C.D. Howe Institute
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Communiqué

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Global investment agreement needed to complement trade liberalization, says C.D. Howe Institute study

A comprehensive set of multilateral rules on investment is essential to reap the full benefits of the Uruguay Round of trade liberalization, argues a study released today by the C.D. Howe Institute. The study urges that progress be made in negotiations on a multilateral agreement on investment (MAI) currently under way among the industrialized countries, and that formal work on investment rules concerning foreign direct investment (FDI) be placed on the agenda of the next ministerial meeting of the World Trade Organization in Singapore in December 1996.

Entitled *Investment Rules for the Global Economy: Enhancing Access to Markets*, the study is a collection of essays co-edited by Pierre Sauvé, Principal Economist in the Trade Directorate of the Organisation for Economic Co-operation and Development in Paris, and Daniel Schwanen, Senior Policy Analyst with the C.D. Howe Institute. The essays, written by experts on trade, investment, and competition policies, are based on the observation that rules governing the presence of foreign firms in a country are an essential underpinning of the ability of these firms to secure effective access to that country's markets.

The essays document the fact that, although national markets have been largely opened up as a result of successive rounds of multilateral trade negotiations, numerous discriminatory restrictions continue to hamper the ability of firms to contest foreign markets by means of an established presence. In a globalizing context, the restrictions ultimately may nullify the benefits of other liberalizing measures. So far, neither traditional trade negotiations, nor the application of domestic competition laws, nor regulatory reforms in various countries have been able to remove these barriers, leaving much that multilaterally agreed rules could do to open up and codify practices related to FDI.

Highlights of the collection of essays include the following:

- Michael Hart, of the Centre for Trade Policy and Law in Ottawa and the Monterey Institute for International Studies, explains why now is the time for multilateral rules on investment, based on the historical record, the new economic context, and the sheer benefit of simplifying a system mostly based on a hodge-podge of bilateral agreements.

- Pierre Sauvé and Edward M. Graham, of the Washington-based Institute for International Economics, provide an overview of existing international instruments with respect to investment, and identify key substantive provisions and negotiating challenges — with respect to investment liberalization, investor protection, and dispute settlement — that a successful agreement must resolve.
- Alan Rugman, of the Faculty of Management at the University of Toronto, and Michael Gestrin, an economist with the United Nations Conference on Trade and Development, writing about a blueprint for an agreement, argue that negotiators should look at the investment provisions of the North American Free Trade Agreement (NAFTA) as the most logical model for a global investment agreement.
- Someshwar Rao and Ash Ahmad, both of Industry Canada in Ottawa, catalogue formal and informal investment barriers in the Group-of-Seven major industrialized countries and provide a practical scorecard against which the success of any agreement must be measured.
- Mark Warner, of the Center for International and Comparative Law at the University of Baltimore, argues that it is important to identify whether the source of a restraint to trade stems from the behavior of private actors or from public policy before deciding in favor of a particular remedy, be it domestic competition policy, or international trade or investment liberalization.
- Christopher Wilkie, of Industry Canada, and John de la Mothe, of the University of Ottawa, examine the problems posed by the increasing importance governments attach to supporting high-technology industries through subsidies, procurement, or other policies aimed at excluding foreign players.
- Lorraine Eden, of Texas A&M University, argues that, as trade barriers fall, investment decisions will, at the margin, be more influenced by differences in taxation regimes. She suggests that greater coordination of tax measures, already evident between the NAFTA countries and in the European Union, will promote better investment decisions in this context.

Together, these articles provide a strong case for pursuing a more coherent approach to doing business in an era of globalization, by promoting multilateral investment rules as a complement to existing trade rules.

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For further information, contact:
Daniel Schwanen or
Susan Knapp (media relations), C.D. Howe Institute
phone: (416) 865-1904
fax: (416) 865-1866
e-mail: cdhowe@cdhowe.org
Internet: http://www.cdhowe.org/eng/pr/new.html

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C.D. Howe Institute
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Communiqué

Embargo: à diffuser *jeudi*, le 19 septembre 1996

Un accord global sur l'investissement est nécessaire pour compléter la libéralisation du commerce, soutient une étude de l'Institut C.D. Howe

Un ensemble complet de règles multilatérales concernant l'investissement est nécessaire à la réalisation des avantages escomptés des accords de libéralisation du commerce du Cycle d'Uruguay, soutient une étude de l'Institut C.D. Howe publiée aujourd'hui. L'étude encourage donc les pays industrialisés à progresser dans leurs négociations d'un Accord Mondial sur l'Investissement (AMI), et recommande que des travaux en vue d'établir des règles concernant l'investissement étranger direct (IED) soient formellement mis à l'ordre du jour de la rencontre ministérielle de l'Organisation Mondiale du Commerce à Singapour en décembre 1996.

Intitulée *Investment Rules for the Global Economy: Enhancing Access to Markets* (Règles d'investissement pour l'économie globale: améliorer l'accès aux marchés), l'étude est une collection d'articles dirigée par Pierre Sauvé, économiste principal à la Direction des échanges de l'Organisation de Coopération et de Développement Économiques, et par Daniel Schwanen, analyste de politique principal à l'Institut C.D. Howe. Les articles, écrits par des experts en politiques de commerce, d'investissement et de concurrence, se fondent sur l'observation que les règles qui gouvernent la présence des firmes étrangères dans un pays sont un élément déterminant de la capacité de ces firmes de s'assurer un accès effectif aux marchés de ce pays.

