行政院所屬各機關因公出國人員出國報告書

出國類別　出席國際會議

出席世界貿易組織貿易與投資關係工作小組報告

報告人　經濟部投資審議委員會
張組長銘斌

會議地點　瑞士日內瓦

會議時間　九十年六月十三日至十四日

出席世界貿易組織貿易與投資關係工作小組報告目錄

壹、會議時間 1
貳、會議地點 1
參、出席單位及代表 1
肆、會議主席 1
伍、我國出席人員 1
陸、會議重要討論事項 1
柒、結語與建議 8

出席世界貿易組織貿易與投資關係工作小組報告

壹、會議時間　九十年六月十三日至十四日

貳、會議地點　瑞士日內瓦

參、出席單位及代表　世界貿易組織所有會員及觀察員代表

肆、會議主席　土耳其駐 WTO 代表團大使 Mr Oquez Demiralp

伍、我國出席人員　經濟部投資審議委員會張組長銘斌

陸、會議重要討論事項

一、世界貿易組織貿易與投資關係工作小組(Working Group on the Relationship Between Trade and Investment)頃於本(九十)年六月十三日至十四日舉行本年度第二次工作小組會議，本次會議由經濟部投資審議委員會張組長銘斌參加，會議由工作小組主席土耳其駐 WTO 代表團大使 Mr Oquez Demiralp 主持。

二、本次會議循例由各國代表於採認議程後，繼續討論本工作小組第一次會議定案之工作彙整表(Checklist)之四項討論議題，摘述各議題討論要旨如次

(二)貿易與投資互動關係對國家發展及經濟成長之意涵

1、按本工作小組首次會議採認之研究清單第一項所示，各會員國應藉探討經濟變數與分析總體經濟現象之方式　如國內儲蓄、財政狀況、國際收支、工業化程度、私有化程度、就業水準、所得與財富分配、競爭力、技術與管理知能移轉、國內競爭態勢、市場結構等，以瞭解貿易與投資間互動關係對國家發展及經濟成長之意涵。

2、依據第一次及第二次工作小組會議中，經濟合作暨發展組織(Organization for Economic Cooperation and Development)、聯合國貿易暨發展會議(United Nations Conference on Trade and Development)、國際貨幣基金會(International Monetary Fund)、世界銀行(World Bank)、及聯合國產業發展組織(United Nations Industrial Development Organization)各代表提出之相關研究報告(參閱 WT/WGTI/W/8, WT/WGTI/W/8/Add 1, WT/WGTI/W/8/Add 2, WT/WGTI/W/8/Add 3, & WT/WGTI/W/8/Add 4)，以及韓國、日本、美國及香港等代表提出書面報告簡介外人投資在其經濟發展中所扮演之角色之經驗(參閱 WT/WGTI/W/16, WT/WGTI/W/18, WT/WGTI/W/14, & WT/WGTI/W/10)，哥倫比亞、古巴、加拿大、玻利維亞等代表繼續提出書面報告簡介外人投資在其經濟發展中所扮演之角色之經驗(參閱 WT/WGTI/W/15, WT/WGTI/W/17, & WT/WGTI/W/20)。美國代表進一步分析外人投資對美國產業技術發展之影響，在其報告中指出美國之外人投資企業有集中於高科技產業，注重技術研發之傾向(參閱 WT/WGTI/W/27)，經濟合作暨發展組織

(Organization for Economic Cooperation and Development)則針對阿根廷、巴西、智利、菲律賓、馬來西亞及印尼等六個國家為研究對象，提出有關外人投資與經濟發展之報告，其詳述外人投資在以上國家所扮演之不同角色，並比較各國外人投資政策與制度之異同。鑒於一九九七年亞洲金融風暴殷鑑未遠，菲律賓等東南亞國家協會代表特別指出外人投資所可能帶來之負面效果不容忽視，並建議工作小組就此作進一步研討，韓國、歐洲聯盟、埃及、印度、墨西哥、UNCTAD等代表亦支持此看法。

3、在本(九十)年三月七日至八日舉行之本年度第一次工作小組會議中，工作小組曾對秘書處提報之外人直接投資(FDI)對國際收支之影響評估報告(請參閱 WTO 文件 WT/WGTI/W/95)進行討論，印度亦在上次會中提交乙份意見(請參閱 WTO 文件 WT/WGTI/W/86)，應工作小組成員要求，秘書處於本次工作小組會議再提出外人直接投資(FDI)對證券投資(portfolio investment)及購併(mergers and acquistions)之影響分析補充報告(請參閱 WTO 文件 WT/WGTI/W/103)，本次會議爰先就前述文件繼續進行討論。哥斯大黎加、智利、匈牙利、挪威、歐洲聯盟、埃及、印度、日本、加拿大、肯亞、瑞士、韓國、巴西等代表分別發言，但多數因尚未深入研究該外人直接投資對證券投資及購併之影響分析補充報告，僅提出初步看法，其中匈牙利代表指出購併對國家收支之助益不大，但歐盟代表認為購併可以引進新的經營技術和管理能力，長期而言，對國家收支仍有極大助益。印度代表認為購併有助於開發中

國家引進技術，但必須犧牲國內的市場與資源作為交換，代價相當昂貴，匈牙利、歐洲聯盟、日本、瑞士、韓國、巴西等代表相繼發言，對於開發中國家常以自製率規定與租稅優惠吸引技術，是否真正能引進新的技術頗有質疑。

4、埃及代表認為購併與競爭政策有極大關係，建議將該外人直接投資對證券投資及購併之影響分析補充報告送交貿易與競爭工作小組討論，惟美國代表強烈反對，認為有違 WTO 運作的慣例，主席最後裁示非正式地交由貿易與競爭工作小組主席參考。由於 WTO 運作的慣例採共識決，故任何議案如有會員提出質疑，都會影響會議之結論，尤其像美國這樣的國家影響力更大，但議案討論原則上透過公開辯論的方式進行，故提出任何主張都必須有相當之理由支持，非理性的杯葛議案也得不到大多數會員的支持。

(二)貿易與投資間經濟關係

1、各國已於第二次工作小組會議中，依據秘書處所做有關貿易與外來直接投資間關聯研究(參閱 WT/WGTI/W/7 & WT/WGTI/W/7/Corr 1)，討論前述研究清單第二項所訂部分內容，即貿易與投資動向之相關度、貿易與投資關係之決定因素、外來投資與競爭政策關聯、貿易政策暨措施對投資動向之影響、投資政策暨措施對貿易之影響等。

2、在本(九十)年三月七日至八日舉行之本年度第一次工作小組會議中，加拿大代表曾提交一份有關各國外人直接投資之障礙報告摘要(請參閱 WTO 文件

WT/WGTI/W/97)，以及一份加拿大工業部有關外人直接投資之報告(請參閱 WTO 文件 WT/WGTI/W/98)，本次會議爰先就前述文件繼續進行討論。歐盟代表認為前述報告很有意義，從投資所在國之角度檢視投資障礙有助於透明化。印度代表要求加拿大能就前述報告提出簡報，但加拿大希望有興趣的人直接上其工業部網站(www strategis ic gc ca)查閱。

3、針對投資優惠措施乙節，香港代表曾在前幾次會議中提議由秘書處就補貼與平衡措施協定(ASCM, the Agreement on Subsides and Countervailing Measures)的適用對投資優惠措施之影響撰擬報告乙節，歷經多次工作小組會議未獲共識，香港同意撤回。

(三)有關貿易與投資之國際規範

依據前述研究清單第三項內容，各國應分析關於貿易與投資之既有國際規範及跨國活動，包括下列二者

1、世界貿易組織法規

秘書處按新加坡部長級會議宣言第廿條揭櫫原則，就世界貿易組織系列法規與投資議題相關之條文進行研究(參閱 Job 2988)，其中服務業貿易總協定、與貿易有關之智慧財產權協定、與貿易有關之投資措施協定、補貼暨平衡措施協定、政府採購複邊協定、申請入會國家提交之貿易體制備忘錄等皆規定須述明相關投資法令

及對外投資暨國內投資政策。依據第三次工作小組會議決議，秘書處研提以主席歸納各國代表於第一次及第二次工作小組會議討論意見，所彙整之檢討綱要做為後續討論之基礎(參閱 Job 6004/Rev 1)，其內容函蓋貨品與服務業貿易之差異、投資設工條件、投資保障、正面表列與負面表列趨向、證券投資、服務業貿易總協定項下限制投資與自然人移動之範圍、投資優惠措施對貿易之效果等議題。

2、雙邊、區域、複邊、及多邊協定或活動

秘書處曾分別就亞太經濟合作會議(Asia-Pacific Economic Cooperation)、東南亞國家協會(Association of South-East Asian Nations)、能源憲章條約(Energy Charter Treaty)、美洲自由貿易區(Free Trade Area of the Americas)、國際貨幣基金會、聯合國歐洲經濟委員會(United Nations Economic Commission for Europe)、聯合國產業發展組織、安地斯集團(Andean Community)、亞歐會議(Asia-Europe Meeting)、東非暨南非共同市場(Common Market for Eastern and Southern Africa)、歐洲復興暨開發銀行(European Bank for Reconstruction and Development)、南部非洲發展集團(Southern African Development Community)、聯合國西亞經濟委員會(United Nations Economic Commission for Western Asia)等國際組織或論壇推動多邊投資活動及建立多邊投資體系情形，撰擬二份報告(參閱 Job 2843 & Job 5279)。另經濟合作暨發展組織、世界銀行、聯合國貿易暨發展會議、亞太經濟合作會議投資專家小組(APEC Investment Experts Group)亦發表

相關報告(參閱 WT/WGTI/W/4, WT/WGTI/W/5, WT/WGTI/W/6, & WT/WGTI/W/9)。

3、日本代表報告，今年三月曾與馬來西亞、WTO、UNTAD 等在吉隆坡舉行研討會，共有東南亞國協等十個國家代表參加，研討會主題在探討國際投資規範之趨勢，開發中國家之政策與國際投資之關係。

4、UNTAD 代表亦報告其最近一系列探討國際投資協定之活動與工作進展。

(四)研究清單第四項內容

1、依該清單所示，各國尚須探究目前關於貿易及投資之各項國際規範間之異同，瞭解制定雙邊及多邊投資法規之利弊，辨明投資人與投資輸出國對接受投資國之權利及義務，尤應分析目前及未來可能進行國際合作之投資政策與競爭政策間之關聯。

2、在本(九十)年三月七日至八日舉行之本年度第一次工作小組會議中，韓國代表曾提交一份有關服務貿易總協定之適用與投資協定之文件(請參閱 WTO 文件 WT/WGTI/W/96)，本次會議除延續上次會議之討論外，並試圖集中焦點討論投資規範如何提供彈性以容納各國之政策目標在內。

3、歐盟代表本次會議提交一份有關外人投資與技術協助與建立吸引外人投資環境之文件(請參閱 WTO 文件 WT/WGTI/W/96)，其重點為投資規範並不是吸引外

人投資之決定因素，最主要的決定因素仍在於市場規模與結構、總體經濟與政治穩定性、基礎設施水準及勞工素質等。智利、香港、匈牙利、韓國、印度、日本、馬來西亞、加拿大、瑞士、美國、埃及、挪威、印尼等代表紛紛發言回應。

4、日本代表並提出一份書面研究報告探討有關發展政策之投資原則(參閱 WT/WGTI/W/104)，巴西、印度、智利、香港、匈牙利、美國、韓國、印尼、挪威、古巴、歐盟、厄瓜多爾、馬來西亞、加拿大、埃及等代表紛紛發言回應，印度、埃及等開發中國家質疑，工作小組之作用只是在研究、對話階段，不應進入討論多邊國際投資規範之實質內容的進程，而且渠等認為投資政策之決定權屬於地主國，地主國有權利用締結雙邊投資條約來尋求國家最大利益，反對制定國際投資規範。

三、訂於本(九十)年十月三日舉行本年度第三次工作小組會議。

柒、結語與建議

由於 OECD 之多邊投資協定談判因為勞工、環保、社會、文化等爭議點無法得

到共識，而無限期擱置，在世界貿易組織之架構下建立多邊國際投資規範頗受期待，所以投資議題在世界貿易組織之後續發展將日益重要。

此外，我國與大陸之入會案將可望於今年十一月在卡達舉行之世界貿易組織部長會議中正式獲得通過，預訂明年一月即可成為世界貿易組織之會員，未來我國可以正式參與世界貿易組織之活動並擁有發言權。因為我國不論在吸引外人投資與對海外投資均扮演極重要之角色，具有極其豐富之經驗，未來應可積極參與易與投資工作小組之活動，將我國之發展經驗提供給其他會員國分享，並藉此開拓我國與各會員國之經貿與外交關係。

WTO/AIR/1551

9 MAY 2001

SUBJECT WORKING GROUP ON THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT

1 THE WORKING GROUP ON THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT WILL HOLD ITS NEXT MEETING ON 13 AND 14 JUNE 2001 IN THE CENTRE WILLIAM RAPARD STARTING AT 10 A M ON WEDNESDAY 13 JUNE

2 THE FOLLOWING ITEMS ARE PROPOSED FOR THE AGENDA OF THIS MEETING

A IMPLICATIONS OF THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT FOR DEVELOPMENT AND ECONOMIC GROWTH (ITEM I OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)

B THE ECONOMIC RELATIONSHIP BETWEEN TRADE AND INVESTMENT (ITEM II OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)

C STOCKTAKING AND ANALYSIS OF EXISTING INTERNATIONAL INSTRUMENTS AND ACTIVITIES REGARDING TRADE AND INVESTMENT (ITEM III OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)

D ITEM IV OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY

E OTHER BUSINESS

3 A NOTE BY THE SECRETARIAT ON THE MEETING HELD ON 7 AND 8 MARCH HAS BEEN CIRCULATED IN WT/WGTI/M/14

4 MEMBERS OF THE WTO, GOVERNMENTS WITH OBSERVER STATUS AND INTERNATIONAL ORGANIZATIONS WITH OBSERVER STATUS (IMF, UNCTAD AND THE WORLD BANK) ARE REQUESTED TO INFORM THE SECRETARIAT AS SOON AS POSSIBLE OF THE NAMES OF THEIR REPRESENTATAIVES THE OECD AND UNIDO ARE ALSO INVITED TO ATTEND THIS MEETING

