its terms of accession, and in particular its country-specific reservations.

It has been more-or-less agreed that it will be left to the Preparatory and Parties Groups to work out the mechanics and conditions for accession. In practice a minimum standard will probably emerge, although this is unlikely to be formally defined. MAI members will naturally be reluctant to accept standards of liberalisation that are significantly worse than the lowest member country standard. They will wish to maintain the MAI as a high standard agreement, which gives investors proper security. To that end it has been broadly agreed that there should be no reservations on systemic matters, such as the definition of investment, investor protection obligations or the core elements of the dispute settlement regime. Reservations should thus focus on the substantive obligations of the MAI, notably national treatment and MFN. It is likely that accession will involve some form of examination as part of the negotiating process, perhaps on similar lines to the WTO accession process, or to OECD style examinations.

It is possible that there might be some form of transition period for new applicants, by which they could be invited to accede at an overall level of liberalisation below the required standard, subject to an obligation to reach that standard within an agreed time-frame. This is also likely to be left to the Preparatory Group to decide.

#### **IV Conclusion**

The MAI will be a free-standing international treaty open to accession to OECD members and non-members alike. All MAI members will participate on an equal basis.

OECD members are united in their wish to see the benefits of MAI membership extended to all who wish to join it, and are able to meet its obligations. The draft provisions in the MAI text are designed to enable this process to begin soon after the Final Act is signed.

## THE INTERESTS OF NON-MEMBERS IN JOINING THE MAI

Hong-Jae Im<sup>1</sup>

We are presently on the threshold of an historic moment for all countries actively involved in the global economy to seize the opportunity to secure and thereby encourage the inflow of foreign direct investment in their domestic economies. The instrument, which is under negotiation at the OECD and is designed to facilitate this action, is known as the Multilateral Agreement on Investment (MAI). The previous speakers have eloquently commented upon the benefits of foreign direct investment, the purpose and characteristics of the MAI and its relationship with other areas, as well as the accession procedure to the MAI. Accordingly, in this context, I wish to focus my comments on some aspects regarding non-OECD Member Countries.

[The MAI Mandate]

Recognizing the primordial role played by international investment in economic development, the MAI mandate seeks to establish a broad multilateral framework for international investment with high standards for the liberalization of investment regimes and investment protection and with effective dispute settlement procedures. The MAI would be a free-standing international treaty in which OECD and non-OECD members, willing and able to take on the commitments of the MAI, would participate on an equal footing.

[Why the MAI negotiations are conducted at the OECD?]

To achieve the MAI mandate, the OECD is believed to be the logical forum to conduct the MAI negotiations in view of the high level of investment flows within the OECD area and the OECD's proven capacity and experience in this field. With regard to investment flows, the OECD countries account for a large share of foreign direct investment. Some 85% of all outflows and almost 70% of all inflows are taking place within the OECD area.<sup>2</sup>

With respect to the OECD's proven capacity in the field of international investment, the OECD has traditionally been in the vanguard in the development of investment rules. The Member Countries share a common outlook towards FDI and a long experience in promoting investment liberalization through existing instruments. The OECD investment instruments consist of the Code of Liberalization of Capital Movements (adopted in 1961), the Code of Liberalization of Current Invisible Operations (adopted in 1961), the National Treatment instrument (adopted in 1976), and the Declaration on International Investment and Multinational Enterprises (adopted in 1976). These instruments have played a major role in maintaining and improving the investment environment in the OECD area. Why then is a new agreement for investment needed? These current instruments have limitations with respect to FDI.<sup>3</sup> The binding elements of the Capital Movements Code apply only to the pre-establishment phase. The post-establishment phase is governed by NTI, which is non-binding.

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<sup>1</sup> Counsellor, Permanent Delegation of the Republic of Korea to OECD

<sup>2</sup> William Witherell, Director for Financial, Fiscal and Enterprises Affairs, OECD, Remarks at the International Conference on the Asia-Pacific Economy, Sydney, Australia (September 1997)..

<sup>3</sup> Alister Smith, "The Development of a Multilateral Agreement on Investment at the OECD: a Preview," Towards Multilateral Investment Rules, OECD, Paris, 1996, p. 34..