Les articles documentent le fait que, malgré l'ouverture des marchés nationaux qui a suivi les cycles successifs de négociations commerciales, plusieurs restrictions discriminatoires continuent d'entraver la capacité des entreprises de contester les marchés étrangers au moyen d'une présence établie. Dans un contexte mondialisant, ces restrictions pourraient en fin de compte annuler les avantages de ces mesures de libéralisation. Jusqu'à présent, ni les négociations commerciales traditionnelles, ni l'application des politiques nationales de concurrence, ni les réformes réglementaires dans divers pays ne sont venues à bout de ces obstacles, laissant beaucoup de progrès qu'un ensemble de règles multilatérales concernant l'IED pourrait accomplir.

Parmi les points saillants du volume:

- Michael Hart, du Centre de Droit et Politique Commerciale à Ottawa et du Monterey Institute for International Studies, explique pourquoi — étant donné l'historique des négociations commerciales, le nouveau contexte économique, et les avantages qu'il y aurait à remplacer un système confus d'accord bilatéraux par un système simplifié — il serait opportun d'arriver à un ensemble de règles multilatérales sur l'investissement.

- Pierre Sauvé et Edward M. Graham, de l'Institute for International Economics à Washington, donnent un aperçu des ententes internationales existantes en matière de politiques d'investissement, et identifient les dispositions clés ainsi que les défis de négociations que tout accord devrait résoudre, notamment en ce qui concerne la libéralisation des investissements, la protection des investisseurs, et le règlement des différends.
- Alan Rugman, de la faculté de Management à l'Université de Toronto, et Michael Gestrin, un économiste à la Conférence des Nations Unies sur le Commerce et le Développement, s'intéressant à la structure d'un accord gloabl et soutiennent que les négociateurs d'un tel accord trouveraient un modèle de base logique dans les dispositions de l'Accord de Libre-Échange Nord-américain (ALENA) concernant l'investissement.
- Someshwar Rao et Ash Ahmad, tous deux d'Industrie Canada à Ottawa, recensent les obstacles formels et informels à l'investissement dans le groupe des Sept plus grands pays industrialisés, ce qui offre une carte de pointage pratique permettant de mesurer la réussite de tout accord.
- Mark Warner, du Center for International and Comparative Law de l'Université de Baltimore, montre qu'il est important de savoir si la source d'un obstacle à l'investissement provient du comportement des agents privés, ou encore des politiques publiques, avant de décider d'utiliser soit les politiques de concurrence, de commerce, ou un accord de libéralisation des investissements comme remède.
- Christopher Wilkie, d'Industrie Canada, et John de la Mothe, de l'Université d'Ottawa, examinent les problèmes posés par l'importance croissante que les gouvernements attachent à l'appui des industries de haute technologie, soit par des subventions, des politiques d'achat, ou autres politiques visant à exclure les firmes étrangères.
- Lorraine Eden, de l'Université du Texas A&M, explique que la chute des obstacles au commerce fait que les décisions d'investissement deviennent relativement plus influencées par les différences entre régimes fiscaux. Elle prédit qu'une coordination plus étroite entre autorités, comme celle qu'on entrevoit actuellement entre les pays de l'ALENA et au sein de l'Union européenne, permettrait de promouvoir de meilleure décisions d'investissement.

Ensemble, ces articles fournissent des arguments à l'appui d'une plus grande cohérence des règles régissant les affaires dans une ère de mondialisation, par le biais de règles d'investissement complémentaires à celles existant pour le commerce.

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Renseignements :
Daniel Schwanen ou
Susan Knapp (relations avec les médias), Institut C.D. Howe
téléphone : 416 865-1904
télécopieur : 416 865-1866
courrier électronique : cdhowe@cdhowe.org
Internet : http: / / www.cdhowe.org

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Contents

Investment and the Global Economy:

Key Issues in Rulemaking

Daniel Schwanen

In May 1995, the members of the Organisation for Economic Co-operation and Development (OECD) agreed to begin negotiations on a multilateral agreement on investment (MAI). This decision followed two decades of increasing intellectual, empirical, and political recognition that foreign investment has become a complement to, rather than a substitute for, international trade in the pursuit of improved global economic outcomes. In other words, the OECD members recognized that giving capital greater freedom to move toward areas where it is most productive (for both its owners and its users) would enhance the benefits of international trade liberalization, as well as those of the domestic regulatory reform that began in earnest in many countries in the 1980s.

This convergence of views has not come smoothly, and it is certainly not complete. Governments have made many attempts in the postwar era to come to grips with the problems believed to stem from the presence of foreign direct investment (FDI). But recent years have seen an interesting reversal. In most countries previously suspicious of FDI, there is now a greater acceptance of the benefits of these flows and hence of efforts to remove impediments to them. Yet, in countries that have been traditional sources of these investments (most notably the United States), recent large FDI inflows have raised the issue of domestic control over sensitive sectors of the economy. Some in these source countries have also begun to question the benefit of a global economy in which firms look on their country of origin as just one of many possible locations for their activities.

Given the ongoing debate on these matters, this essay starts by describing some key economic and business issues underlying the need for an MAI. The subsequent section, drawing on the papers in this volume, reviews the core elements required to make an MAI successful — the basic changes in countries' policies toward FDI required to address the underlying issues calling for an agreement in the first place. I then turn to some issues apparently tangential to an MAI; most are related to *national* policies but require attention because their interaction with *foreign* investment becomes more palpable as the core investment barriers recede. My penultimate section looks at important questions of the negotiating process, which are addressed by a number of authors in this volume. Finally, I offer a personal assessment of the main policy conclusions to be drawn from the studies presented here.