MIKE MOORE

Working Group on the Relationship between Trade and Investment

ANNOTATED AGENDA FOR THE MEETING OF 13 AND 14 JUNE 2001

Informal Note by the Secretariat

1 The notice convening this meeting was circulated in WTO/AIR/1551 dated 9 May 2001 Pursuant to the decision taken by the General Council in December 1998 on the continuation of the work of this Working Group the agenda proposed in this notice provides for discussion of issues raised by Members with respect to the subjects identified in the Checklist of Issues Suggested for Study

2 The annex to this note contains a list of written contributions relating to specific items of the Checklist of Issues Suggested for Study A report on the meeting held on 7 and 8 March has been circulated in WT/WGTI/M/14 dated 30 April 2001

A IMPLICATIONS OF THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT FOR DEVELOPMENT AND ECONOMIC GROWTH (Item I of the Checklist of Issues Suggested for Study)

3 At the meeting of 7 and 8 March the Working Group discussed a Note by the Secretariat on Foreign Direct Investment and the Balance of Payments (WT/WGTI/W/95) The statements made on this Note are summarized in paras 3 20 of WT/WGTI/M/14 As requested by the Working Group the Secretariat will supplement the Note with an analysis of portfolio investment and mergers and acquisitions (WT/WGTI/M/14 paras 17 20)

4 At the meeting of 7 and 8 March the Working Group also reverted to a communication by India contained in WT/WGTI/W/86 (WT/WGTI/M/14 paras 21 40)

B THE ECONOMIC RELATIONSHIP BETWEEN TRADE AND INVESTMENT (Item II of the Checklist of Issues Suggested for Study)

5 At the meeting of 7 and 8 March the delegation of Canada introduced a written contribution (WT/WGTI/W/97) which summarized the findings of a report on foreign investment barriers and a written contribution (WT/WGTI/W/98) which described the research conducted by Industry Canada in the area of foreign investment (WT/WGTI/M/14 paras 41 44)

6 At its last meeting the Working Group also continued its debate on investment incentives[1] in which connection there remained differences of view on a proposal for a Secretariat Note on the applicability of the Agreement on Subsidies and Countervailing Measures (WGTI/M/14 paras 45 57)

C STOCKTAKING AND ANALYSIS OF EXISTING INTERNATIONAL INSTRUMENTS AND ACTIVITIES REGARDING TRADE AND INVESTMENT (Item III of the Checklist of Issues Suggested for Study)

[1] A statement made by the representative of Singapore on this subject has been circulated in WT/WGTI/ W/99

7 At the meeting of 7 and 8 March the Working Group was informed of recent activities undertaken by UNCTAD (WT/WGTI/W/101) and the OECD (WT/WGTI/W/100) and of recent regional seminars organized by the European Communities and Japan (WT/WGTI/M/14 paras 59 62)

D ITEM IV OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY

8 At the meeting of 7 and 8 March Korea introduced a communication (WT/WGTI/W/96) on the GATS and its implications for an investment agreement (WT/WGTI/M/14 paras 65 75) The Working Group also reverted to several contributions that had been introduced at previous meetings In this regard statements were made on a contribution by the European Communities (WT/WGTI/W/84) on the impact of international investment rules on national policies a contribution by Hong Kong China (WT/WGTI/W/90) on transparency and a contribution by Japan (WT/WGTI/W92) on the definition of investment (WT/WGTI/M/14 paras 76 82)

9 In his concluding remarks under this item of the agenda the Chairman suggested that it might be useful to consider the possibility of more structured debate along thematic lines and that one theme that could benefit from a more focused discussion was the question as to how investment rules could provide for flexibility to accommodate domestic policy objectives (WT/WGTI/M/14 para 81)

E OTHER BUSINESS

10 At the meeting held on 7 and 8 March the Chairman recalled that the Working Group had agreed in November 2000 that it would decide at the meeting of 13 and 14 June when to hold further meetings in 2001 (WT/WGTI/M/14 para 83)

ANNEX

Summary of contributions received in the Working Group on the Relationship between Trade and Investment

Symbol (WT/WGTI/W/)	*Member / Other source*	*Where introduced (Reference in Minutes)*	*Topic*
W/1	European Community and member States	M/1 Paras 7 9	General submission on issues for study
W/2	Switzerland	M/1 Paras 7 9	General submission on issues for study
W/3	India	M/1 Paras 7 9	General submission on issues for study
W/4	OECD	M/1 Para 4	Presentation on relevant activities of organization
W/5	WORLD BANK	M/1 Para 4	Presentation on relevant activities of organization
W/6	UNCTAD	M/1 Para 4	Presentation on relevant activities of organization
W/7 + Corr 1		M/2 Para 18	The Relationship between Trade and Foreign Direct Investment – Note by Secretariat
W/8 + Adds 1 4		M/2 Paras 4 8	Implications of the Relationship between Trade and Investment for Development and Economic Growth – Work Undertaken in Other Intergovernmental Organizations
W/9	APEC	M/2 Para 41	Presentation on relevant activities of organization
W/10	Hong Kong China	M/2 Para 28	Experience of Hong Kong China regarding the relationship between FDI and development the relationship between trade and investment and between investment and competition policy WTO provisions relevant to investment possible approaches for addressing the interrelationship between trade investment competition
W/11	Japan	M/2 Para 12	Impact of FDI on development and growth the relationship between trade and investment existing international instruments and activities regarding trade and investment
W/12	European Community and member States	M/2 Para 31	Analysis of the relationship between trade and FDI and determinants of FDI based on study of outward FDI from the United Kingdom

Symbol (WT/WGTI/W/-)	*Member / Other source*	*Where introduced (Reference in Minutes)*	*Topic*
W/13	Poland	M/2 Para 13	The role of FDI in Poland s transition from a centrally planned economy to a free market economy
W/14	United States	M/3 Para 4	Trade of foreign affiliates in the United States FDI relationship between the United States and the European Union US EU goods and services trade between related parties
W/15	Colombia	M/3 Para 13	Impact of FDI on the Colombian economy the influence of trade policy on FDI FDI policy of Colombia
W/16	Korea	M/3 Para 16	Trends in FDI role of FDI in Korea s economic development the relationship between trade and investment
W/17	Cuba	M/3 Para 12	Impact of FDI on the Cuban economy
W/18	Japan	M/3 Para 4	Japan s historical experience with FDI policies analysis of existing international investment agreements
W/19	Canada	M/3 Para 39	Stocktaking of existing agreements
W/20	Bolivia		Trends in FDI role of FDI in the Bolivian economy the interrelationship between investment trade and technology and implications for development analysis of existing investment agreements issues relevant to a possible multilateral framework and implications for development
W/21	UNCTAD		Reports on expert meetings on investment held in May and September 1997 and on the second session of the Commission on Investment Technology and Related Financial Issues held on 29 September 3 October 1997
W/22		M/4 Para 45	Bilateral Regional Plurilateral and Multilateral Agreements – Note by the Secretariat
W/23	Australia	M/3 Para 29	WTO provision relevant to investment
W/24		M/4 Para 30	Availability of Statistics on Foreign Direct Investment and on the Activities of Foreign Affiliates – Note by the Secretariat
W/25		M/4 Para 30	The Relationship between Trade and Foreign Direct Investment Foreign Direct Investment Originating in Developing Countries – Note by the Secretariat

Symbol (WT/WGTI/W/)	*Member / Other source*	*Where introduced (Reference in Minutes)*	*Topic*
W/26	OECD	M/4 Para 8	Analysis of the relationship between FDI and economic development on the basis of case studies of six developing countries
W/27	United States	M/4 Para 6	Effect of foreign affiliates on science and technology development in the United States
W/28 - Corr 1	Switzerland	M/4 Para 47	Bilateral investment treaties
W/29	United States	M/4 Para 47	Bilateral investment treaties
W/30	European Community and member States	M/4 Para 57	Identification of common features and differences of existing international investment instruments from the perspective of the European Community and its member States (including rights and obligations of home and host countries and of investors and host countries)
W/31	Costa Rica	M/4 Para 3	Trends in FDI impact of FDI on the Costa Rican economy FDI policy of Costa Rica
W/32	United States	M/4 Para 38	Faced divestiture
W/33	Hong Kong China	M/4 Para 39	Identification of differences possible conflicts and gaps in existing international investment instruments
W/34	Japan	M/4 Para 47	Bilateral investment treaties common elements of existing investment treaties suggestions regarding treatment of specific issues in future multilateral work
W/35	Cuba	M/4 Para 29	Outward FDI from Cuba
W/36	Canada	M/4 Para 39	Stocktaking of existing agreements benefits of multilateral rules
W/37	Turkey	M/4 Para 28	Evolution of FDI policy of Turkey legal framework of FDI in Turkey impact of FDI liberalization on FDI flows relationship between trade and FDI
W/38		M/5 Para 7	Synthesis of the Information made available to the Working Group on the Links between Foreign Direct Investment and Development – Note by the Secretariat
W/39	India	M/4 Para 36	Relationship between the mobility of capital and the mobility of labour
W/40	OECD	M/5 Para 39	Guidelines for Multinational Enterprises
W/41	ASEAN	M/5 Para 18	Investment incentives
W/42	Korea	M/5 Para 27	Bilateral investment treaties

Symbol (WT/WGTI/W/)	Member / Other source	Where introduced (Reference in Minutes)	Topic
W/43	Japan	M/5 Para 52	Definition of investment
W/44			W/44 WAS NEVER ISSUED
W/45	Cuba	M/5 Para 30	Measures affecting Cuba s trade and investment relations
W/46	UNCTAD	M/6 Para 53	Report on the UNCTAD expert meeting on Existing Regional and Multilateral Investment Agreements and their Development Dimension 1 3 April 1998
W/47	Peru	M/5 Para 27	Bilateral investment treaties
W/48	Niger	M/6 Para 40	Bilateral investment treaties
W/49	Korea	M/5 Para 52	Definition of investment
W/50	UNCTAD	M/6 Para 53	Calendar of UNCTAD activities in the field of investment
W/51	Turkey	M/6 Para 40	Bilateral investment treaties
W/52	UNCTAD	M/6 Para 64	Comparison of draft UN Code of Conduct on Transnational Corporations and OECD Guidelines for Multilateral Enterprises texts of UN documents on transnational corporations transfer of technology and restrictive business practices
W/53	UNCTAD	M/6 Para 53	Recent UNCTAD publications relevant to the Working Group
W/54	European Community and member States	M/6 Para 59	Different approaches to the admission of investment in international investment agreements
W/55	United States	M/6 Para 23	The relationship between foreign investment and competition policy
W/56		M/6 Para 9	The Impact of Investment Incentives and Performance requirements on International Trade – Note by the Secretariat
W/57	Korea	M/6 Para 24	The relationship between foreign investment and competition policy
W/58	UNCTAD	M/6 Para 54	Agreed Conclusions of the Third Session of the UNCTAD Commission on Investment Technology and Related Financial Issues 14 September 1998
W/59	Japan	M/6 Para 29	The relationship between foreign investment and competition policy
W/60	Costa Rica	M/6 Para 86 M/7 Para 50	Definition of investment
W/61	IMF	M/6 Para 93 M/7 Para 13	Definition of investment
W/62	Korea	M/6 Para 10	Investment incentives
W/63	European Community and member States	M/7 Para 23	The relationship between foreign investment and competition policy
W/64	Mexico	M/7 Para 12	Investment incentives
W/65		M/7 Paras 3 10	The Effects of Foreign Direct

Symbol (WT/WGTI/W/)	Member / Other source	Where introduced (Reference in Minutes)	Topic
			Investment on Development Technology and other Know how Transfers and Spillovers Note by the Secretariat
W/66			International Intergovernmental Organizations – Observer Status in the Working Group on the Relationship between Trade and Investment
W/67	Japan	M/7 Para 40	The differences between multilateral and bilateral agreements on investment rule making
W/68	Costa Rica	M/7 Para 45	Treatment of Investment and Investors National Treatment and Most Favoured Nation Treatment
W/69	Korea	M/8 Para 4	FDI Flows and the Asian Financial Crisis Korea s experience
W/70	Korea	M/8 Para 72	A Benefit of Multilateral Investment Rules Enhanced Transparency
W/71	India	M/8 Para 47	Stocktaking of India Bilateral Agreements for the Promotion and Protection of Investments
W/72	India		Relationship between Trade Investment and Development
W/73	India	M/8 Para 5	Investment Development and Technology Transfers
W/74	India	M/8 Para 70	The development dimension of international investment agreements
W/75	Japan	M/8 Para 71	Ensuring Transparency and Stability
W/76			Issues raised and points made on the definition of investment – Note by the Secretariat
W/77	UNCTAD	M/9 Paras 76 79	Note on International Investment Agreements Concepts allowing for a certain flexibility in the interest of promoting growth and development
W/78	UNCTAD	M/9 Paras 76 79	Report on the UNCTAD Expert Meeting on International Investment Agreements Concepts allowing for a certain flexibility in the interest of promoting growth and development 24 26 March 1999
W/79	Korea	M/9 Para 41	Multilateral Framework on Investment A Realistic Approach
W/80	Australia	M/9 Para 75	Definition of Investment
W/81	European Community and members States	M/10 Para 9	Responsibilities of foreign investors and corporate codes of conduct
W/82	Korea	M/11 Para 2	FDI and transfers of technology

Symbol (WT/WGTI/W/)	*Member / Other source*	*Where introduced (Reference in Minutes)*	*Topic*
W/83	Hungary	M/11 Para 41	The need for a multilateral framework for FDI The Hungarian experience
W/84	European Community and members States	M/11 Para 39	Advantages and disadvantages of entering into bilateral regional and multilateral rules on investment including from a development perspective Impact of international investment rules on current national policies
W/85	UNCTAD	M/11 Para 36	International Investment and Development A report of UNCTAD s Work Programme in the area of investment after UNCTAD X
W/86	India	M/11 Par 23	Checklist of Issues Suggested for Study Issues that still need to be clarified
W/87	Japan	M/11 Para 40	Improving transparency
W/88	World Bank	M/11 Para 27	Study on Trade FDI and Transfer of Technology
W/89	European Community and member States	M/12 Paras 15 46	Flexibility and non discrimination
W/90	Hong Kong China	M/12 Para 48	Transparency of investment environment
W/91	Korea	M/12 Para 49	Investment Protection Expropriation and Compensation
W/92	Japan	M/12 Para 50	Definition of investment
W/93	OECD	M/12 Para 41	Revised OECD Guidelines for Multinational Enterprises
W/94	UNCTAD	M/12 Para 38	International Investment and Development A report on UNCTAD s Work Programme in the Area of International Investment
W/95		M/14 Para 2	Foreign Direct Investment and the Balance of Payments – Note by the Secretariat
W/96	Korea	M/14 Para 64	The General Agreement on Trade in Services (GATS) and its Implications for an Investment Agreement
W/97	Canada	M/14 Para 41	Foreign Investment Barriers A Report by the Canadian Chamber of Commerce in partnership with Industry Canada
W/98	Canada	M/14 Para 43	Industry Canada Research Program on Foreign Direct Investment
W/99	Singapore	M/14 Para 45	The Economic Relationship between Trade and Investment Investment Promotion and Incentives