The working methods of the OECD, based upon confidential dialogue and peer pressure in an intimate atmosphere, have proven to be effective and practical in negotiating the rules of game. This is particularly striking to Korea, the Benjamin of the Organization. The OECD, which consists of generally like-minded countries, has enjoyed a high degree of homogeneity among members, sharing basic values of open market economy, plural democracy and respect for human rights. Even though the degree of economic development varies to a certain extent, the OECD Members are close to each other in many aspects [very close economic and political ties, interdependence, tradition of good faith, and respect for international commitments]. Peer pressure, unique to the OECD, works very well in this atmosphere, which, combined with confidential dialogue, will promote the effective negotiation of a set of wide-ranging and complex rules for investment within a short period of time.

#### [Accession of Non-Member Countries to the MAI]

To follow-up on the discussion of the previous speakers with regard to the accession procedure to the MAI, it would be very useful to highlight some of the provisions of accession of non-Members to the MAI, as described in the draft Agreement. First, the draft states that the MAI is open for accession by any State, regional economic integration organization, and any separate customs territory with full autonomy, which is willing and able to undertake its obligations on terms agreed between it and the Parties Group. Second, the decision on accession shall be taken by the Parties Group. Third, accession shall take effect on the 30th day following the deposit of the instruments of accession. The draft Agreement does not embody the criteria for willingness and ability. I believe this willingness and ability will be closely examined and assessed during the accession negotiation.

#### [Potential Benefits of MAI Accession]

The potential benefits to be gleaned from MAI accession encompass issues which seek to provide greater protection and security for the investor and the investment. The Secretariat noted, through consultations with non-Member countries, that a number of non-OECD Members wish to join the MAI for the same reasons as the OECD countries.<sup>4</sup>

- First, MAI signatories can expect to attract greater investment flows because the MAI will establish a new internationally recognized standard of market access and legal security for potential investors. In this regard, the MAI will prove to be a more potent instrument than bilateral treaties because it will cover all phases of investment, including the entry and establishment phase, and it will have stronger dispute settlement provisions.
- Second, for countries that are also capital exporters, the MAI will offer market access guarantees and legal security in most of the world's major investment destinations. The scope of the MAI, which will cover all economic activity, including all manufacturing and natural resources and services, will surpass other international treaties and bilateral investment treaties.
- Third, upon signing the MAI, the acceding country will have access to the "MAI Parties Group" which will facilitate the implementation and operation of the agreement. All countries will participate in the Parties' Group on an equal footing.

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<sup>4</sup> Witherell, op. cit..

### [Why Then do Some Countries Say They are Unprepared to Accept the MAI?]

Despite such potential benefits, some countries may have doubts about the implications of MAI accession upon their domestic enterprises, the settlement of disputes, and their sovereignty over investment in their country. I wish to briefly elaborate upon each of these.

- First, some domestic companies may believe that they are unprepared to compete on an equal footing with multinational enterprises which usually possess far superior endowments in capital, technology, production, and marketing. As stated in the draft MAI, since a Contracting Party shall accord national treatment and most-favored-nation treatment to the investors of another Contracting Party and to their investments [in the like circumstances], foreign companies must be given the same rights as domestic ones. While some domestic enterprises may be unprepared to compete on an equal footing with multinational enterprises, in the long-run, they will be able to benefit from the MAI's level playing field approach to strengthen their competitiveness. The overall spirit of the MAI's provisions affirms the positive contributions of competition upon the domestic economy and its sustained development.

- Second, some concern could be expressed that the MAI may significantly augment the dispute settlement claims. The MAI provides detailed procedures for dispute settlement, not only for State-to-State dispute, but also for investor-to-State dispute for investment through all investment phases. So, under the MAI, companies are allowed to sue countries directly. This situation, which is currently occurring under the NAFTA, is said to be problematic. With regard to the concern that the same situation may occur under the MAI, I expect that there are ample opportunities to amicably resolve most of the dispute claims through consultation. All dispute claims will not necessarily be submitted automatically to arbitration. The submission to arbitration will only be a last resort.

- Third, accession to the MAI may limit national sovereignty with respect to investment policies. All international agreements contain elements which call for the relinquishing of sovereignty; however, this process only occurs through agreement by the governments of the Contracting Parties. At the same time, with regard to the MAI, the Contracting Parties will be allowed to make reservations for their control over the framework of investment, which is believed to be necessary for the effective management and operation of their investment regimes. The MAI does not take away sovereignty from the Contracting Parties.