Economic and Business Issues Underlying an MAI

An easy way to think about the various reasons for an MAI is to classify its purposes as ways of harnessing the advantages of globalization, of managing its pressures, and of simplifying the international regime. Like most taxonomies, this one is not perfect, but it does clarify the issues.

Harnessing the Advantages of Globalization

The postwar economy has been characterized by increased integration of national economies into the global marketplace. The initial shift came largely from the more open access to foreign markets provided by trade liberalization. Firms often invested in production facilities in a foreign market only as a substitute strategy in the face of remaining restrictions on trade or as a means of accessing natural resources unavailable at home. Since the 1980s, however, the deepening of international linkages has been far more the result of the spectacular growth in FDI, not only as a substitute source of access to foreign markets for manufactured goods or to raw materials, but also as a way for firms to come in closer contact with increasingly sophisticated consumers, to benefit from economies of scale, and to acquire more costly and shorter-lived technology.

This development has been much facilitated — indeed, to a large extent, necessitated — by the evolution of financial, communications, and transportation technologies that allowed firms to conduct global operations and access inputs ever more easily from any part of the world (Lipsey 1993). The growing importance of services in all economies and the increasing international competition in services markets that has resulted, for example, from widespread regulatory reform (see United Nations 1993; Hoekman and Sauvé 1994) has also spurred FDI since many services, such as engineering or banking, cannot be provided without some active presence in the market being served.

Today, therefore, whole countries' production apparatus and many key ingredients of their future economic growth are, in some form or another, geared to the outside world. The main agent of this linkage is the transnational corporation (TNC). In this system, a more open investment regime provides, at least in principle, net advantages for both capital-exporting and capital-importing countries.[1] Inward investment brings capital, expertise, and other inputs to the domestic economy, while outward investment makes a domestic firm more competitive and allows it to grow. In both cases, FDI enhances incomes at home (and abroad).[2]

The question for recipients of FDI has thus shifted from one of how to balance its perceived benefits and disadvantages in the context of relatively autonomous national economies to one of whether

1 Just as a country's standard of living improves as a result of both exports and imports in an open trade regime.

2 Globerman (1995), among others, argues that outward FDI allows firms to spread the costs of firm-specific advantages over a wider base and to gain access to markets that would otherwise be lost or difficult to penetrate.

any country today can afford to remain outside the international network of products, customers, suppliers, financing, and technology embodied in the activities of TNCs.

The evidence is generally that an increase in the contestability of an economy spurs a more efficient use of resources and creates powerful incentives to innovation, resulting in higher standards of living and faster economic growth than would otherwise be the case.[3] This effect may come from greater *domestic* contestability of markets, through, for example, regulatory reform or wider application of antitrust laws, or from the increased *international* contestability of markets stemming from more openness to foreign trade and to the presence of foreign investment (see Beviglia Zampetti and Sauvé 1996).

Indeed, as separately highlighted by Michael Hart, Mark Warner, and Pierre Sauvé in this volume, it becomes apparent that the various policies included in what Sauvé calls the contestability toolbox are, at the limit, interchangeable. Thus, a comprehensive set of rules fostering the openness of markets must encompass foreign investment issues since, in today's globally integrated economies, there really is no free trade without free FDI. An agreement covering all issues related to international investment would have to cover both trade and domestic competition policies because no open foreign investment policy can be understood apart from the investor's ability to trade and compete in the host market. And openness to foreign trade and investment is, in the final analysis, only an extension of domestic policy fostering greater competition.

This essential substitutability of policy tools is a recurring theme of this volume because it has practical implications for the proper architecture of an MAI in relation to existing multilateral rules and institutions. In practice, however, a stand-alone MAI may still be needed because traditional international trade and domestic competition policies so far have secured only limited contestability of markets.

3 See, for example, Australia (1996); OECD (1995, especially 103–108); Canada (1994).

Managing the Pressures of Globalization

To fully realize the positive results expected from the liberalization of investment flows, an MAI must also take into account the potential problems for national and global economic management created by greater freedom of capital movements. The challenges posed by the globalization of investment flows can be divided into two main categories: the control of investment subsidies and the prevention of anticompetitive behavior.

States are now often induced to engage in subsidy wars to attract increasingly footloose but increasingly crucial FDI. In their contribution to this study, Christopher Wilkie and John de la Mothe describe financial incentives provided per employee for some high-profile investments — a striking indicator of governments' increased propensity to subsidize the establishment of economic activity on their territory. And as demonstrated in Edward Graham and Pierre Sauvé's appendix (also in this volume), states' overbidding for FDI is certainly advantageous for the firm making the investment and perhaps also for the region paying the subsidy and receiving the investment.[4] But the result is almost certainly a globally inefficient allocation of investment, either because firms choose locations costlier in terms of resources than would otherwise be the case or because competition to attract particular industries makes them subject to global overinvestment (consider, for example, the historical example of automobile or steel manufacturing).

This problem is compounded by the fact that some countries are better equipped than others to engage in subsidies competition, because of their attractive market size or their deep pockets. Small and medium-sized countries must see that this kind of behavior is somehow circumscribed. They are the ones who lose in bidding

4 The latter is true only in comparison to a situation in which the region would otherwise receive no investment on account of establishments' being systematically bid away to other locations.

wars, because of their relative difficulty in attracting their share of investments and as a result of the smaller global economic pie.

A second problem arising from the globalization of FDI is that certain forms of anticompetitive behavior, such as cartel schemes, which might come under antitrust legislation at a national level, are more difficult to prevent at the global level. As Warner argues, such behavior can be "naturally occurring," or it can be rendered possible by unnecessary government regulations that enable firms to prevent potential competitors from entering certain markets. Although Warner argues that, in the latter case, the first-best solution is to remove the regulatory source of the firm's or cartel's market power, his analysis supports Hart's statement that the possibility of anticompetitive practices taking place at the global level is leading to "a much more broadly conceived interest in the development of an international regime regulating not only transborder investment transactions, but also international business more generally."