Symbol (WT/WGTI/W/)	*Member / Other source*	*Where introduced (Reference in Minutes)*	*Topic*
W/100	OECD	M/14 Para 61	Summary of OECD Work on Issues Related to Investment Policy Analysis
W/101	UNCTAD	M/14 Para 62	Recent work undertaken within UNCTAD s work programme on international investment agreements

WORLD TRADE ORGANIZATION

RESTRICTED
WT/WGTI/M/14
30 April 2001

(01 2175)

Working Group on the Relationship between Trade and Investment

REPORT ON THE MEETING OF 7 AND 8 MARCH 2001

Note by the Secretariat

1 The Working Group on the Relationship between Trade and Investment met on 7 and 8 March 2001 under the Chairmanship of Ambassador Demiralp (Turkey) The Working Group adopted the agenda proposed in WTO/AIR/1482

A IMPLICATIONS OF THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT FOR GROWTH AND ECONOMIC DEVELOPMENT (ITEM I OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)

2 The Working Group discussed a Note by the Secretariat on Foreign Direct Investment and the Balance of Payments (WT/WGTI/W/95) In addition the Working Group reverted to a contribution that had been submitted by India in June 2000 (WT/WGTI/W/86)

(i) The relationship between FDI and the balance of payments

3 The representative of Japan observed that even though it was difficult to draw general conclusions on the impact of FDI on the balance of payments the Note by the Secretariat was consistent with a contribution submitted by Japan in WT/WGTI/W/11 which provided evidence of the positive effects of Japanese outward FDI on the balance of payments of host countries The representative of Hungary stated that because of the difficulty of drawing general conclusions on the relationship between FDI and the balance of payments this issue should be discussed on the basis of the national experiences of individual WTO Members As explained in paragraphs 17 and 18 of WT/WGTI/W/83 FDI had improved Hungary's trade balance by enhancing the competitiveness of Hungarian exports and had also helped finance the deficit on the current account He encouraged delegations to share their national experiences regarding the relationship between FDI and the balance of payments of FDI especially if such experiences were different from Hungary's The representative of Mexico stated that notwithstanding the fact that FDI might have a negative impact on the balance of payments in certain sectors or in certain periods in the life of an investment the fact was that most countries particularly developing countries considered that on the whole FDI made a positive contribution to the growth of their economies and to their external situation through its various direct and indirect effects Significant in this regard was the fact that the last decade had witnessed an intensification of competition between countries to attract FDI The representative of Brazil stated that empirical evidence albeit scarce would seem to point to an overall positive relationship between FDI and the balance of payments but that it was difficult to draw any conclusions given the complexity of the factors involved and the need for a dynamic analysis

4 The representative of Canada stated that it was important to determine the proportion of FDI that was related to the balance of payments and to distinguish between short term and long term capital movements With regard to long term capital movements transfer of funds issues were particularly important Many restrictions existed in this area In the interest of promoting investor

confidence there was a need to promote transparent and predictable investment regimes The annual work of the IMF on capital exchange and import restrictions was very helpful in this respect As a small open economy Canada was highly dependant upon foreign capital skills technology and markets and could not reasonably isolate itself from these trends Extensive research undertaken in Canada had documented the benefits for Canada from the growth of foreign investment and the increasing globalization of business activities The findings of this research pointed to the need for governments to create the basic fundamentals of an economic infrastructure that enhanced the economy s ability to benefit from inward and outward FDI Key factors included effective education and training of workers and management the efficiency of capital markets the existence of competitive domestic markets secure access to international markets the availability of mechanisms to facilitate economic adjustment and tax and regulatory policies which recognized the responsiveness of investment to differences between countries

5 The representative of India stressed the complexity of the relationship between FDI and the balance of payments which required a case by case analysis Whether or not FDI had a positive impact on the balance of payments depended upon factors such as the import intensity of the investment the size of FDI relative to gross domestic investment the particular sector of economic activity in which investment took place the extent to which investment was export oriented and the size of the domestic market of the host country In examining the impact of FDI on the balance of payments it was possible to distinguish between on the one hand negative effects which resulted from the import of capital goods and intermediate inputs the repatriation of funds and transfer pricing and on the other positive effects resulting from the role of FDI in increasing exports from the host economy and in enhancing the competitiveness of local firms In the latter regard however, he questioned whether there was empirical support for the assertion that FDI resulted in transfer of technology to host countries The consideration of these various possible negative and positive effects of FDI on the balance of payments had important policy implications Thus if it was accepted that increased exports were a key aspect to the positive contribution of FDI to the balance of payments countries should have the ability to apply export performance requirements Likewise the fact that the potential of FDI to improve the balance of payments position depended upon the specific sector of economic activity in which FDI took place as illustrated by the difference between investment in consumer goods and investment in infrastructure meant that countries should have the policy freedom to channel investment into areas of priority He pointed to the possible negative implications of mergers and acquisitions as an area requiring further analysis On the whole if one considered the range of possible negative and positive effects of FDI on the balance of payments the conclusion was that while there might not be conclusive evidence that FDI had a negative impact on the balance of payments it was also not possible to state that FDI would certainly lead to an improvement of a country s balance of payments situation In order for FDI to improve the balance of payments it was necessary for countries to have in place an appropriate regulatory structure

6 The representatives of Korea Hungary and the United States agreed with the view expressed in paragraphs 3 4 of the Note that changes in economic conditions and policy orientations notably the shift from market seeking FDI in an environment of protective import substitution policies to export oriented FDI meant that certain studies that had been undertaken in the 1970s on the potentially negative effects of FDI on the balance of payments of host countries were of questionable relevance to current analysis The representative of Hungary stressed the export oriented nature of recent FDI inflows to Hungary and pointed to the size of the domestic market of a host economy as an important factor determining whether an investment was of a market seeking or export oriented nature The representative of India stated that it was important to also take account of other changes that had occurred in the international policy environment including the reduced scope for application of trade restrictions for balance of payments purposes The representative of the United States underlined the point in paragraph 4 that the existence or lack of a competitive environment was a key determinant regarding the positive or negative effect of FDI on a country s balance of payments

7 The representatives of Japan Hungary the European Communities Mexico and Brazil underlined the comment made in paragraph 6 of the Note that the effects of FDI on the balance of payments of a host economy were bound to be country specific and sensitive to the type of investment and its age structure It was noted that the size of the market of the host economy and the specific sector in which FDI occurred were also relevant in this context

8 The representatives of Korea Hungary the European Communities Mexico Brazil and Switzerland agreed with the view expressed in paragraphs 6 8 of the Note that the impact of FDI on the balance of payments needed to be analyzed from a holistic perspective within an analytic framework that encompassed both the direct and indirect and the static and dynamic effects of FDI and that grouping together selected effects of FDI on a host country s balance of payments could give a misleading picture Thus it was stated that account should be taken not only of the trade and financial transactions of foreign affiliates but also of the trade and financial transactions of domestic enterprises and of the cumulative effect of increased economic activity stimulated by FDI on a host country s savings investment relationship In examining the trade effects of FDI, the demand for imports generated by FDI should be analysed in conjunction with the contribution of FDI to the growth of exports and with the import substitution effect of FDI The mutually supportive relationship that developed over time between foreign affiliates and local suppliers and subcontractors reduced the need for the foreign affiliate to import inputs and was an important vehicle for the transfer of technology More generally it was argued that the very notion of positive and negative effects of FDI on the balance of payments of host economies was not meaningful in that it did not take into account the dynamic effects of FDI through the transfer of technology and management and know how spillover effects that were widely seen as the most important aspect of the positive contribution of FDI to development of host economies Such positive dynamic effects occurred through imports of capital goods which from a static point of view could be seen as having a negative impact on the balance of payments

9 With regard to paragraph 9 of the Note the representative of Hungary agreed that it was difficult to disentangle empirically the effects of FDI on the balance of payments and that FDI was seldom the most important factor influencing the balance of payments position of a country In the case of small open economies however with a heavy international debt service FDI could be a very important factor in the formulation of balance of payments policy The representative of Egypt considered that developing countries needed to formulate comprehensive policies aimed at improving all aspects of their balance of payments position which required an assessment of the effects of FDI as one variable affecting the balance of payments The representative of Norway agreed with the point in this paragraph that negative balance of payments effects of imports of capital goods and machinery should be considered as positive from the point of view of capital formation and transfer of technology

10 Regarding the issue of FDI and imports of capital goods and intermediate inputs (Section III of the Note) the representative of Mexico noted the observation in paragraph 12 of the Note that FDI in manufacturing tended to be more intensive in terms of imports of inputs and machinery as compared to FDI in agriculture and services The representative of Brazil stated that the view that FDI in services was less import intensive than FDI in manufacturing might need to be qualified in view of the importance of imports of capital goods in certain service sectors such as telecommunications Thus it was possible that in certain service sectors FDI was more import intense than in manufacturing

11 The representative of Japan referring to his delegation s contribution in WT/WGTI/W/11 observed that while FDI increased imports this was more than compensated for by its import substitution effect and its impact on increased exports The representative of Hungary stated that Hungary had not experienced a trade problem created by FDI as even in the initial phase of FDI inflow during the early 1990s the considerable increase in imports attributable to FDI had been more

than offset by increased exports The representative of the European Communities stated that empirical evidence suggested that even in sectors where foreign investors were heavily dependent upon imported inputs and where local content was low FDI generated foreign exchange for the host country Moreover foreign affiliates that were highly dependent on specialized imported inputs tended to create backward linkages in the host economy and several studies confirmed that over time foreign investors tended to rely less on imports and more on local sourcing The representatives of the United States and Mexico also pointed to these studies The representative of the European Communities further stated that comparisons of imports and exports by foreign affiliates were misleading in that they ignored the import substitution effect of FDI which was illustrated in the Note by the case of Japanese FDI in ASEAN countries Moreover the short term negative effects on the balance of payments resulting from imports of capital goods needed to be weighed against future growth in income and savings The representative of Switzerland stated that the question of the import intensity of FDI should be seen in the perspective of the process of globalization of business activity which meant that firms undertook various stages of a production process in different countries A country in the first stage of this process would produce most of the parts and components but a country at the end of this process would import and assemble parts and components and then usually re export them The representative of Egypt stated that evidence showed that FDI resulted in an increase in imports consumed directly by foreign affiliates in the host country and that this increase varied according to several factors notably the industrial sector in which the FDI was made the age of the project and the level of economic development of the host economy As evidenced by the UNCTAD studies mentioned in paragraphs 16 and 21 of the Note the trade inflows associated with FDI had significant negative effects on the balance of payments of a host country that could be felt in the short and medium term He noted that the analysis in this part of the Note covered only certain regions and requested the Secretariat to extend the coverage of its analysis to include countries in Africa and the Middle East

12 The representative of Norway pointed out that in regard to the trade effects of FDI account should be taken of the existence of intra regional networks of FDI and trade as described in paragraph 18 of the Note The role of FDI as a vehicle for regional economic cooperation was illustrated by Norway s experience with FDI which to a large extent had occurred within the context of European economic integration

13 With reference to paragraph 23 of the Note the representatives of Hungary and the European Communities stated that while local content requirements were frequently used to reduce the import intensity of FDI empirical studies had shown that such requirements could actually reduce a country's export potential so much as to result in a deterioration in the balance of payments The representative of Hungary observed in this regard that there were WTO compatible tools available for governments to channel investment to sectors which were mostly export oriented The representative of Korea stated that Korea s experience demonstrated that domestic content requirements were not an appropriate policy tool to reduce the import intensity of FDI The representative of India questioned the view expressed in the study referred to in paragraph 23 that a country s export potential might actually be reduced by a domestic content mandate especially in light of the statement by the European Communities that foreign investors tended to rely on local sourcing

14 With respect to FDI and transfer pricing (Section IV of the Note) the representative of Hungary stated that transfer pricing was a genuine problem that required attention from a competition policy perspective rather than a balance of payments perspective As an example of anti competitive conduct transfer pricing illustrated the need to supplement a multilateral framework for FDI with a multilateral framework on competition policy in the WTO which should provide safeguards against certain restrictive business practices The representatives of the United States, the European Communities and Egypt referring to recent work by UNCTAD on this subject drew attention to the role of bilateral treaties on the avoidance of double taxation as a means to address concerns regarding transfer pricing

15 Regarding the issue of FDI and the repatriation of profits and dividends and payments of royalties (Section V of the Note) the representatives of Hungary the European Communities and the United States stated that the outward payments of direct investment income should not be viewed in isolation but in conjunction with other effects of FDI including reinvestment of profits by foreign affiliates The representative of Egypt considered that governments of host countries had a role to play in regulating the practices of multinational enterprises relating to the transfer of funds and that bilateral investment treaties provided the necessary policy flexibility in this regard