### [Implications of MAI for African Countries]

A principal priority for the African region as well as other regions is sustained economic growth and development. Policy-makers, involved in examining various policy tools and policy mixes to achieve this goal, also take into consideration the role FDI plays in this process. As noted by the previous speakers at this symposium, the key to economic growth and prosperity lies with investment which unlocks economic resources, propels economic growth, and enhances trade.

As the developed and developing countries exist in an increasingly globalized world, their economic futures become mutually interdependent. The following data recently published by the OECD<sup>5</sup>

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<sup>5</sup> OECD, Towards a New Global Age: Challenges and Opportunities, C/MIN(97)25, OECD, Paris, 1997, pgs. 15-19

To reiterate some comments delivered by our previous speakers, the OECD's key purpose in intensifying its Outreach to non-Members, and particularly with respect to the MAI, is to strengthen its ties with the non-Member countries, to extend the MAI mandate, and to make the MAI compatible with the overall multilateral system as well as a useful instrument which contributes to this system.

confirm this point. According to the OECD's "high performance scenario," by the year 2020, the global economic weight would shift towards the present non-OECD countries. Their weight in the global economy could increase to more than 60% (from around 40% in 1995). During this same time period, their share in world trade could rise from one-third to one-half. The "economic catching-up" by non-OECD economies could see their standards of development rise to 30% of those found in the OECD area in 2020, compared with about 15% in 1995. Linkages among all economies will become much closer as trade might rise from 30% of world GDP today, to some 50% in 2020.

The OECD states that the non-OECD countries will be able to realize this high-performance outcome if policy-makers adopt the appropriate policy decisions and undertake the necessary reforms. In the important area of international investment, to encourage investors to invest and to promote the most efficient utilization of investment resources require a stable and secure economic, legal, political, and social environment. In a functioning market economy, such an assumption seems natural and logical. The main purpose of my comments is to demonstrate the advantages and some drawbacks which will be incumbent upon a country acceding to the MAI.

When making an investment decision, an investor seriously considers numerous variables, including the size and dynamic nature of the market, as well as its geographical proximity. The investor takes into account the extent of liberalization of the host country's investment system. In regard to this last point, the MAI will make a significant contribution.

The MAI represents an ambitious task, and while it may prove too soon for some non-OECD countries to accede to the MAI, the elements and criteria of the MAI will offer useful policy advice and

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In this effort, since 1995, some MAI Outreach events have taken place in the context of a regional workshop in the following countries: Brazil (Latin American region); New Zealand, Hong Kong and Korea (Asian-Pacific region); Estonia (Baltic Rim and Central European region); and Egypt (African countries). In addition, regular briefings are conducted in Paris between members of the MAI Bureau and non-Members. During the Negotiating Group meeting in mid-September, five non-OECD economies - Argentina, Brazil, Chile, Hong Kong, and the Slovak Republic - joined the Negotiating Group as "Observers" for the first time. Further, a special session of the MAI Negotiating Group, held at the same time period, brought together the negotiators from the OECD countries and senior investment policy officials from a number of interested non-OECD countries.

To reiterate some comments delivered by our previous speakers, the OECD's key purpose in intensifying its Outreach to non-Members, and particularly with respect to the MAI, is to strengthen its ties with the non-Member countries, to extend the MAI mandate, and to make the MAI compatible with the overall multilateral system as well as a useful instrument which contributes to this system.

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direction to policy-makers during the policy formulation process. The MAI negotiations are laying the necessary foundation for securing and protecting both investors and investment which will enhance the level and standard of international investment. Benefits will be gleaned from the MAI if the policy advice and lessons provided by the MAI are integrated into investment policy decisions.

To reiterate some comments delivered by our previous speakers, the OECD's key purpose in intensifying its Outreach to non-Members, and particularly with respect to the MAI, is to strengthen its ties with the non-Member countries, to extend the MAI mandate, and to make the MAI compatible with the overall multilateral system as well as a useful instrument which contributes to this system.

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## **DISPUTE SETTLEMENT**

### **Ambassador Marino Baldi<sup>1</sup>**

The MAI shall be an agreement with high standards for the treatment and protection of investments. In order that such high standards are properly implemented by Contracting Parties, an effective dispute settlement system is necessary which, in principle, covers all obligations under the MAI. Such a dispute settlement system is needed not only because it helps to solve possible disputes under the MAI through formal proceedings, but also -- and perhaps even more importantly -- because it encourages dispute avoidance and helps to resolve divergencies of views informally. It is, therefore, in any case, highly important for the credibility and the viability of the MAI that parties to a dispute have recourse to binding arbitration in the event of an alleged breach of the Agreement and this in two ways: for States wishing to take action against another state (state-to-state arbitration) and for investors wishing to directly submit a case to arbitration against their host country (investor-to-state arbitration).