Usefully, Someshwar Rao and Ash Ahmad remind us in their essay in this volume that the process of economic integration in the European Union required members to delegate to EU competition policy both the discipline of state subsidies deemed to affect the crossborder location of industry within Europe and the surveillance of the competitive practices of businesses possessing a European dimension (as opposed to a national or local one).

Reducing the Complexity of the Current Regime

As practitioners of the marketplace, business people may be forgiven for occasionally thinking that international agreements are designed to obfuscate, rather than simplify, trade and investment relationships. Apart from the fact that rules can and do differ from one agreement to another, liberalizing principles are often subject to extensive and sometimes hard-to-interpret exceptions. As Alan Rugman and Michael Gestrin forcefully highlight in this book, complicated rules of origin and other restrictions designed to capture locally the benefits of regional trade agreements may actually reduce these benefits by diverting trade and investment away from their most productive use. As well, although the North American Free Trade Agreement (NAFTA) and the agreements of the World Trade Organization (WTO) have made great strides in establishing effective government-to-government dispute settlement procedures, private parties' recourse to such mechanisms to challenge governments under trade agreements remains in its infancy, except perhaps within the EU and as provided in the NAFTA's investment chapter.

Moreover, almost the entire range of economic, social, and environmental issues once reserved for the domestic arena is now also addressed in many multilateral forums, reinforcing the feeling that the amount of paperwork generated may be getting out of hand in relation to true progress in making markets more contestable. In short, some business people (and analysts) think that "treaty congestion" may be upon us.[5]

Existing investment relations among states — and among states and TNCs — provide little relief. Referring to the hundreds of domestic, bilateral, and plurilateral laws, agreements, codes, and other documents governing international investment relations, Hart observes:

> [t]hese agreements cover many of the issues that would have been covered by...[a] multilateral agreement, but they do so on a bilateral basis and often reflect the asymmetrical relationship between the negotiating partners....Additionally, because they conform to the exigencies of the laws, practices, and preoccupations of the individual negotiating partners, they lack the necessary degree of uniformity, convergence, and enforcement to provide a basis for a modern, widely accepted regime.

Countries must work to build such a regime if society is to capture the potential advantages of an MAI. International economic agreements lose much of their value when the very businesses and individuals that stand to make the most productive use of their provisions

5 For further thoughts on this issue, see the penultimate section of Wilkie and de la Mothe in this volume.

have no clear understanding of the opportunities they provide or fear exploring these opportunities lest the minefield of exceptions and trade remedies constituting disguised protectionist tools make access to foreign markets dependent on a battery of lawyers, experts, and lobbyists (as Sauvé and Wilkie and de la Mothe put it in their respective essays). Such situations also favor the status quo between existing global corporations and smaller emerging firms, with attendant limits on the global economy's growth potential.

The Substance of an Agreement

Each of the papers in this volume addresses the components or considerations to be included in an MAI that would make significant progress on the agenda just described. Here I attempt to summarize these points in a way that would probably garner consensus among the contributors (although each would naturally emphasize different elements of the same issue).

I divide the questions to be addressed into core investment issues and issues of deeper integration.[6] The former are primarily formal state policies or mechanisms that apply explicitly to investors who are non-nationals and to their investments. The latter include policies and practices, public or private, that can affect foreign investors or investments (without necessarily targeting them) and therefore would influence the effectiveness of an MAI.

The Core Investment Issues

As several contributors to this volume show, the core elements of an MAI have been considered at various times in the past, not only in the economic and business literature but also in negotiations and in attempted or actual codification. The latter forums have been as diverse as the discussions on the International Trade Organization

6 The latter term is borrowed from Eden's paper in this volume.

in the late 1940s, the OECD in the 1970s (for example, the 1976 OECD Declaration on International Investment and Multinational Enterprises), and, more recently, a number of regional arrangements, notably the EU and the NAFTA.

Protection of Investors and Investments

Many, if not most, governments recognize the need to protect foreign investors against what amounts to confiscatory behavior (for example, expropriation without compensation or limits on the transfer of investment income out of the country). The availability of such protection is a basic requirement for attracting global FDI flows.[7]

Today, therefore, many countries voluntarily apply these basic protections unilaterally or through bilateral treaties with investors' home countries. In the terms of Sauvé's analysis, this basic protection of investors and their investments is a motherhood issue, one that countries have every incentive to address on their own. Nevertheless, including these protections in an MAI would have many advantages, such as the uniform codification of this expected behavior, an increase in the ability to submit alleged violations to international dispute settlement, the locking in of changes already made through domestic policies in a number of countries (particularly developing countries), and an enticement to a greater number of countries to participate in an agreement.

National Treatment and the Right of Establishment

A basic principle of any trade, investment, or competition agreement aimed at fostering the contestability of markets among a group of countries is that the laws, policies, and standards of each jurisdiction

7 At least in a normal setting. In certain circumstances, the temptation of high rewards can offset risks, but these situations are, by their nature, temporary.

ought to apply equally within it to domestic and foreign goods, services, and investors. Such *national treatment* is, however, meaningless for foreign investors not already present in a country unless they are also granted the right of establishment in that market.[8]

Thus, this broadly conceived national treatment principle should apply to measures covering, in Hart's description, "the establishment, acquisition, expansion, management, conduct, operation, taxation, and sale or other disposition of any investments."