16 Regarding Section VI of the Note (FDI Balance of Payments Management and Financial Crisis) the representative of Switzerland underlined the comment that a current account deficit resulting from higher growth rates was not by itself problematic and that the key issue was how such a deficit could be financed In this connection the representative of Egypt noted the statement that the sustainability of a current account deficit over time depended importantly on the extent to which increased export earnings became available to meet external financial obligations arising from the foreign capital inflow This underscored the need for WTO Members to continue their efforts to improve market access opportunities especially for products of interest to the more vulnerable economies The representatives of Korea Hungary the United States the European Communities Mexico Norway Switzerland and India agreed with the point that FDI was a more stable source of investment than other components of private capital flows Reference was made to Annex Table 1 which provided evidence of the contrast between the stability of FDI and the volatility of other capital flows in the context of the Asian financial crisis The representative of Hungary also mentioned the fact that FDI inflows to Hungary had not been affected by the Russian crisis of 1998 In his delegation s view the greater stability of FDI as compared to other capital movements meant that a realistic agreement on investment in the WTO should focus on FDI The representative of Mexico drew attention to the important role of FDI in the financing of Mexico s recent current account deficit and observed that balance of payments difficulties that might arise from a liberalization of FDI could be addressed through inclusion of a balance of payments safeguards clause in a possible framework of multilateral rules in the area of investment The representative of Norway pointed to the problem of the concentration of FDI inflows in a limited number of host countries OECD countries accounted for two thirds of FDI inflows while ten developing countries accounted for 75 per cent of the remaining one third of global FDI inflows Thus as had been reiterated in a number of UNCTAD studies the important question was what made countries attractive as destinations for FDI

17 The representative of the United States observed that the Note was limited in its focus on mergers and acquisitions as compared to several references to greenfield investment and asked whether this omission stemmed from the limited availability of data on mergers and acquisitions and their impact on the balance of payments or was in response to a certain rationale for focusing on one type of FDI versus another In addition she suggested that further work on this topic could include an analysis by the Secretariat of the economic benefits of portfolio investment the reasons why investors decided to invest through portfolio investment and the inter relationship between FDI and portfolio flows which would highlight any advantages of attracting portfolio flows in order to increase FDI flows This analysis should also examine the concerns that had been expressed by other Members with regard to portfolio flows and the options that had been used in international agreements to address such concerns

18 The representative of the Secretariat stated that the Secretariat could try to supplement the Note with an examination of portfolio investment and of mergers and acquisitions In response to the question raised by India on the study referred to in paragraph 23 he stated that the argument in the study cited in this paragraph was that local content requirements frequently would involve a foreign or domestic producer purchasing higher cost inputs than would otherwise be the case which would reduce their competitiveness including on export markets

19 The representative of India stressed the need for any study by the Secretariat of portfolio investment analysis to be to balanced regarding the positive and negative effects of such investment flows

20 The Working Group agreed that the Secretariat would supplement its Note with an examination of portfolio investment and mergers and acquisitions along the lines suggested by the United States and India

(ii) Comments on India s written contribution in WT/WGTI/W/86

21 The Working Group reverted to a communication that had been introduced by India at the meeting of the Working Group held in June 2000 (WT/WGTI/W/86)

22 In recapitulating the main themes of this contribution the representative of India stated that his delegation acknowledged the important role of FDI in the economic development of countries including developing countries but that account should be taken of the fact that liberalization of investment regimes was undertaken autonomously by a number of countries and of the existence of a well established network of bilateral investment treaties Such treaties were favoured by countries like India because they did not require countries to make fundamental changes to their FDI policies required countries to grant national treatment only in the post establishment phase and made it possible to vary the definition of investment in light of the particular needs of the parties to such treaties Contrary to the rich experience with bilateral investment treaties there was no experience with investment rules at the multilateral level apart from the unsuccessful attempt to conclude a Multilateral Agreement on Investment As had been observed by his delegation in relation to a written contribution from Hungary (WT/WGTI/W/83) there was no basis to believe that a multilateral framework would lead to increased FDI inflows Interestingly a recent study predicted that FDI flows would increase very substantially in the next ten years and that this growth of FDI flows should not be seen as a zero sum game The study also indicated that the share of developing countries in world wide FDI inflows was not expected to change The broad range of factors on which the study s forecast of FDI flows was based including market size economic policies growth rate input costs geography and natural resource endowments underlined the fact that a country s attractiveness to FDI was determined by many factors other than its investment regime The example of the industrial development policies pursued by Korea which had permitted FDI only when other means of accessing foreign technology were not available demonstrated that the benefits of FDI were related to the ability of host countries to place some conditions of FDI This ability to place conditions on FDI in the form of export performance requirements or transfer of technology requirements was critical to explaining the development of Korea and of some of the ASEAN countries In summary his delegation considered that not sufficient experience had been gained at the international level other than in the context of bilateral investment treaties that a multilateral framework of rules would not lead to increased flows of FDI and that developing countries could only derive benefits from FDI if they retained the policy flexibility to place certain conditions on FDI

23 The representative of the European Communities agreed with India that investment was not a zero sum game which implied that there was perhaps more scope for cooperation between governments in this area than in other areas The fact that investment decisions were primarily based on evaluations of how various economic conditions affected the profitability of an investment project did not mean that other factors did not matter Governments had a role to play in establishing a friendly climate for foreign investment which was perfectly compatible with the pursuit of domestic policy objectives The possible value added of multilateral rules on investment in the WTO should be seen in this light It had never been suggested that the establishment of such rules was key to enhancing the attractiveness of host countries to FDI Rather they would make a limited but valuable contribution by enhancing legal certainty for investors With respect to the comment by India that host country governments needed to be able to impose conditions on foreign investment he stated that

India s interpretation of Korea s experience would appear to be different from the conclusions drawn by Korea The notion that host countries needed to be able to impose conditions on foreign investment was in contradiction with the fact that experience had demonstrated that the imposition of conditions on FDI was often not an effective policy instrument For example available evidence indicated that investors were reluctant to use their best technology in host countries if faced with conditions imposed upon them by host countries

24 The representative of Argentina referring to the comments by the European Communities stated that the question of the relationship of FDI and the quality of technology transferred to host countries required further analysis FDI did not necessarily entail a transfer of the best technology by a foreign investor Rather depending upon the structure of the particular market foreign investors sometimes preferred to use less advanced forms of technology for example in the case of captive markets

25 The representative of the European Communities stated that FDI was a major channel for the transfer of technology but that there was no mechanical relationship between the presence of FDI and the transfer of technology In order to realize the potential of FDI to contribute to transfer of technology host countries needed to develop a capacity to absorb and benefit from imported technology In addition effective transfer of technology could be impeded by certain market conditions For example the lack of competition in a protected market reduced the incentive for investors to use their best technology However the imposition of a transfer of technology requirement in such a protected market environment was not an efficient policy instrument

26 The representative of the United States wondered whether the reference by India to bilateral investment treaties included the bilateral investment treaties concluded by the United States which provided for national treatment and Most Favoured Nation treatment with respect to the pre establishment phase Concerning India s reference to Korea s experience with FDI and transfer of technology she recalled that in its written contribution on this topic Korea had actually argued against the use of transfer of technology requirements

27 The representative of Norway referring to the observation in India's contribution in WT/WGTI/86 that quality FDI brought with it not only capital but also intangible assets such as technology entrepreneurship management skills and employment highlighted the role of FDI in various stages of Norway s industrial development FDI had been of major importance as a source of capital and technology in the process of rapid industrialization that had occurred in Norway during the first decades of the last century on the basis of the introduction of hydro electrical power The substantial inflow of FDI during this period had resulted in a deficit on the balance of payments Similarly foreign capital and technology associated with FDI had played a major role in the process of reconstruction following the second world war and in the development of Norway s oil and gas extraction industry since the late 1960s Regarding India s views on the issue of policy flexibility he stated that the advantages of such flexibility in enabling countries to adopt policies suited to their individual development needs should be seen in conjunction with its negative impact in engendering short term policies which reflected pressures from various special interest groups Norway s experience for example in the context of the WTO and the EEA was that international rules could help governments confront such pressures when economic policy changes were necessary Likewise the flexibility provided for under bilateral investment treaties might lead to a lack of predictability and transparency and to discrimination In addition handling a host of bilateral investment treaties might create domestic as well as external conflicts While not contesting the value of bilateral investment treaties his delegation considered that in the absence of a broader multilateral framework it was difficult to ensure consistent treatment of investors Regarding India's observations on the issue of performance requirements he considered that it might be useful to address the issue of the different perceptions of what constituted a performance requirement In this respect he questioned whether requirements with which foreign investors were expected to comply pursuant to domestic health

environmental and safety regulation could be considered as performance requirements The article by Hoekman and Saggi mentioned in India's contribution raised the important issue of whether investment incentives should be addressed A key question in this context was whether subsidies and investment incentives were comparable Finally the elements that were mentioned in the concluding section of India's contribution including non discrimination predictability transparency pre establishment and post establishment warranted a more focused discussion in the Working Group

28 The representative of Costa Rica stated that the positive role of bilateral investment treaties was generally recognized but that the proliferation of such treaties in recent years had given rise to problems of discrimination and lack of transparency which needed to be addressed in the context of the WTO In addition to generating a lack of transparency and predictability for investors existing agreements failed to address the trend toward concentration of FDI inflows on a small number of countries His delegation disagreed with the assertion that an investment agreement in the WTO would constrain the ability of countries to pursue their development policies Existing WTO rules in the field of trade in services which also covered investment did not limit the authority of governments to regulate and to pursue development policies On the contrary such rules provided an appropriate framework within which such policies could be pursued in a transparent and non discriminatory manner

29 The representative of Malaysia stated that his delegation remained unconvinced of the need for multilateral rules on investment in the framework of the WTO and that Malaysia s interests were best served by bilateral investment treaties He wondered whether the European Communities and other proponents of multilateral investment rules were prepared to envisage the possibility of permanent carve outs of sectors and policies from the scope of the national treatment requirement In response to the comments by Norway on the difficulties generated by bilateral investment treaties in the absence of a multilateral framework he stated that his delegation viewed the benefits of such treaties primarily in terms of the assurances which they offered with regard to the treatment and protection of the investors from the parties to such treaties At the same time the Most Favoured Nation clauses contained in such treaties protected investors from the risk of discrimination as compared to investors from third countries Thus the concern expressed regarding the possible discriminatory effects of bilateral investment treaties was unfounded

30 In response to the question posed by Malaysia the representative of the European Communities stated that most WTO rules with the possible exception of rules on transparency were subject to exceptions and that it was obvious that a multilateral framework on investment based on WTO principles would also contain exceptions The nature and scope of such exceptions were a matter for negotiation The national treatment obligation of the GATT which was subject to permanent exceptions and the national treatment obligation of the GATS which was applied in the context of a bottom up approach to specific commitments were illustrative of different possible approaches to provide flexibility in the application of a national treatment rule

31 The representative of the United States stated that even the principle of transparency was sometimes qualified as illustrated by the provisions on confidential information in Article 63 of the TRIPs Agreement

32 The representative of Malaysia stressed that the question which he had raised pertained to the possibility of permanent carve outs as distinguished from the kind of approach embodied in the GATS The concern with that GATS approach advocated by many delegations was that over time it would generate pressure on countries to assume additional commitments in sectors in which they had initially not assumed obligations In response to the comments by some delegations that bilateral investment treaties entailed greater costs than a multilateral framework he stated that the difficulties currently encountered by developing countries in obtaining extensions of the transition period in the TRIMs Agreement illustrated the kind of problems developing countries were likely to face if their

development needs required a modification of commitments undertaken in the context of a multilateral investment agreement

33 The representative of the European Communities stated that the notion of permanent carve outs advanced by Malaysia was a new concept that might perhaps merit further consideration but that the proposal made by the European Communities for investment negotiations in the WTO already provided sufficient flexibility for countries to pursue developmental and other domestic policy objectives In response to Malaysia s concern about pressures exerted on countries to assume further liberalization commitments he stated that there was no mechanism in the WTO by which countries could be compelled to liberalize against their will Rather WTO Members engaged in new negotiations only when they deemed it in their interest to do so

34 The representative of Japan stated that Japan did not deny the importance of bilateral investment treaties as evidenced by the fact that Japan was currently in the process of negotiating several such treaties However since the content of such treaties was determined by the economic conditions of the two parties involved they were inadequate as a means to secure a consistent investment environment on an international basis In consequence the fact that bilateral investment treaties were useful did not detract from the need for multilateral rules on investment to complement such treaties Regarding the notion of flexibility he stated that the importance of flexibility in the context of investment rules was generally recognized but that flexibility used to discriminate against certain investors was problematic It was therefore necessary to ensure that flexibility was exercised consistently with WTO rules

35 The representative of Hungary noted that at the meeting held in October 2000 India had made reference to a paragraph in Hungary s contribution in WT/WGTI/W/83 on the role of government intervention in addressing certain policy challenges arising in connection with FDI India had suggested that these policy challenges warranted a case by case screening of investment In fact however as stated in paragraph 19 of WT/WGTI/W83 Hungary s experience was that it was possible to address such problems without resort to the use of screening mechanisms

36 The representative of Korea referring to the comments by the United States and to his delegation s contribution in WT/WGTI/W/82 stated that the conclusion from Korea s experience with FDI and the transfer of technology was that the appropriate policy was to refrain from imposing discretionary conditions on foreign investors and to invest in infrastructure and training In respect of the issue of the advantages and disadvantages of bilateral investment treaties and multilateral rules he considered that a disadvantage of existing bilateral investment treaties was the lack of an integrated approach to the pre establishment and the post establishment phase of investment Although it was difficult to predict whether investment flows would actually increase as a result of the establishment of a multilateral framework his delegation was convinced of the potential long term benefits of such a framework in that it would enhance transparency and predictability and thereby lead to more stable FDI flows and contribute to overall economic growth and development

37 The representative of Switzerland stated that notwithstanding that a multilateral agreement on FDI would not lead to significant increases in FDI flows such a multilateral framework was preferable to the very large number of existing bilateral investment treaties The GATT and GATS demonstrated how in the fields of trade in goods and trade in services multilateral rules which provided for flexibility to take into account the needs of individual countries had been found to be more efficient than bilateral treaties A multilateral framework of rules on investment would ensure non discrimination and a consistent treatment of investors He acknowledged that the negotiation of such a framework would raise difficult questions that required careful consideration such as performance requirements and investment incentives In respect of the view expressed in the study referred to by India that priority should be given to the GATS before considering the adoption of investment rules he stated that investment rules should apply not only to services but also to other

sectors of economic activity In response to the question raised by Malaysia he considered that an investment agreement based on the GATS model of positive commitments would provide for an appropriate degree of flexibility to accommodate the circumstances and levels of development of individual countries

38 The representative of Chile stated that the establishment of multilateral rules on investment would provide for a more homogeneous international framework and thereby enhance predictability for investors In addition it would reduce the considerable administrative costs to governments of negotiating myriad bilateral investment treaties Such a multilateral framework could go beyond the existing bilateral investment treaties by building on the GATS approach to pre establishment commitments to create a single integrated framework for investment in goods and services