The MAI Negotiating Group entrusted Expert Group N°1 on Dispute Settlement and Geographical Scope with the task of developing a dispute settlement system. After thorough discussions on the scope and the possible features of such a system, broad agreement was reached on the basic elements and on most of the issues that came up in the negotiations. The text that resulted from this work was submitted a few months ago to the Negotiating Group for further consideration and resolution of the outstanding points. In my presentation, I shall first give an overview of the main elements of the dispute settlement system, after which I shall briefly explain some of the issues that proved the more difficult ones in our negotiations.

#### **I. Main characteristics of the system**

##### *i) State-to-state arbitration*

With regard to state-to-state arbitration, five points can be highlighted:

- a) Following the precedent set by the WTO, the Contracting Parties to the dispute should, as a first step, attempt to resolve their dispute through consultations. If the Contracting Parties fail to come to an amicable solution, the dispute may, at the request of any Contracting Party to the dispute, be submitted to an *arbitral panel*.
- b) Panels shall consist of either three or five members. Three members will be selected by agreement of the Parties to the dispute, based on a proposal made by the Secretary-General of ICSID. Either disputing Party can opt for a five member panel, in which case each will appoint one additional member. This represents a compromise between those favouring an arbitrator being appointed by each of the two disputing parties ("party arbitrators"), as in most bilateral investment agreements, and those believing that a majority of non-party arbitrators is preferable for a multilateral agreement, which should develop an institutional jurisprudence.

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1. Ambassador Baldi is Chairman of Expert Group N°1 on Dispute Settlement and Geographical Scope. He is also Deputy-Director of the Federal Office of External Economic Affairs, Bern, Switzerland.

c) The MAI will set out basic rules and procedures for state-to-state arbitration. However, for particular disputes, the Parties to the dispute can always agree to apply modified rules. If gaps in the MAI rules appear during a dispute and the Parties are not able to agree on supplementary rules, the PCA Optional Rules for Arbitrating Disputes between two States (=UNCITRAL rules) serve as default rules.

d) The substantive law to be applied would be the provisions of the MAI, but other international law would be relevant as concerns the interpretation and application of a treaty. Domestic law could be taken into account where it is relevant to and consistent with the MAI.

e) Awards issued by a Panel will be final and binding upon the Parties to the dispute. An award shall be provided first to the Parties as a draft to give them the opportunity to comment. This procedural safety valve should help to avoid aberrant decisions, particularly with respect to questions of fact. Possible remedies that a panel may include in an award are: a declaration that an action is in contravention of a provision of the MAI; the granting of a pecuniary award; a recommendation that a Party bring its measures into conformity with the MAI; or any relief to which the Party against whom the award is made consents (this may include restitution in kind).

*ii) Investor to state arbitration*

There has always been agreement that in addition to state-to-state arbitration there should exist an investor-to-state procedure. Investors generally wish to have at their disposal a dispute settlement mechanism that they can activate. Governments also see advantages in dispute settlement procedures to which they do not need to become a party. Yet, if there is general agreement that the MAI should provide for investor-to-state arbitration, it is not yet absolutely clear whether such arbitration should cover all disciplines of the MAI.

What would be the main characteristics of investor-to-state arbitration? Three basic elements may be mentioned:

- a) The investor may choose whether to submit the dispute for resolution to one of the following:
- any competent court or administrative tribunal of the Contracting Party to the dispute;
  - in accordance with any dispute settlement procedure agreed on prior to the dispute arising; or
  - the procedures provided for by the MAI.
- b) MAI Parties, through the adoption of the Agreement, will give unconditional consent to submission of a covered dispute to arbitration, under:
- the ICSID rules of arbitration or under the rules of the ICSID Additional Facility;
  - the UNCITRAL rules; or
  - the ICC Court of Arbitration.

Prior consent by the Contracting Parties practically means that in a given case it is exclusively up to the investor to decide whether or not to refer the dispute to arbitration.

c) The forms of relief that awards of any of these tribunals may provide will be specified in the MAI. They include: a declaration that the Contracting Party has failed to comply with its obligations under the MAI; pecuniary compensation; restitution in kind in appropriate cases and, with the consent of all Parties to the dispute, any other form of relief.