The application of the principles of national treatment and of the right of establishment constitutes states' recognition that attempting to distinguish between domestic and foreign-based TNCs in the conduct of policy is fruitless in most situations. To the extent that the realities of the marketplace apply to firms irrespective of the nationality of their ownership, those that face similar circumstances should be expected to react similarly to a particular policy. As Safarian concludes in a recent study of the impact of multinational enterprises (MNEs)[9] on public policy, "[i]t is difficult to see why the welfare effects for various interests are any less important simply because the source of the [investment] decision is a domestic firm, a domestic MNE or a foreign MNE" (1993, 507).

At the same time, states can conduct policies that differ significantly[10] and still pursue freer global trade and investment. Thus, national treatment of investors and their investments is, as Rugman and Gestrin point out in their analysis, a natural point of departure for states wishing to garner the advantages of increased international competition and investment for their domestic economies while retaining a full range of economic and social policy options.

8 In the same way, exporters' right to receive national treatment for their products in a foreign market is meaningful only if it is associated with low barriers to the initial crossing of the border into that market.

9 Safarian, like many authors, prefers *multinational enterprise (MNE)* to TNC. The two terms are interchangeable.

10 Apart from those, such as tariff reductions, that apply to all on a mutually agreed basis.

Clarifying and Reducing Exceptions to National Treatment

Experience shows, however, that states bargain to retain their ability to require ownership by nationals or to continue to discriminate between nationals and foreign investors. Even countries that sign agreements to liberalize often reserve specific policies or sectors from their general commitment. Thus, agreements such as the NAFTA contain many exceptions to the right of foreign-owned firms operating in certain sectors to establish themselves, acquire ownership of firms, or otherwise be treated on par with domestic firms.[11]

Several authors in this volume, most notably Rao and Ahmad, list the most prevalent of these exceptions to the right of establishment and national treatment principles. Most of the specific sectoral exceptions are in the services sector. A major challenge of an MAI is to make these exceptions as transparent as possible. One way, which is used in the NAFTA, is through "negative lists" of exceptions to national treatment. This approach also facilitates the removal of exceptions over time, should the political will exist to do so.

In addition, an MAI should eliminate requirements that a foreign investor meet certain performance levels as a condition of the right to invest in the domestic economy.[12] (Many have, of course, already been eliminated through the WTO Agreement on Trade-Related Investment Measures [TRIMs].) The related question of foreign investors' having to meet performance requirements (or "offsets") as a condition of receiving government procurement contracts should be handled by extending the WTO's procurement code to more countries and sectors.

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11 For an excellent treatment of how these reservations and exceptions were dealt with in the NAFTA, see Gestrin and Rugman (1993).

12 This is not the same thing as making the receipt of state aid conditional on meeting certain performance requirements, providing a certain level of training, or locating an investment in a particular region, as long as such subsidies are generally available to both foreign and domestic firms. The NAFTA makes this distinction in Article 1106, Performance Requirements.

More difficult to deal with will be the blanket exemptions countries provide for certain policy objectives (as opposed to specific policies or sectors), most notably "national security." As Rao and Ahmad note, "[i]n the United States,...the definition of national security is rather vague and broadly defined, thus leaving the authorities with sufficient scope to interpret it quite liberally." Without an effort to better define the meaning of national security in the context of trade, investment, and competition policies, other countries may attempt to protect certain sensitive industries (for example, food production, publishing, or broadcasting) by invoking broadly defined "security" or similar concerns.[13]

Investor-State Dispute Settlement

An MAI should also contain an investor-state dispute settlement mechanism. With TNCs' developing into increasingly stateless institutions, such a mechanism is becoming an essential complement to the state-state mechanisms traditionally used to settle trade disputes. It would also offer states the clear foreign policy advantage of having the option of staying out of disputes between firms headquartered on their territory and foreign governments.[14]

At present, investors do have recourse under the International Convention for the Settlement of Investment Disputes, although the use of ICSID mechanisms remains voluntary for these types of disputes and are rarely invoked. But, as Hart points out,

> the positive...experience of most governments and private firms with [the operations of ICSID] suggests that [it] should be viewed

13 In this context, it is interesting that, as noted by Rao and Ahmad, while Canada is the only major country in which "national security" is not formally considered grounds for foreign investment review, it demanded and obtained in the NAFTA the ability to extend a wide protective blanket over an extensive list of cultural industries.

14 I am indebted to my co-editor, Pierre Sauvé, for his observations on the advantages of firms' being able to seek redress in ways that do not require government intervention on their behalf.

> as [an] important building [block] for a more comprehensive universal regime for the conduct of business in the global economy.

Again, the NAFTA model is instructive here. Under it, the investor can invoke ICSID mechanisms (or the Arbitration Rules of the United Nations Commission on International Trade Law) in case of disputes. Graham and Sauvé make a persuasive case that the NAFTA's investor-state dispute settlement mechanism is likely to be the minimum acceptable to investors and the maximum acceptable to states in an MAI. Therefore, it naturally recommends itself as a model for an agreement.

Issues of Deeper Integration

Although the non-core issues for a MAI concern indirect or informal barriers to investment, two characteristics link them inextricably with the core issues.

First, as core barriers recede, indirect barriers assume more visibility and acquire a greater potential for distorting investment flows (Lawrence 1996). As Warner puts it, "[i]nternational and global businesses seeking to implement their new strategies for market access and presence increasingly discover a network of informal barriers to trade and investment that curtail their ability to function efficiently."