39 The representative of India stated that it was clear from the debate that it was generally acknowledged that a multilateral framework of rules on investment would not guarantee an increase in FDI inflows into developing countries In addition the implications of such a framework for the balance of payments positions of countries were complex and there were divergent views among Members on whether a positive relationship existed between FDI and the transfer of technology It thus appeared that the main arguments advanced in favour of a multilateral framework on investment pertained to the contribution that such a framework could make to enhancing transparency and predictability In the view of his delegation these arguments were not compelling Given that there was ample information available on bilateral investment treaties the existence of a large number of such treaties could not be considered to have caused a problem of lack of transparency that would warrant the creation of multilateral rules Similarly bilateral investment treaties adequately provided for predictability for the investors of the parties concerned while taking into account the specific circumstances of individual countries which would be difficult if a uniform multilateral approach were adopted On the other hand while the alleged advantages of multilateral rules on investment in the WTO in terms of enhanced transparency and predictability were questionable such rules would certainly entail costs by exposing countries to the risk of WTO dispute settlement proceedings

40 The Working Group took note of the statements and agreed to revert to Item I of the Checklist at its next meeting

B THE ECONOMIC RELATIONSHIP BETWEEN TRADE AND INVESTMENT (ITEM II OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)

(i) New written contributions

41 The representative of Canada introduced a contribution (WT/WGTI/W/97) which summarized the findings of a recent report on foreign investment barriers that had been undertaken by the Canadian Chamber of Commerce in partnership with the Department of Industry She recalled that at the meeting held in October 2000 the European Communities had informally circulated the results of a similar survey of attitudes of European firms toward international investment rules and of obstacles to foreign investment experienced by European investors Based on a survey of responses from some 70 Chamber of Commerce member companies the report provided detailed information on the kinds of impediments or barriers encountered by businesses the regions involved and industries affected the transparency of the implementation of the barrier the degree of restriction to Canadian investors and the importance of safeguarding Canadian investments abroad The main findings of the report were that 28 per cent of the respondents had faced restrictions in one form or another over the past five years that 38 per cent of the barriers identified had resulted in the investment being cancelled or suspended and that 43 per cent of these barriers had resulted in the terms of the investment being altered The report had also found that 71 per cent of the identified barriers were in countries outside of the OECD that 56 per cent of the restrictions were transparent barriers while 19 per cent of the restrictions involved non transparent barriers and that 25 per cent

of the restrictions involved discretionary decision making on the part of host country governments The report concluded that for Canada with an internationally oriented economy the creation of a commercial environment that was based on rules transparency openness and predictability was critical for future economic prosperity In response to a question by the representative of India she stated that the report which was available on the Government of Canada s investment website provided extensive information on the nature of the barriers covered by the survey

42 The representative of Korea highlighted the findings in the report that 56 per cent of the restrictions involved transparent barriers that 38 per cent of the barriers had resulted in the investment being cancelled or suspended, and that 43 per cent had resulted in the terms of the investment being altered These figures illustrated the substantial costs engendered by investment restrictions

43 The representative of Canada also introduced a written contribution (WT/WGTI/W/98) describing the Industry Canada research programme that had been conducted over the last several years Through its micro economic research programme Industry Canada had been in the forefront in efforts to promote an understanding of the nature and the effects of FDI including FDI of foreign firms in Canada and FDI by Canadian firms in other countries The results of these research undertakings were quite extensive and were documented in several volumes in the Industry Canada research series as well as in a number of Industry Canada working papers discussion papers and occasional papers While the research programme had been undertaken in the context of Canada s economic experiences its results were instructive more generally and might be helpful in the analytical and educative work of the Working Group

44 The representative of Switzerland stated that the research programme described in WT/WGTI/98 was highly relevant to the work of the Working Group in that it covered a broad range of aspects of Canada s experience with FDI as well as a number of important theoretical subjects

(ii) Investment incentives

45 The representative of Singapore made a statement on the benefits of investment incentives[1] The debate in the Working Group on investment incentives should be more balanced and not be focused only on the alleged trade or investment distortive effects of incentives His delegation disagreed with the proposal made at a previous meeting by Hong Kong China for a Secretariat study on the applicability of the Agreement on Subsidies and Countervailing Measures (ASCM) to investment incentives

46 The representative of India stated that his delegation was still reflecting on the issue of investment incentives A fundamental question was whether incentives could distort FDI flows and if so whether there was a willingness to contemplate disciplines

47 The representative of Canada considered that there were a number of questions that might usefully be explored with regard to investment incentives Over the past few decades international investment flows had increased dramatically and both developed and developing countries had become more conscious of the importance of investment for their economies Governments had come to value the role of international investment as an engine of growth and job creation and a source of competitiveness including through the introduction of new technologies and managerial skills At the same time more and more governments appeared to compete to attract investment As noted by Singapore such competition could have beneficial effects by inducing governments to strengthen economic fundamentals improve infrastructure and reduce the restrictive and discriminatory elements of their investment regimes On the other hand however global competition for FDI might also have unforeseen and negative effects For example bidding wars could have a particular negative impact

[1] Circulated in document WT/WGTI/W/99

on smaller economies which did not have the resources to compete There might also be a distortionary impact on the allocation of capital For these reasons Canada believed that the area of incentives merited further discussion and analysis by the Working Group with regard to the range of issues that had been raised

48 The representative of the European Communities stated that the ASCM applied to investment incentives to the extent that incentives were subsidies but that because of its focus on trade effects the Agreement was not effective in avoiding distortions to investment flows Referring to the questions raised by India he considered that available evidence indicated that investment incentives had the potential to distort investment flows and that international disciplines were therefore warranted While various policy reasons could be advanced in favour of the use of investment incentives as argued by Singapore there were also many reasons why disciplines on the granting of incentives were necessary including the race to the bottom effect the disparities between countries in terms of their financial capacity to grant such incentives and the inefficient resource allocation resulting from incentives Whether such disciplines should be similar to those contained in the ASCM was a matter for further consideration An underlying principle of the ASCM that could usefully be applied to disciplines on investment incentives was that disciplines on the trade distorting effects of subsidies needed to be accompanied by a recognition of the role of subsidies in the pursuit of domestic policy objectives

49 The representative of Argentina agreed with the views expressed by the European Communities The capacity to grant incentives varied greatly among countries including among developing countries The case of the automobile sector amply illustrated how incentives could distort trade

50 The representative of Australia stated that in Australia's experience incentives definitely had the potential to distort investment flows and her delegation therefore wished to explore this subject further especially with regard to the question of whether incentives were trade distorting subsidies and their effects in distorting competition Her delegation supported the right of each government to develop and use the policy tools it deemed appropriate to attract investment but it also agreed that certain disciplines were necessary to avoid distortions

51 The representative of Hong Kong China recalled that on previous occasions his delegation had emphasized the importance it attached to further work on the issue of investment incentives In particular further study was necessary to determine under what conditions the use of incentives had undesirable effects In this respect he reiterated the proposal made by his delegation at previous meetings for a factual study by the Secretariat on the applicability of the ASCM to investment incentives The Group's discussion on the balance of payments implications of FDI illustrated how such a study by the Secretariat could stimulate debate among Members Because the Working Group was a forum for educational work and was not engaged in a negotiation he disagreed with the view that its work should be based only on contributions by Members While Members could of course provide their own contributions on the scope of the ASCM in relation to investment incentives and its drafting history a study by the Secretariat would be more neutral and objective The preparation of such a study was entirely consistent with the practice of the WTO in particular in light of the fact that Secretariat background notes were sometimes even used in the context of negotiations In any event a note by the Secretariat along the lines suggested by his delegation would not constrain Members' ability to grant incentives

52 The representative of the United States stated that before it could support the proposal for a factual study by the Secretariat her delegation wished to have further discussion from the perspective of Members In addition her delegation considered that discussions in the Working Group should focus on more traditional investment issues such as transparency and Most Favoured Nation

treatment and national treatment Investment agreements traditionally had not focused on investment incentives beyond those related to performance requirements

53 The representative of Mexico stated that studies that had been reviewed by the Working Group and several contributions submitted by individual Members provided evidence of the potential of investment incentives to distort trade and investment flows especially when incentives were granted in the context of competition between countries to attract investment It was therefore necessary to explore what kind of multilateral disciplines could address such distortive effects She reiterated her delegation s support for the proposal by Hong Kong China for a study by the Secretariat of the applicability of the ASCM to investment incentives With regard to Singapore s argument that investment incentives served useful policy purposes such as to correct for poor economic fundamentals or to direct investment to particular regions of a host country she considered that as explained in her delegation s contribution in WT/WGTI/W/64 investment incentives were often second best policy instruments which in most cases did not attain the stated objectives Instead of attempting to compensate for the effects of market failures policies should be aimed at the causes of such failures For example if the objective was to enhance the attractiveness of a particular disadvantaged region to FDI the optimal policy was to invest in infrastructure In addition to being sub optimal policy instruments investment incentives generated significant costs in terms of discrimination against small firms and domestic investors rent seeking behaviour and inefficient allocation of capital which had a negative impact on the host country s comparative advantage

54 The representative of Japan stated that whether incentives had a distorting effect depended upon how one defined the meaning of distortions in this context His delegation did not consider that investment rules should regulate all possible distorting practices The appropriate definition of what constituted a distortion that needed to be addressed in such rules should be determined in negotiations

55 The representative of Hungary agreed with the views expressed by the European Communities Argentina Australia Mexico and Hong Kong China His delegation supported Hong Kong China s proposal for a Secretariat study

56 The representative of Poland stated that the subject of investment incentives was very important and required further deliberations in the Working Group She noted that competition between governments to attract FDI occurred especially in relation to greenfield FDI which had remained stable as distinguished from FDI in the form of mergers and acquisitions which had increased substantially in recent years Recent studies suggested that investment incentives perhaps had more positive than negative effects and that they influenced the relative attractiveness to foreign investors of countries within the same region but did not affect choices by investors between countries that were located in different regions of the world

57 The Working Group took note of the statements and agreed to revert to Item II of the Checklist at its next meeting

C STOCKTAKING AND ANALYSIS OF EXISTING INTERNATIONAL INSTRUMENTS AND ACTIVITIES REGARDING TRADE AND INVESTMENT (ITEM III OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)

(i) WTO provisions on matters related to investment

58 No statements were made on this indent of Item III

(ii) *Bilateral regional plurilateral and multilateral agreements and initiatives implications for trade and investment flows of existing international instruments*

59 The representative of the European Communities drew attention to two regional seminars that had been organized by his delegation The first had been held in Santiago de Chile in November 2000 and had been co hosted by the Government of Chile The second seminar had been held in Cape Town in February 2001 and had been co hosted by the Government of South Africa The seminars focused on four possible subjects for negotiation in the WTO investment competition environment and trade facilitation The aim of the seminars was to provide for informal discussion with capital based policy makers in the two regions concerned Representatives of the business community and academic experts had also participated Care had been taken to present the full spectrum of differing views on these subjects Specifically with regard to investment the debate at these seminars had revealed that there was wide support for the view that stability transparency and non discrimination played a role as one of the factors that determined the attractiveness of host countries to FDI The importance of the degree to which countries were integrated into the international economy had also been emphasized The need for a gradual approach to investment liberalization had been highlighted especially in respect of capital movements In respect of investment incentives it had been remarked that they were already covered to some extent by existing WTO rules and that they could adversely affect the interests of the poorer developing countries At the same time it had been argued that there was a need for developing countries to retain the capacity to provide certain incentives Another theme that had attracted attention was the need for special and differential treatment of developing countries in the design of international investment rules which should not simply be in the form of exemptions In the case of the African seminar attention had been drawn to the problem of the existence of risk perceptions that were not in line with actual economic conditions and to the role of multilateral investment rules in bridging this gap between perception and reality However it had been acknowledged that international rules could not solve problems of lack of political stability and other structural problems The risk of investment policies being captured by special interests of powerful foreign or domestic investors had been highlighted in which connection it had been argued that multilateral rules could help countries resist pressure from such interests A very prominent theme of discussion had been the issue of the need for flexibility for developing countries Finally the specific needs of developing countries for technical assistance in an investment negotiation had been discussed

60 The representative of Japan stated that an APEC regional seminar on investment had taken place in Manilla in November 2000 organized by the Government of the Philippines and the Government of Japan and that a bilateral seminar on investment had been held in Beijing in February 2001

61 The representative of the OECD made a statement on recent OECD work on investment[2]

62 The representative of UNCTAD made a statement on recent UNCTAD work on investment[3]

63 The Working Group took note of the statements made and agreed to revert to Item III of the Checklist at its next meeting

Circulated in document WT/ WGTI/W/100
Circulated in document WT/WGTI/W/101

D ITEM IV OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY

(i) New written contributions

64 The representative of Korea introduced a written contribution on the GATS and its implications for an investment agreement (WT/WGTI/W/96) He emphasized that in accordance with the educational character of the work of the Working Group the sole purpose of this contribution was to facilitate discussions in the Working Group without prejudice to any Member's views The contribution identified major elements of investment rules MFN treatment and national treatment progressive liberalization and free transfer of payments provisions on transparency and standstill and on expropriation and compensation and other investment protection measures provisions on performance requirements and investment incentives and special provisions on developing countries and technical assistance In view of the flexibility provided for in the GATS the importance of developmental considerations in the GATS and the fact that the GATS already contained most of the above mentioned major elements of investment rules Korea considered that the GATS could serve as a benchmark in formulating multilateral rules on investment in the WTO However it was necessary to address certain issues that were dealt with in other international investment agreements but not in the GATS including expropriation and compensation and performance requirements In considering how the GATS model could provide a basis for multilateral rules on investment the Working Group could usefully discuss a number of questions at a technical level whether the services sector should be included in new investment rules or whether such rules should apply only to non services sectors how to bridge the differences between the definition of investment in a multilateral framework and the concept of commercial presence in the GATS how to treat and define the scope of specific market access commitments in the GATS how GATS provisions relating to transparency and domestic regulation monopoly suppliers business practices and safeguard measures transfers of funds and balance of payments measures should be applied in a multilateral framework in particular whether they should apply equally to the pre establishment and the post establishment phases and whether they should be defined as conditional or unconditional principles and how to address other elements of investment rules not dealt with by the GATS such as incentives performance requirements and expropriation and compensation