## **II. Difficult issues and open questions**

Let me now, after this description of the dispute settlement system as a whole, turn to some of the issues that in our negotiations proved to be politically sensitive and on which it was, or still is, particularly difficult to find solutions.

### **a) *State-to-state arbitration***

#### *Role of the Parties Group*

An important question, which may still not be entirely solved, is whether the Parties Group should have a role in dispute settlement, particularly as a forum for multilateral consultations that precede state-to-state arbitration in addition to bilateral consultations. We tentatively agreed that the Parties Group should have such a role, though a limited one: in the event bilateral consultations have failed to resolve a dispute, the Parties to the dispute may, by agreement, request the Parties Group to consider the matter and to make the recommendations it deems appropriate. The more straightforward solution supported by some delegations would have been a unilateral right of the Parties to the dispute to request multilateral consultations.

#### *Ripeness of a dispute for arbitration*

Another difficult issue within the state-to-state procedure that so far has only been solved on a provisional basis, relates to the question of when a dispute is ripe for arbitration. The main question is whether a Party that wants to challenge a measure of another Contracting Party would have to demonstrate concrete harmful effects of that measure or whether potential harmful effects (abstract non-compliance with the MAI) would suffice. As a result of our discussions we drew the line somewhat differently: on the one hand we found that merely theoretical harmful effects should not prompt a “legal dispute”. On the other hand an immediate threat of harm or damage could in our view well constitute a case for arbitration. At what point a dispute would be ripe for arbitration would ultimately be for an arbitral panel to decide, in the light of all the relevant circumstances.

#### *Enforcement of awards*

Another important unsolved question concerns the enforcement of awards. What measures or countermeasures shall be permitted to bring about compliance with an arbitral award? Possible measures are the suspension of the non-complying Party’s voting right in the Parties Group and its right to invoke the dispute settlement provisions of the MAI. The point at issue is what countermeasures should be allowed: should the MAI explicitly provide for measures which could be taken against a Contracting Party that does not comply with an arbitral award? If so, should such measures be confined to the withdrawal of concessions under the MAI or should no such limits be imposed (with the consequence that countermeasures would be allowed if taken in conformity with general principles of public international law)? Another possible approach would be not to permit countermeasures and instead provide for the payment of pecuniary compensation (punitive damages).



## ***b) Investor to state arbitration***

### *Scope of arbitration procedure*

The scope of investor-to-state arbitration has been debated at great length. The main question was whether investor-to-state procedures should apply to all MAI obligations, including those relating to the pre-establishment phase of an investment, or whether such procedures should only be applicable to post-establishment questions? We eventually decided not to make use of the distinction between pre-and post-establishment issues in relation to dispute settlement (the distinction would anyway not have been very practicable) and in principle to subject all MAI obligations to both dispute settlement procedures, i.e. state-to-state and investor-to-state procedures. It should, however, be mentioned in this context that some delegations take the view that a few particular MAI disciplines should be excluded from investor-to-state dispute settlement.

### *Prior consent*

Although I mentioned prior consent as one of the main characteristics of the investor-to-state procedure, which it undoubtedly is, it should be noted that a few delegations still do not accept the idea of prior consent at all. The draft dispute settlement text provides for prior consent without mentioning any possibility for country specific reservations. The countries in question will therefore have to find a solution to their problem. There is one important qualification to the prior consent rule: Contracting Parties will be allowed to withhold consent in cases where the investor has previously submitted the dispute either to a national court or to international arbitration in accordance with any other dispute settlement procedure. In other words: Contracting Parties are entitled to impose what is called a “fork in the road”.

### *Standing*

There was much debate in the negotiations on whether a company established in a MAI country that is controlled by an investor of another MAI country would have standing to act as the foreign investor in bringing a claim to arbitration against the host government. To take an example: would, in a case involving Volkswagen United States as an investment of Volkswagen Germany, the former company, i.e. Volkswagen US, have standing before an arbitral tribunal or would only Volkswagen Germany, as the investor, be entitled to submit the case to international arbitration? There are good arguments in favour of the more generous of these solutions (the two companies would alternatively have standing) but also understandable concerns about it. The Expert Group on Dispute Settlement decided to give standing to the investment (in my example, Volkswagen US) but also to allow country specific reservations with respect to this rule.

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