Second, just as formal barriers to trade and investment can substitute for each other, so barriers that are not strictly issues of investment can act as substitutes for formal investment barriers.[15] Thus, rules governing mergers and takeovers, policies supporting technology development and other types of subsidies, rules concerning the taxation of international activities, and national differences in the coverage, the substantive norms, and especially the enforce-

15 Rao and Ahmad note, for example, that, in certain cases in the United States, performance requirements for foreign firms — a "core" barrier formally banned in trade agreements such as the NAFTA — have effectively been reinstated through the examination of FDI required under that country's Exon-Florio legislation, which is ostensibly concerned with national security.

ment of antitrust laws all give governments or private actors some latitude in preventing foreigners from fully contesting markets and thus give rise to issues of global governance.

The implication is that an MAI must be negotiated with a view to preventing these policies from thwarting (in trade parlance, "nullifying and impairing") the benefits achieved through an agreement on core issues.

Barriers to Crossborder Mergers and Acquisitions

Rao and Ahmad's essay addresses a broad range of measures that, although not formal barriers to FDI, can constitute serious impediments to foreign takeovers. These measures include:

> ownership barriers, tactical or technical barriers; barriers due to the application of merger control laws; administrative practices which influence the parameters of the takeover (for example, consultations with officials, performance requirements, local content rules); and, finally, other barriers arising from government-business linkages which work to deflect unwanted foreign takeovers.

Note that this list includes both public and private barriers to foreign ownership.[16] Of public barriers, the authors note in particular that, although merger control laws are, in principle, "applied indiscriminately to both domestic and foreign firms in like situations," in reality, "[w]ith the decline of traditional means of state intervention (FDI control and nationalization), the attractiveness of merger control as an alternative means of intervention is much enhanced."

As for private barriers to foreign ownership, Ahmad and Rao note that, in some jurisdictions, such as Japan and Germany,[17] implicit barriers to outside ownership

16 Warner suggests that, in a sense, *all* such barriers are public because public law allows the private barriers to be maintained.

17 And even some sub-central jurisdictions, such as Quebec.

> stem from the relative size and importance of stock markets as markets for corporate control, from the structure and ownership patterns of quoted companies and state-owned enterprises, and from the web of financial and commercial linkages in the economy.

Included in this list are tactical takeover barriers that are permitted by company bylaws in some countries.

Although Graham and Sauvé argue,

> [o]n balance, it would appear that the matter of such private practices, where they do exist, raises issues that are perhaps best addressed by competition policy rather than investment rule-making,

the substitutability of policy tools may make it impossible to isolate the problem simply by requiring countries to better enforce their competition laws. Rao and Ahmad note, for example, that

> [w]hile Germany is considered to have a relatively rigorous antitrust [competition] policy, it can be argued that strict formal rules are not really required to impede unwanted foreign acquisitions because the presence of various ownership and tactical barriers acts as a formidable obstacle to hostile takeovers.

Part of the solution to reducing these barriers is to require an unbiased application of antitrust and merger policies as well as more transparent public and private procedures with respect to FDI. These measures may, however, leave a set of obstacles to foreign takeovers that results from differences in views and practices over what constitutes anticompetitive behavior. (This "systems friction"[18] is further addressed later.)

Technology

Issues relating to high-technology industries are bound to surface in discussions of an MAI because of a combination of two factors. First, a growing amount of trade and of investment is in high-technology-

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18 A term first coined by Ostry (1990).

intensive goods and services. Second, governments engage in (or encourage — often with state funds) collusive behavior in these sectors, behavior that would not normally pass muster with any national antitrust authority if the firms involved were in low-technology sectors. The stated rationale is inevitably, say Wilkie and de la Mothe, "the nebulous and self-defining concept of national security or the ostensible importance of creating national champions" — what Ostry and Nelson (1995) call "technology fetishism."

Wilkie and de la Mothe warn that, in an environment of increasingly rapid "creative destruction" and short product life, attempts by nation-states to appropriate for themselves the rents from new technologies may not only backfire (as they back too many horses or the wrong one) but also hinder global economic growth.

Wilkie and de la Mothe stop short of calling for an international agreement specifically devoted to this issue. Instead, they recommend that any MAI recognize its importance by addressing how the national treatment provisions (one of the core issues) might apply to government-supported high-technology consortia and by disciplining more strongly the amounts, conditions, and transparency of subsidies. Rugman and Gestrin concur, reminding us that such disciplines are most important for the small and medium-sized countries that cannot engage in state-sponsored efforts on the same scale as larger ones.

Wilkie and de la Mothe also note that the high-technology issue is closely linked to government procurement and intellectual property rights, which are areas already subject to multilateral disciplines under the aegis of the WTO. Reinforcing and extending these agreements with a view to facilitating and protecting investment flows specifically related to high-technology activities may be a more appropriate strategy than attempting to revisit these issues in a separate MAI.

State Subsidies

Regarding subsidies more generally, the recent Agreement on Subsidies negotiated as a result of the Uruguay Round of the General

Agreement on Tariffs and Trade (GATT) already prohibits some of the most trade-distorting ones. The agreement also legitimizes a number of subsidies in the sense of declaring them "nonactionable" under the WTO provided they are "generally available" — that is, not intended to benefit a particular industry.[19]

The gray area of subsidies that are "actionable" but not "prohibited" leaves open to question many types of state aid intended to woo specific investments to a particular location or to keep unprofitable operations afloat. As Graham and Sauvé show, the problem is not that subsidies cannot sometimes be justified (even from a global welfare perspective); rather, the lack of rules means that globalization creates an incentive for governments to overbid for investments to locate in their particular region or industry. Although disciplining this kind of behavior multilaterally would be difficult without the type of supranational authority that the EU commands over the practices of its member states, some codification of incentives practices (beyond what the WTO has achieved) should be attempted as part of the negotiations on an MAI.