65 The representative of Switzerland stated that regarding the pre establishment phase his delegation agreed with the views of Korea on the desirability of a bottom up approach as the basis for multilateral investment rules With regard to the post establishment phase attention needed to be paid to performance requirements investment protection investment incentives and the relationship of multilateral investment rules in the WTO to the GATS the TRIMs Agreement the ASCM bilateral investment treaties and other international agreements The questions posed by Korea at the end of its contribution would help facilitate a more focused discussion in the Working Group

66 The representative of Hungary referring to his delegation s position on a realistic approach to multilateral investment rules in the WTO agreed with Korea that the GATS, which covered FDI through its commercial presence mode of supply could serve as a model for an agreement on investment in the WTO The GATS covered many important issues that should be included in such an agreement provided a considerable degree of flexibility and had operated to the satisfaction of Members In respect of paragraph 4 of Korea s communication he noted that the national treatment provision in the GATS was not only conditional on the existence of specific commitments in a particular sector but was also subject to conditions and qualifications set forth in schedules of commitments of individual Members The obligation in GATS Article III 1 regarding the prompt publication of all relevant measures of general application pertaining to or affecting the operation of the GATS was not absolute as Article III 2 provided that if publication of such information was not practicable Members were required to make it otherwise publicly available He also drew attention to the requirement of Article III 3 of the GATS that Members inform the Council for Trade in Services of the introduction of relevant new laws, regulations and administrative guidelines and of changes to

such laws regulations and guidelines In respect of the comments in Korea's communication on standstill provisions in the GATS he noted that the GATS required Members seeking to modify or withdraw a commitment to enter into negotiations with a view to reaching an agreement on any necessary compensatory adjustments and that Members were required to endeavour to maintain a general level of mutually advantageous commitments Most of the questions posed by Korea in paragraph 11 of its communication would become relevant after a decision had been taken at the next Ministerial Conference to establish a mandate for negotiations on investment but at this time it was perhaps premature to consider these questions in detail

67 The representative of the European Communities shared the view that the GATS was a very useful model for a possible investment agreement in the WTO especially in regard to issues such as market access but that it would be necessary to go beyond the GATS in respect of certain subjects not addressed in the GATS including performance requirements and investment incentives He concurred with Hungary that the questions posed by Korea in paragraph 11 of its communication were very pertinent but that they could only usefully be addressed once a decision had been taken to negotiate investment rules in the WTO

68 The representative of India stated that his delegation was concerned that Korea s communication went beyond the mandate of the Working Group and in this respect he welcomed Korea s statement that this communication was without prejudice to the views of any Member With respect to paragraph 4 of Korea s communication he observed that a central feature of the GATS which provided flexibility to developing countries was that national treatment was not a general obligation but applicable only to the extent Members had made specific commitments which were subject to conditions and qualifications inscribed in a Member s schedule One fundamental problem with Korea s communication stemmed from the notion of the GATS as a bottom line or starting point This seemed to imply that the objective was to achieve a higher level of ambition over time and that developing countries that had entered into a negotiation in good faith on the basis of certain parameters would eventually face pressures to assume higher levels of obligation Another basic concern with Korea communication arose from the fact that the questions in paragraph 11 seemed to contemplate a consideration of possible amendments to the GATS the TRIMs Agreement and the ASCM which would have far reaching implications In sum his delegation considered that Korea s communication failed to provide a precise indication of the level of ambition sought by the proponents of investment negotiations in the WTO Rather it raised additional questions and concerns by referring to the GATS as a bottom line or starting point and by suggesting that an investment negotiation might engender amendments to existing WTO agreements

69 The representative of Brazil considered that an approach based on the GATS was consistent with the idea of a realistic approach to a possible multilateral framework on investment in the WTO because of the extensive flexibility provided for in the GATS through the positive list approach and through the exemptions from MFN treatment He seconded the comments by Hungary and India on the statements on national treatment and transparency in paragraph 4 of Korea s contribution The flexibility enjoyed by developing country Members with regard to the scheduling of specific commitments enabled them to apply conditions aimed at achieving the objective of Article IV of the GATS to increase the participation of developing countries in trade in services and to include in their schedules provisions on performance requirements and investment incentives Referring to the comments by India he observed that, if the objective was to develop a realistic approach one should be careful in using the concept of the GATS as a starting point He agreed with previous speakers that the questions in paragraph 11 were important but that addressing them at this time might be premature He asked Korea to explain what was meant by the question raised in the third bullet in paragraph 11 of how to treat and define the scope of market access commitments in the GATS

70 The representative of Chile stated that the GATS was a good model for an investment agreement in so far as it provided for liberalization on the basis of a positive list approach but that in

other respects further consideration was necessary of whether the principles applied to trade in services could also be applied to investment The questions in paragraph 11 of Korea s communication could only be addressed at a later stage once it had been decided to negotiate on a multilateral framework on investment and having regard to further negotiations in the framework of the GATS She noted that in most countries regulations applicable to investment did not distinguish between services and non services sectors Referring to the comments by India she observed that while it was true that national treatment in the GATS was not a general obligation account should also be taken of the fact that most Members were parties to bilateral investment treaties in which national treatment was a general obligation in the post establishment phase Regarding the comments made on Korea s reference to the GATS as a starting point she observed that for her delegation the starting point in an investment negotiation in the WTO would not be the GATS as such but rather the specific commitments made by Members in respect of the commercial presence mode of supply

71 The representative of the United States recalled that at previous meetings especially the meetings held in 2000 her delegation had expressed its views on the general notion of the GATS as a model for an investment agreement

72 The representative of Japan agreed with Korea that the Working Group was an educational forum and that the work in the Group was not intended to prejudge the positions of Members on the issue of the negotiation of a multilateral framework on investment He shared Korea s view that the GATS could be refered to as a benchmark when formulating investment rules in the WTO He agreed with previous speakers that the questions posed in paragraph 11 might be somewhat premature

73 The representative of the European Communities responding to the comments made by India stated that the GATS could be regarded as a bottom line in the sense that many questions that had been discussed in this Working Group were not addressed by the rules of the GATS including investment protection and subsidies He agreed with India that a negotiation on investment rules should not give rise to amendments to existing WTO agreements Thus in the case of the GATS any amendments could only result from the ongoing process of negotiations in the framework of the GATS On the other hand an investment negotiation would necessarily have to deal with the question of how to ensure coherence between possible investment rules and existing WTO agreements in areas such as services subsidies and TRIMs

74 The representative of Malaysia noted the statement by Korea that its contribution was without prejudice to any Member s position on the need for investment rules in the WTO The references to the possible inclusion of rules on performance requirements and investment incentives and possible amendments to the ASCM and the TRIMs Agreement reinforced the view that what was envisaged was to use the GATS as a building block to construct a more ambitious agreement In this respect the comments by the European Communities had not alleviated his delegation s concerns regarding the concept of the GATS as a bottom line Referring to his remarks earlier at the meeting on the need for permanent carve outs for developing countries he stated that the Korean communication focused on liberalization without addressing the need for flexibility for developing countries If it was intended to arrive at a consensus in this Group on a negotiating mandate from Ministers it was incumbent upon the proponents of investment negotiations in the WTO to assure other Members that a GATS approach would adequately accommodate the developmental policies and programmes of developing countries The questions in paragraph 11 of Korea s contribution should only be discussed when the Group was given a new mandate by ministers to negotiate an investment agreement

75 The representative of Korea referring to the comments that had been made on paragraph 4 of WT/WGTI/W/96 stated that because this paragraph was intended to provide a succinct description of the main investment related provisions of the GATS certain details might have been omitted Regarding the notion of the GATS as a starting point or bottom line he agreed with the comments by the European Communities Chile and Japan and stated that these terms should be understood in the

sense of the GATS as a reference point In response to the view that the questions raised in paragraph 11 were premature he stated that the primary objective of his delegation was to encourage thinking about questions that would inevitably arise in case the GATS model were used to design investment rules for non services sectors

(ii) Further discussion of contributions submitted in 2000

76 The representative of the European Communities recalled that in June 2000 his delegation had introduced a communication (WT/WGTI/W/84) which showed that international investment rules especially multilateral rules need not be incompatible with the pursuit of domestic policy objectives The issue addressed in this communication of flexibility to accommodate domestic policy objectives was important for all countries and should be distinguished from the particular flexibility that might be necessary with respect to developmental concerns The communication analysed how provisions of existing international investment rules in the areas of market access the standards of treatment applicable to the post establishment phase of investment and the preferential treatment of foreign investment enabled countries to pursue domestic policy objectives Regarding market access existing rules provided for varying degrees of flexibility with the highest degree of flexibility provided by the bottom up approach which his delegation proposed to use in negotiations on an investment agreement in the WTO On the issue of standards of treatment the analysis in the paper concluded that international investment rules need not affect domestic policies in the area of employment and environmental protection because such policies could effectively be applied by countries on a non discriminatory basis Finally if countries wished to grant preferential treatment to foreign investment this could be accommodated through exceptions to non discrimination rules

77 The representative of Hong Kong China referring to the discussion that had taken place at the meeting in October 2000 on a communication by his delegation on transparency of the investment environment (WT/WGTI/W/90) stated that past deliberation in the Working Group had revealed that Members generally recognized the importance of a transparent global investment environment to international investors but that views diverged on the costs and benefits of new international initiatives in this area This difference in view warranted further work aimed at achieving a better understanding of the costs and benefits of new international measures to promote transparency of the investment environment In this respect he offered several considerations for further discussion First benefits of possible new international initiatives to promote transparency should be weighed carefully against their costs Second there had to be an assessment of the needs of potential beneficiaries of new transparency measures Third possible new transparency rules should provide sufficient guidance to Members on how they should comply with such rules For example a standard form designed in connection with a notification requirement would help Members focus their efforts on gathering essential information Fourth the development dimension had to be at the core of transparency provisions with respect to foreign investment Sufficient flexibility and capacity building for certain categories of Members would need to be explored to accommodate the special needs and concerns of developing countries Finally new transparency measures should not be introduced unless full compliance was assured In this regard there were useful lessons to be learnt from the experience with notification requirements of the existing WTO agreements notably the ASCM Given the high costs of non compliance new transparency disciplines should be supported by a strong collective will to fulfill the obligations involved He concluded by saying that Hong Kong China had no preconceived views on whether and how best to pursue more transparency on investment policy in a WTO context and that the purpose of his intervention was only to identify relevant considerations concerning the costs and benefits of measures to promote transparency

78 With regard to the issue raised in the contribution by Hong Kong China of the administrative costs of measures to enhance transparency the representative of Chile stated that such measures would perhaps be less burdensome than sometimes suggested because many countries had already unilaterally taken steps to enhance the transparency of their investment regimes

79 The representative of the European Communities stated that European investors had indicated that one of the main problems they faced when investing abroad was the difficulty of acquainting themselves within a reasonable period of time and at a reasonable cost with all relevant regulations affecting the establishment of foreign investment and its treatment in the post establishment phase This lack of transparency was mainly due to an insufficient institutional capacity of host countries to identify what particular kind of information was relevant to foreign investors and to disseminate such information This capacity problem often resulted in risk perceptions that were not in line with economic realities Consequently while WTO provisions on notification and collective monitoring would be useful the issue of transparency of investment regimes should be addressed in a manner that went beyond the traditional WTO approach In this connection consideration should be given to the possible role of the WTO with respect to technical assistance activities aimed at enhancing the ability of host countries to analyze their investment regime with a view to disseminating all relevant information to foreign investors Referring to the specific questions raised by Hong Kong China in WT/WGTI/W/90 he stated that all countries and investors would benefit from increased transparency that rules on transparency should apply to all levels of government and that procedures for the notification of legislation prior to its adoption would be useful but that it was unrealistic to require such procedures in all cases He agreed with Hong Kong China that the opportunities created by new technologies such as the Internet to facilitate the dissemination of information should be taken into account in the efforts by WTO Members individually or collectively to enhance transparency in the area of foreign investment With regard to the question raised by Hong Kong China concerning possible exceptions to transparency provisions he considered that this should be distinguished from the question of the protection of confidential information There should be no exceptions to the principle of transparency of laws and regulations but the question of the most practicable means to ensure such transparency merited further consideration in particular in order to minimise the administrative burdens on developing countries A strong commitment to provide technical assistance would be necessary in this respect

80 Regarding a written contribution introduced by Japan in October 2000 on the issue of the definition of investment (WT/WGTI/W/92) the representative of Hungary stated that the definition of investment in international agreements was always a matter for negotiation because this definition had to reflect the particular objectives and ambitions of the parties to the agreement It was therefore not possible to arrive at a single definition of investment in the Working Group outside the context of a negotiation The analysis in Japan s contribution reinforced his delegation s view that a realistic multilateral framework on investment should focus on foreign direct investment The representative of the European Communities stated that for the purposes of the educational work in this Working Group his delegation found particularly useful the distinction between FDI on the one hand and capital movements particularly short term capital movements on the other This was a concept rather than a definition The refinement of this concept into an operational definition could only take place in the context of negotiations on the nature of the substantive disciplines to which that definition would apply

81 The Chairman suggested that it was perhaps useful to consider the possibility of a more structured debate at the next meeting along thematic lines One theme that might merit a more focused discussion was the issue of how investment rules could provide for flexibility to accommodate domestic policy objectives

82 The Working Group took note of the statements made and agreed to revert to Item IV of the Checklist at the next meeting

E DATE OF THE NEXT MEETING

83 The Chairman recalled that at its meeting of 16 November the Working Group had agreed that its second meeting in 2001 would be held on 13 and 14 June and that at that meeting in June it would take a decision on when to hold further meetings in 2001

WORLD TRADE ORGANIZATION

WT/WGTI/W/102
29 May 2001

(01 2684)

Working Group on the Relationship between Trade and Investment

Original English

COMMUNICATION FROM THE EUROPEAN COMMUNITY AND ITS MEMBER STATES

The following communication dated 23 May 2001 has been received from the Permanent Delegation of the European Commission

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TECHNICAL ASSISTANCE AND CAPACITY BUILDING RELATED TO FOREIGN DIRECT INVESTMENT

I INTRODUCTION

1 International Investment rules at bilateral regional and multilateral level can play a key role for the purpose of improving the legal environment for FDI world wide as a complement to domestic reforms It is widely acknowledged however that investment rules alone are not enough to ensure that all countries attract a greater proportion of the increasing flows of FDI The main determinants of international investment flows in a given country are market size and structure macroeconomic and political stability level of infrastructure labour skills etc

2 At the same time it is also clear that the enabling environment for FDI is crucial to attract foreign investors or at least to avoid discouraging them In our view an improved legal framework should be developed together with accompanying measures aimed at creating a supportive business framework which would maximise the potential that countries have for attracting FDI This enabling environment for FDI should include beyond the legal framework good governance effective justice systems respect for the rule of law etc The benefits of a sound enabling environment are widespread Not only does it make a country more attractive to FDI inflows but also helps it to absorb the flows in a more productive way for example through the efficiencies of better governance It can also help reduce capital flight and encourage greater domestic investment In this context it will be crucial to identify what appropriate assistance could be envisaged to ensure that developing countries exploit their full potential by attracting more capital flows and consequently increase their economic growth

3 As a first step developing countries could receive assistance on two fronts on the one hand assistance should aim at identifying the key requirements for increasing their attractiveness as investment locations and the key bottlenecks that frustrate domestic policies to this end On this basis assistance could then be directed at building capacity to (1) regulate the domestic markets in order to attract investment (2) identify and deal with obstacles to ordinary market functioning e g competition policy On the other hand developing countries should receive assistance to negotiate effectively international investment rules and to transpose the results of negotiations into domestic laws and regulations

4 This paper attempts to identify possible fields for technical assistance in the context of the possible future negotiations of international investment rules The paper also refers to some of the existing technical assistance instruments provided by the European Community as well as by international organisations

5 This submission does not propose to reach conclusions on these issues Rather its objective is to open a debate among Members on

(a) whether the existing instruments are adequate

(b) whether they should be revised to take into account specific needs and objectives that are not fully taken into account yet

(c) whether notable gaps exist in the field of technical assistance and Capacity building related to investment and how they could be filled

6 Thus the paper is articulated into 2 main sections The first section looks at the wider issue of capacity building in the general context of sustainable development of Developing countries and gives some suggestions on how the WTO and its Members could contribute to improve the coherence of the existing Technical assistance/Capacity building initiatives related to trade and investment The second part deals with the immediate needs of a developing country wishing to negotiate international investment rules in terms of both identifying and defending its interests in such a negotiation and then transposing the results of the negotiations into domestic laws and regulations

7 This paper does <u>not</u> deal with the bigger issue of actually increasing and improving the capacity building element of development assistance This is an issue that goes well beyond the mandate and the ability of the Working Group

1 Building capacity to attract, absorb and benefit from FDI – Defining needs and identifying gaps in current assistance programmes

8 As mentioned above the main challenge relates to improving the overall capacity of many developing countries to attract a higher share of FDI flows and to absorb inflows in a manner conducive to its smooth and sustainable economic development This is a medium to long term issue which needs co ordinated and coherent support by international institutions and individual developed country donors also in order to maximise the benefits for those developing countries undertaking efforts on their own in this regard Clearly all efforts in this area should be fully consistent and developed within the context of the World Bank/UN global strategy on sustainable development and poverty eradication

9 The WTO and its Members however could kick start a process of coherence in the area of investment by providing developing WTO Members with resources to (a) identify the priorities for action (b) catalogue the technical assistance and capacity building initiatives already under way (c) identify gaps in the overall assistance being provided (d) ensure greater coherence of the action of international institutions and individual donors (e) identify the capacity bottlenecks that limit the ability of developing countries to attract absorb and benefit from FDI (f) better target international assistance to this end WTO Members should consider to what extent existing instruments such as for instance the Integrated Framework for LDCs or JITAP could be used for this purpose

10 This would help developing countries to better target their request for assistance and greatly improve the effectiveness of the assistance itself It remains clear that there is *no single model of technical assistance* that all countries should follow The technical assistance programmes have to be targeted at the specific priorities and needs to be identified by individual or groups of developing

countries that would allow them to effectively implement as well as benefit from multilateral investment rules

11 Multilateral investment rules are designed to underpin domestic investment regimes and to reassure foreign investors that whatever the rules of a potential host country look like they will always comply with certain basic principles The resulting greater legal certainty would produce greater propensity to invest abroad and greater FDI flows overall and would also minimise the risk of capital flights Moreover a large number of potential host countries especially among developing countries suffer from a perception gap whereas they are perceived by foreign investors as posing a much greater risk that the reality would justify This multilateral underpinning of domestic investment rules would go a long way towards bridging that gap

12 Nevertheless even once issues of (real or perceived) legal (un)certainty have been totally or partially laid to rest the fact remains that many developing countries have a limited capacity because of their physical or geographical situation or precisely because of their undeveloped economy to attract a growing share of FDI absorb it into their economic fabric and in the end fully benefit from it The fact that neither multilateral rules nor the WTO as an organisation can solve this problem does not mean that they cannot play a positive role towards finding solutions

13 The areas for improvement are many for instance better market opportunities (including through regional integration) a functioning legal system establishment and enforcement of fair competition rules to curb abuses by foreign and domestic firms development of better banking and financial structures including better lending facilities for local entrepreneurs domestic laws and regulations clarifying investors responsibilities improved governance etc Efforts by developing countries to achieve improvements in these areas could be supported through coherent and co ordinated programmes by international institutions (World Bank IMF UNDP etc) regional institutions and individual donors The need for co ordination and participation of many donors in this area is particularly acute

14 By now the EU and its Member States have gained considerable experience with financial and technical assistance in developing and transition countries EU programmes are currently being provided to numerous partner countries including those of Central and Eastern Europe Russia and the CIS several countries in the Mediterranean Latin America ACP countries etc Some of these programmes cover technical assistance designed to strengthen public administration harmonise standards or reform legal systems

15 In the context of foreign investment such assistance – as will be provided for example by PROINVEST[1] – is intended to focus on private sector development on support of investment promotion agencies as well as on legal and financial sector weaknesses in order to reduce non commercial risk and to increase investors confidence to engage in these markets To foster development it is thereby crucial to create a virtuous cycle of finance investment and growth *Adherence to the rule of law nationally and internationally* and *local capacity building* in this respect deserve special attention in (future) EU assistance programmes

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[1] The overall objective of the programme is to increase investment (domestic cross border and foreign) in the ACP regions leading to economic growth job creation and the strengthening of the private sector thus contributing to economic integration within these Regions and their incorporation in the world economy

The programme serves to address a market failure where information on investment opportunities lacks transparency and is difficult to obtain ACP companies specially SMEs also have difficulty in identifying potential foreign partners In addition the market is not supplying sufficiently objective information on the risks involved in investment Specifically the programme seeks to promote investment and inter enterprise co operation agreements (ICAs) in key sectors (e g agro industry tourism mining light engineering building materials) including strengthening the role of the Investment Promotion Agencies (IPAs) and intermediary private organisations in the ACP Regions

2 The negotiation of international investment rules and their transposition into domestic laws and regulations

16 Besides the longer term issue relating to the capacity of a developing country to attract a significant share of FDI flows and to absorb inflows in a manner conducive to its smooth and sustainable economic development the WTO and its Members could start considering what could be done in the short to medium term

17 In particular should investment negotiations be launched WTO Members would be faced with the need to identify and analyse their domestic laws and regulations that would be relevant to the operations of foreign investors and that could be affected by multilateral rules This issue would be relevant to both the negotiation and the implementation phase of investment rules

18 This analysis assumes that in an investment agreement WTO Members would negotiate obligations in three main areas

(a) Transparency

(b) Non discrimination (both MFN and National Treatment)

(c) Market Access

19 Technical assistance needs in these areas will be briefly examined in turn In general however an important element to improve developing WTO Members negotiating capacity would be their ability to identify domestic laws and regulations that may need to be preserved in order to pursue developmental objectives through for instance MFN exemptions National Treatment exceptions no or limited commitments on access etc

20 Thus enabling developing WTO Members to recruit and train staff for this work and/or (perhaps on a transitional basis) to use external specialised human resources (e g teams of lawyers and economists) could go a long way towards improving their ability to negotiate investment rules compatible with their level of development as well as to enable them to transpose these rules in their domestic legal order

(a) Transparency (and dissemination of information)

21 The transparency of the domestic investment regime is crucial to attract foreign investors in any given country The question of identifying the domestic laws and regulations that are of most immediate interest to prospective investors and especially the dissemination of this information should be an important element of investment promotion

22 It is objectively difficult for any country to identify and list all the domestic laws and regulations that may be relevant to the operation of foreign investors (or of domestic investors too for that matter) These laws and regulations are usually scattered in different legislative and regulatory texts (even where some of them are collected in an investment code) and are the responsibility of different branches of government or in many countries of independent agencies or sub national governments A developing country will need help in financing and training the human resources to comb through such domestic laws and regulations and to devise suitable effective and non-cumbersome procedures to comply with any multilateral transparency and notification requirements

23 The World Bank (MIGA[2] FIAS[3]), for instance has instruments aimed at improving dissemination of information and investment promotion In the Asia Europe Meeting (ASEM) context partners have also created a website (the Virtual Information Exchange) which provides information on the investment regime in each of the ASEM partners and on the implementation of the ASEM Investment Promotion Action Plan (IPAP) including a list of most effective measures to attract FDI[4] WTO Members should try to make the most of these instruments and share information in order to identify best practices for investment promotion and dissemination of information

24 Technical assistance for the specific goal of improving transparency could build on existing projects and offer officials and investment promotion agencies from Developing Countries support in terms of know how as regards (i) identification of national legislation concerning investment, (ii) dissemination of information and (iii) strengthening the capacity to upgrade regulatory frameworks and to maintain this upgrading In this context the existing activities of the World Association of Investment Promotion Agencies (WAIPA) could also be very useful[5]

(b) Non discrimination

25 Non discrimination provisions are likely to take the form of both MFN and National Treatment obligations Whatever negotiating format is chosen neither of these obligations is likely to be an absolute one realistically speaking There will be exceptions or exemptions from these obligations in one form or another A WTO Member therefore will have to identify the areas and analyse the reasons for which it needs to preserve flexibility when deciding whether or not to grant MFN or NT treatment to foreign investors For instance GATS today contains a list of MFN exemptions If a similar mechanism were to be used in an investment agreement a WTO Member would need to decide which exemptions it wishes to maintain

26 Again the problem developing WTO Members face here is one of having sufficient resources to carry out this identification exercise This identification would also be the obvious basis for the implementation of MFN and National Treatment provisions in the domestic legal system after conclusion of the negotiations

27 Technical assistance for policymakers and their officials could concentrate on (i) the identification and analysis of host countries relevant legislation and (ii) the analysis of the cost and benefits of excluding certain areas from MFN/NT provisions

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[2] The MIGA Agency part of the World Bank group aims at encouraging foreign investment by providing viable alternatives in investment insurance against non commercial risks in developing countries thereby creating investment opportunities in those countries MIGA is also involved in programs dissemination of information on investment opportunities and technical assistance that enhances national investment promotion capabilities

[3] The Foreign Investment Advisory Service (FIAS) helps developing and transition country governments design initiatives to attract foreign direct investment FIAS advises on laws policies incentives institutions and strategies It helps countries increase the amount of investment they receive and the benefits this investment produces

[4] See more information on http //europa eu int/comm/external_relations/asem_ipap_vie/intro/prog_report_en htm

[5] http //www waipa org

(c) Market Access

28 This assumes that the preferred option to deal with access of foreign investors is that of voluntary commitment sector by sector by each WTO Member In this case too a WTO Member needs to make a cost benefit analysis as part of the negotiation process Some WTO Members may need to identify the sectors where opening to foreign investors would be problematic for their developmental objectives and where they wish therefore to maintain restrictions to access The same analysis would then be the basis for dismantling in the implementation phase those restrictions that the Member has chosen not to maintain

29 Technical assistance for policymakers in this area could focus on (i) the economic analysis of removing or maintaining restrictions to entry in a given sector (ii) programmes aimed at facilitating the transposition of international rules into domestic legislation

30 Good examples in the area of technical assistance for the negotiation of investment rules already exist UNCTAD is running a multi donor project aimed at assisting developing country governments in the negotiation of international investment agreements

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WORLD TRADE ORGANIZATION

WT/WGTI/W/103
7 June 2001

(01 2821)

Working Group on the Relationship between Trade and Investment

MERGER AND ACQUISITION ACTIVITY AND THE BALANCE-OF PAYMENTS, FOREIGN PORTFOLIO INVESTMENT

Note by the Secretariat

1 This Note has been prepared in response to a request from the Working Group for an analysis of the balance of payments effects of merger and acquisition activity to supplement WT/WGTI/W/95 and for an analysis of portfolio flows of foreign investment including the reasons investors choose to invest through portfolio investment the inter relationship between FDI and portfolio flows of foreign investment with a view to highlighting any advantages of attracting portfolio flows in order to increase FDI concerns that have been expressed by some Members with regard to portfolio flows of foreign investment and options that have been used in international agreements to address such concerns [1]

2 Section I of this Note covers the balance of payment effects of cross border merger and acquisition activity

3 Section II beginning on page 3 deals with the various aspects of foreign portfolio investment that the Secretariat has been asked to review

I CROSS-BORDER MERGER AND ACQUISITION ACTIVITY AND THE BALANCE-OF PAYMENTS

4 Foreign direct investment (FDI) through merger and acquisition (M&A) activity is conventionally defined as a transaction in which a foreign purchaser acquires a stake of 10 per cent or more in an existing domestic enterprise[2] In most instances the stake is in practice considerably higher than that UNCTAD estimates that about two thirds of acquisitions by foreign firms in developing countries in 1999 were majority or full (50 100 per cent) acquisitions [3]

5 Inward FDI to developing countries through M&A activity increased sharply in 1996 99 Much of it was the result of major privatization programmes in Latin America particularly Brazil and Argentina and foreign acquisitions of enterprises in South East and South Asia associated with the effects of the financial crisis This resulted in the share of the value of M&A activity in total FDI to developing countries rising to more than one third in 1997 99[4] However given the particular circumstances surrounding the increase this share may not be sustained In most developing countries M&A activity is still negligible

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[1] WT/WGTI/M/14 paras 17 20

For a review of cross border M&A activity see UNCTAD World Investment Report 2000 Chapter IV

Ibid p 99

[4] *Ibid* p 114

6 As the Secretariat noted in WT/WGTI/W/95 (paragraph 7) analysis of the balance of payments effects of FDI involves much the same general factors whether the initial capital inflow to the host country represents greenfield investment or M&A activity In a static sense, it will involve an initial capital inflow coupled with subsequent capital inflows (new injections of capital) and outflows (repatriation of profits royalties and dividends) and trade inflows (imports of capital goods and intermediate inputs associated with the initial investment and subsequent operations of the enterprise) and outflows (the substitution of domestically produced goods and services for imports as well as exports of goods and services)

7 Beyond the initial foreign capital inflow associated with M&A activity its balance of payments effects hinge largely on whether placing ownership and control of an existing enterprise in foreign hands results in a significant change in its operations particularly its imports and exports of goods and services and its imports of operating capital and exports of profits royalties and dividends

8 Little can be said in a general way about the overall significance of this issue It is perhaps worth noting that balance of payments considerations did not figure in the recent recommendations of the UNCTAD Commission on Investment Technology and Related Financial Issues on M&A activity [5] The Commission focused instead on the impact of M&A activity on domestic enterprise development employment and competition With regard to balance of payments effects the following points could be relevant but would need to be assessed in specific instances of FDI on a case by case basis

9 Greenfield investment and M&A activity both represent an initial injection of liquidity into a host country s economy As noted in W/95 in the case of greenfield investment this may be associated with a high initial propensity to purchase imports of machinery equipment and intermediate goods and services needed for the start up of the enterprise concerned A proportion of the initial investment will then be ear marked for this purpose and it will not enter the host country as an uncommitted capital inflow

10 In the case of M&A activity it seems less likely in general that an established enterprise will need immediately to be re equipped although in specific instances this may happen – so that the initial propensity to import stemming directly from the foreign investment will be lower than in the case of a greenfield investment With less of the investment pre committed to imports of new machinery and equipment the trade effects of the initial injection of capital will depend largely on the overall import propensity of the host economy If the M&A activity represents a significant share of the productive capital of the host economy in question it may be necessary to consider the specific import propensity of the local beneficiaries of the sale of assets in other words what proportion of their spending or re investment of the funds they receive from the sale goes on imports?