Taxation

Negotiators of an MAI should carefully examine how tax liability is assigned in a world of global production. The methods by which international activities (of either domestic- or foreign-owned TNCs) are taxed may come to have an inordinate effect on the location of investment. As well, difficulty in assigning tax liability could easily become a negotiating stumbling block on the road to greater investment *and* trade liberalization.

As Lorraine Eden explains in her essay in this volume, the fall in trade barriers creates added incentives for transfer-pricing manipulations and ultimately for investment distortions. The NAFTA, she quotes Raymond Vernon as pointing out,

19 For a description of the agreement and its potential pitfalls, see Cadsby and Woodside (1996).

> does not deal directly with the many questions of taxation in which the three signatory governments have mutual or conflicting interests. Nevertheless, as the operations of multinational enterprises expand and become more deeply integrated across national borders, the agreement promises to complicate and exacerbate these questions substantially.

No doubt the same dynamic is at work globally.

In examining the trade, taxation, and transfer pricing policies as they relate to TNCs, domestic and foreign, Eden notes that the NAFTA countries' various bilateral tax treaties with each other are a way of encouraging FDI. Such agreements provide greater transparency and certainty for investors, as well as more streamlined repatriation of profits through reduced withholding taxes (at the cost, for would-be tax avoiders, of increased cooperation between governments on the tax front). Yet they offer only a palliative for some of the problems created by differences in countries' corporate income tax regimes, especially differences between highly integrated economies, in which many crossborder transactions involve parties that are not operating at arm's length. Eden agrees with those who recommend that free trade should, therefore, be accompanied by ultimately moving toward harmonization of national tax levels for corporations.

In the meantime, more transparency and streamlined dispute settlement mechanisms are in order. One useful measure seems to be the harmonization of methods within and across countries for the valuation of non-arm's-length transactions, always a problem because, as Eden notes, "of the increased scope for manipulating transfer prices (over- or underinvoicing intrafirm trade flows)."[20] An agreed-on WTO code now exists for the customs valuation of such transactions, but only nonbinding guidelines exist to assist OECD countries in dealing with bilateral transfer-pricing issues.

20 The United States (but not Canada) now requires that customs valuation be taken into account in determining the transfer price for tax purposes.

Eden also recommends that arbitration be used as a dispute resolution technique, “particularly in cases where the tax amounts in dispute are very large and one of the governments is unwilling to provide offsetting relief.” She notes that the European Union started such a regime in 1995 for a trial three-year period. The successful application of a formal multilateral arbitration procedure on this issue could, over time, lead governments toward tax measures that are more compatible.

Competition Policies and Systems Frictions

The issues raised so far concern types of behavior that all governments engage in or permit. For negotiating an MAI, therefore, they become issues of removing or codifying what any government might reasonably agree are discriminatory barriers against foreign investors or investments, be that discrimination direct or indirect, justifiable (often said of one’s own) or not (often said of others’).

A different kind of problem arises in regard to disagreements over what constitute the rules of fair competition, even if the rules are applied in a scrupulously similar manner between local and foreign entities; in other words, what should negotiators do where there is competition among the various models of competition themselves. Should they, for example, scrutinize Pennsylvania’s “raider disgorgement” provisions (described in Rao and Ahmad’s paper), which apply equally to foreign and domestic corporate raiders? Should the UK government have the right to “prohibit or subject to conditions a merger or takeover involving investors from a non-EU country if absence of reciprocity in that country would cause the takeover to be against the public interest in the United Kingdom”?

The outcome of these systems friction issues inevitably involves countries’ extending a certain treatment to the nationals of some countries — those they feel offer their own investors broadly comparable competitive opportunities — but not to the nationals of others. This practice runs counter to the most-favored-nation (MFN) approach of multilateral trade liberalization,[21] but it may be necessary to allow it to happen. If we insist on the full application of MFN treatment in an MAI, we may limit the possibility of ever reaching an agreement. Governments may be very reluctant to engage in ironclad commitments to open their markets to anyone, even nationals of countries that they consider as open to competition as they are, lest they be forced to open up to everyone, including potential free riders. By insisting on unconditional MFN treatment as part of an MAI, we may slow liberalization and end up thwarting, rather than encouraging, competition among various models of competition.

The Process of an Agreement

The TRIMs agreement calls for consideration, before 2000, of "whether the Agreement should be complemented with provisions on investment policy and competition policy." It certainly needs such a complement because it applies only to certain investment measures that "can cause trade-restrictive and distorting effects",[22] and only with respect to trade in goods.

As Sauvé explains, the WTO's General Agreement on Trade in Services (GATS) has indirectly made important strides on investment barriers[23] through its promotion of basic principles such as the right of access to markets and of national treatment for services providers. The application of these principles is, however, limited to a list of sectors inscribed in each member country's schedule of commitments. Future rounds of negotiations have been mandated with a view to achieving further sectoral liberalization but, on the whole, specific commitments to roll back barriers have been difficult to obtain.

21 For a country to agree to apply MFN treatment in the context of an international agreement is to commit itself to extending to all signatories of the agreement any concession that it extends to one of them.

22 Such as requiring an investor to purchase a specified volume or value of products of domestic origin before being allowed to proceed with an investment.

23 Which tend to be most egregious in the services sectors.

Optimism about the liberalizing effects of the GATS must also be guarded, given the recent failure or uncertainty of three sets of global negotiations, called for in the agreement's sectoral annexes, with respect to financial services,[24] maritime transport services, and telecommunications. The problem in all three cases was clearly the imbalance between those countries that offered significant market-opening measures in these areas and others that did not make meaningful offers. Although countries in the former group could, in theory, begin to open up their markets to each other, they cannot do so in practice because the GATS agreement, like the GATT, requires the application of MFN treatment; any benefits granted reciprocally between countries willing to liberalize extensively would have to be extended to all countries — even those offering nothing of their own with respect to services liberalization.

By and large, therefore, the existing multilateral measures with respect to investment and services, although admittedly still in their infancy, have only a limited effect on liberalizing foreign direct investment. More is required.

Where to Negotiate an MAI

Views differ as to what forum is best suited for advancing the agenda of liberalizing global investment regimes. The chief candidates are the OECD and the WTO.

Recognizing the shortcomings of the existing multilateral structure, in 1995 the OECD countries began negotiations on an MAI, to be completed in 1997. The OECD makes sense as a forum because the member countries already share some practices and codes regarding foreign investment and because they account for the vast majority of the outstanding stock of FDI. Their basic protections for investors can be extended and codified, and their protectionist measures in a number of sectors can be traded off against each other.

24 Only a tame, temporary agreement was reached by a group of countries that did not include the United States.

The question arises, however, of whether an agreement among some of the world's richest countries can be extended to, or can attract, all the others without extensive renegotiations. More fundamentally, since developing countries now receive some 40 percent of the total flow of FDI and considering the inherent complementarity of trade and investment issues, would not the goals of an MAI — to help sort out relations between states and enterprises — be better served by a more global agreement, one linked more closely to the existing international trade regime, than an agreement negotiated with regard solely to investment within the OECD? As the WTO, admittedly not an uninterested party, puts it:

> The question that has been raised is whether, because of the substantive interlinkages between the subject matter of these [investment] negotiations and WTO rules — for example, in the areas of trade in services, intellectual property and trade-related investment measures...it is desirable that the WTO decide at an early stage to initiate an examination of investment policy issues. (1995, 17.)

The views of this volume's authors differ somewhat on this issue. Some would prefer an in-depth OECD agreement, which subsequently could serve as a template for a comprehensive set of investment rules lodged within the WTO. Others emphasize the benefits of the WTO's beginning work on the issues as soon as possible, using the expertise accumulated at UNCTAD as well as at the OECD, which would facilitate the involvement of developing countries at an early stage.

My view is that major benefits would be generated from applying basic rules governing investments — protection of investors and their investments as well as national treatment — to developed and developing countries alike. A working plan for global negotiations on the core issues identified above should, therefore, be initiated at the WTO at the December 1996 Singapore Ministerial meeting.

Clearly, however, the negotiations begun at the OECD level will have the best chance of succeeding within a short time frame. The particular challenges here for the OECD countries are twofold: to be able to implement even a core investment agreement applicable to sectors in which negotiations in other forums — in particular, the GATS — have hitherto failed to secure basic liberalization, and to set the stage for talks to consider some of the issues of deeper economic integration mentioned above. The less progress the OECD talks make on these two fronts, where the organization's members have a comparative advantage, the more an early "migration" of talks to the WTO makes sense.

Conclusion

National economic performance increasingly depends on the quantity and quality of the linkages between a country's domestic economy and those of the outside world. A common set of rules aimed at improving these linkages would achieve better global economic performance. It would harness the linkages' beneficial effects and contain the problems they create. Such rules would naturally apply not only between states but especially to relations between governments and TNCs, the main providers of these international economic networks.

These potential benefits point to the desirability of exploring an MAI. For such an agreement to be effective, it must be as widely applicable and as transparent as possible, and it must complement, rather than duplicate, the market-opening efforts embodied in existing trade and competition rules.

The issues an MAI should cover can be divided into core issues and issues of deeper integration. With respect to the former, the signatory governments should aim to agree to guarantee basic protections for investors and their investments, apply the basic rights of establishment and national treatment to foreign investors, make the inevitable exceptions to those rights as clear as possible by listing them explicitly, deal (either within the agreement itself or in existing WTO forums) with ancillary issues of market access such as those related to the imposition of performance requirements and access to procurement markets, and provide for an investor-state dispute settlement mechanism such as exists in the NAFTA.

Although OECD members have already begun work on an MAI, it would be worthwhile (if ambitious) to contemplate launching a concrete work program leading to negotiations in a truly multilateral setting, a decision that should be at least seriously envisaged at the WTO Ministerial meeting in Singapore in December 1996. Such negotiations could become especially attractive if the OECD countries do not manage to take advantage of the facts that they share a high level of development, already cooperate on a number of investment issues, and account for most of the stock of foreign direct investment, and if they do not manage to make progress among themselves in opening up sectors to greater contestability in areas that have thus far eluded liberalization under the WTO's various instruments, including the GATS.

Working toward a better understanding of the issues of deeper integration would, however, be natural for the OECD countries, where differences in policies that are mainly domestic loom larger at the margin in considering whether a particular market will be open to foreign investors even if, in principle, foreign and domestic investors are treated on par. For example, differences in the application of mergers and acquisitions policies, in eligibility criteria for technology and other types of subsidies, in the taxation of the global activity of TNCs, and even in the application of competition policy in otherwise similar cases can result in barriers to investment or in inefficient investments, ultimately leading to an unsatisfactory allocation of global resources and reduced growth potential.

In all these areas, the challenge is eventually to devise an agreement that would not impose such uniformity as to compromise competition itself but would guarantee that each country applies its policies without detriment to the ability of firms in one country to contest markets in another.

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