11 Again at a general level there is little that can be said on this point Analysis would need ideally to be carried out on a case by case basis taking into account *inter alia* the size of the capital inflow involved relative to the domestic monetary base and structural and policy characteristics of the host economy For example in the case of sales involving the privatization of state owned assets the proceeds to the government may be used to reduce budget deficits or to increase fiscal expenditure either of which could have different effects on the balance of payments In the case of private sector sales concluded in the context of an economy wide financial crisis such as happened in several Asian

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[5] UNCTAD Report of the Commission on Investment Technology and Related Financial Issues on its fifth session (12 16 February 2001) Impact of international investment flows on development Mergers and acquisitions – policies aimed at maximizing the positive and minimizing the possible negative impact of international investment (TD/B/48/4) See also background material contained in TDB/COM 2/29 /26 and /EM 7/2

countries in the late 1990s some of the proceeds may be expatriated for at least as long as the crisis lasts resulting in an offsetting capital outflow although it would be more appropriate to link this to the crisis situation prevailing in the host country than to M&A activity per se

12 It is equally difficult to draw general conclusions on likely differences in the import intensity and export intensity of the operations of enterprises financed through greenfield investment or M&A activity They will depend primarily on whether the influence of foreign management led to a significant change in the enterprise s operations relative to the situation prevailing beforehand and this requires case by case analysis For example it has been suggested by the World Bank that M&A activity in developing countries in the 1990s broke new ground by entering into sectors that produce non tradeable goods and services whereas greenfield FDI has largely been based in manufacturing[6] According to the World Bank about half of the M&A activity in East Asia in recent years has been in such non tradeable industries as wholesale and retail trade real estate and the financial sector particularly involving the re capitalization of the banking industry after the financial crisis Taken at face value this could imply that foreign investment through M&A activity is likely to be less export oriented than FDI However whether or not these industries remain in the non tradeable sectors of the economy once ownership and control has passed to foreign investors will depend upon the management decisions those investors take

13 As for outflows of profits and royalties it was suggested in W/95 that in the case of greenfield investments these are likely to be delayed until the enterprise concerned has become productive and profitable In the case of M&A activity in an existing productive and profitable enterprise these outflows can begin at once There is no obvious reason to suggest however that over the long run the outflows will be systematically higher in the case of an M&A investment than a greenfield investment

14 In summary while certain hypotheses can be put forward about how the likely balance of payments effects of M&A activity might differ in general from the balance of payments effects of greenfield investment – a lower initial propensity to import machinery and equipment for example or a higher initial outflows of profits and royalties – the empirical evidence is very thin and the same general qualifications apply that were made in W/95 meaningful results depend largely on case by case analysis and conclusions should be drawn on the basis of the overall effects of an investment on the balance of payments not on the basis of just a select few of the trade and capital flows involved

II FOREIGN PORTFOLIO INVESTMENT[7]

15 Foreign portfolio investment in developing countries is a more recent phenomenon generally than FDI As a result it has been less well researched and analysed and for the time being there is little empirical work available The collection of data and statistics on foreign portfolio investment is also less advanced and in certain respects it poses greater conceptual difficulties than the collection of data and statistics on FDI[8]

A DEFINITION

16 Total private capital flows to developing countries comprise foreign bank lending and private foreign investment Bank loans and trade finance remain important sources of external financing for

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[6] World Bank Global Development Finance 2001 (Washington D C) p 36

[7] This section draws on two particular sources UNCTAD Comprehensive Study of the Interrelationship between Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) UNCTAD/GDS/DFSB/5 June 1999 and World Bank Global Development Finance 2001 (Washington D C)

[8] One of the agreed conclusions of the recent UNCTAD Expert Meeting on foreign portfolio investment was given the importance of FPI countries should increase their efforts to ensure the accurate statistical reporting of such flows for analytical and policy making purposes (TD/B/COM 2/EM 6/L 1 para 2)

many developing countries but generally they are not classified as foreign investment and they are excluded from consideration in this Note

17 Foreign investment comprises FDI and foreign portfolio investment and the most widely used convention for differentiating between them is the IMF s *Balance of Payments Manual*

18 The IMF s benchmark definition for FDI is based on the 'lasting interest" that the investor has in his investment in an enterprise resident in another country[9] A lasting interest implies the existence of a long term relationship between the direct investor and the enterprise and a significant degree of influence by the investor over the management of the enterprise such that the benefit the investor expects to derive from the investment goes well beyond the property income that accrues on the capital invested For statistical reporting purposes the specific criterion used is that the foreign investor holds 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent for an unincorporated enterprise All subsequent equity and debt transactions between affiliated enterprises are also classified by the IMF as direct investment as are reinvested earnings

19 Foreign investment involving an equity share of less than 10 per cent is classified by the IMF as foreign portfolio investment along with other kinds of equity securities (American depositary receipts mutual funds and investment trusts) and debt securities (bonds notes money market instruments and financial derivatives) that do not fall into the category of FDI An essential characteristic of portfolio instruments according to the IMF is that they are tradeable so that transactions typically take place through established capital markets (such as stock exchanges)[10]

20 Depending upon the specific focus of analysis and policy making foreign portfolio investment can in principle be broken down further One standard differentiation made is between portfolio investment in equities and portfolio investment in debt securities mainly bonds When considering foreign portfolio investment in conjunction with FDI it may be appropriate to focus on foreign portfolio investment that is enterprise specific and so to separate out and exclude foreign portfolio investment in public sector debt securities (i e government bonds even though some of these may be enterprise specific in that they are used to finance the operations of publicly owned enterprises) In some circumstances it may be considered appropriate to make a further differentiation so as to exclude short term debt securities (with a maturity of less than one year)

21 Even with refinements such as these it is important to remember that the differentiation described above between FDI and foreign portfolio investment is designed for statistical reporting purposes for which a clear delineation is needed and that for analytical and policy purposes the dividing line is often not so clear cut For example the terms lasting interest in an investment and 'significant management influence' over an enterprise are not quantifiable ex ante and are not necessarily associated directly with a 10 per cent equity threshold an investor with less than 10 per cent equity share may have a lasting interest and exercise significant management control and vice versa

22 For working purposes it is useful to note that FDI and enterprise specific foreign portfolio investment typically involve two different kinds of investor with different motivations and expectations about the benefits they will derive from their investment By and large FDI investors are firms engaged in the production of goods and services that are motivated by expanding their commercial activities Portfolio investors are either financial institutions institutional investors (such as pension funds insurance companies or investment trusts) or individuals who are motivated by the

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[9] See IMF 1993 (fifth edition) *Balance of payments Manual* and the OECD s 1992 (2nd edition) *Detailed Benchmark Definition of Foreign Direct Investment*

[10] IMF Coordinated Portfolio Investment Survey Guide 1996

financial return on their investment through capital gains or dividends and who ex ante have no expectation of taking a lasting interest in an enterprise nor any direct interest in managing it [11]

23 As discussed later in this Note most existing international investment agreements (mainly bilateral investment treaties) do not distinguish between FDI and foreign portfolio investment – they cover both through a comprehensive asset based ' definition of investment

B THE MAGNITUDE OF FOREIGN PORTFOLIO INVESTMENT FLOWS

24 Even at the most aggregated level data on foreign portfolio investment are not accurate and at more disaggregated levels their reliability deteriorates considerably Part of the problem is data availability and measurement errors Even among OECD countries for example only a few systematically record foreign portfolio equity investments separately from other foreign portfolio investment flows or even from FDI [12] Part of the problem also is one of concept and definitions For example the IMF notes that in recent years there has been an 'internationalisation of emerging market economies equity markets that has seen enterprises increasingly bypassing local stock exchanges to raise capital and resorting to depositary receipts traded on foreign stock exchanges issuing initial public offerings on foreign stock exchanges and even changing their country of domicile so as to reduce risk premia [13] All of this adds to the difficulty of accurate data collection and data on foreign portfolio investment based on gross financing statistics (Annex Table 1) show large discrepancies from statistics collected for balance of payments purposes (Table 1) [14]

25 Notwithstanding the data problems it is clear from Table 1 that private capital flows have become a far more important source of finance for developing countries in the 1990s than official capital flows and that FDI and foreign portfolio investment have become more important relative to bank lending particularly in the emerging market economies (see also Annex Table 2) According to UNCTAD in the mid 1980s international bank lending accounted for over 50 per cent of total private capital flows to developing countries FDI for 22 per cent and foreign portfolio investment for 18 per cent [15] By the mid to late 1990s the data in Table 1 suggest that their respective shares were about 14 per cent for bank lending 52 per cent for FDI and 34 per cent for foreign portfolio investment

26 FDI exceeded foreign portfolio investment (including sovereign and public bond financing) in developing countries in all years except 1993 and in most developing countries FDI flows are a significantly more important source of foreign financing than foreign portfolio investment flows According to a survey by UNCTAD for example balance of payments data for 1990 97 show that for two thirds of a sample of 30 developing countries and economies in transition FDI was on average larger than foreign portfolio investment [16]

27 By the mid 1990s it appeared from the data that foreign portfolio bond financing was quickly outstripping foreign portfolio equity investment in its importance as a source of foreign financing for developing countries However while both bond and equity investment flows suffered during the years of the Asian financial crisis equity investment flows seem to have proved the more resilient of the two increasing sharply in 1999 and 2000 In contrast to bond investment flows they have now

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[11] Even so the distinction can blur for example the time horizon of venture capital investment may be as long as FDI and it may involve significant management control but the primary motive of the investment is to share in the capital gains of the equity of a local enterprise when eventually it is listed on the stock exchange

[12] See UNCTAD World Investment Report 1997 p 109 for a discussion of data problems

[13] IMF International Capital Markets (Washington D C) September 2000 pp 72 73

[14] *Ibid* p 51

[15] TD/B/COM 2/EM 6/2 and Corr 1 of 15 April 1999

[16] *Ibid* p 8

recovered to levels prevailing before the financial crisis and account for around 15 20 per cent of private capital flows to developing countries[17]

Table 1

Selected net long term resource flows to developing countries 1991 2000
(US$ billions)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total of which	123 0	155 8	220 4	225 7	261 2	311 2	342 6	334 9	264 5	295 8
Private flows of which	62 1	99 3	166 8	175 7	206 1	279 5	299 8	280 3	219 2	257 2
FDI	35 7	47 1	66 6	90 0	107 0	131 5	172 6	176 8	185 4	178 0
FP1	18 5	25 2	87 6	73 4	66 9	111 7	79 2	56 5	59 9	78 1
(Equity)	(7 6)	(14 1)	(51 0)	(35 2)	(36 1)	(49 2)	(30 2)	(15 6)	(34 5)	(47 9)
(Bond)	(10 9)	(11 1)	(36 6)	(38 2)	(30 8)	(62 5)	(49 0)	(40 9)	(25 4)	(30 3)
Bank Lending	5 0	16 2	3 4	8 7	30 5	55 7	45 2	50 0	24 6	0 7

Source World Bank Global Development Finance 2001 Table2 5

Notes Long term resource flows have a maturity of one year or more Inflows of debt (bonds and bank lending) are net of amortization payments and FDI is net of disinvestment Figures for bond financing include sovereign public and private bond issues the IMF calculates that in 1998 99 private bond issues accounted for about 31 per cent of the total[18]

Table 2

Net long term resource flows of FDI and portfolio equity investment to developing countries, by region 1998-1999
(US$ billions)

	All developing countries	E Asia and Pacific	Europe and Central Asia	Latin America and Caribbean	Middle East and N Africa	South Asia	Sub Saharan Africa
FDI (net)							
1998	185 4	56 0	26 5	90 4	1 5	3 1	7 9
1999	178 0	58 0	28 8	76 2	4 5	3 2	7 3
Portfolio equity flows							
1998	34 5	21 1	3 5	3 9	0 7	1 3	3 9
1999	47 9	28 6	5 5	9 9	0 9	2 1	0 8

Source World Bank Global Development Finance 2001

[17] See World Bank *op cit* p 46 15 per cent based on capital market commitments and 18 per cent based on net long term resource flows

[18] *Ibid* p 53

28 For the time being foreign portfolio investment is even more heavily concentrated in just a few developing countries than is FDI primarily in upper middle income countries which have well developed capital markets and which are associated with sound macro economic policies and relatively high growth rates Using data from Table 1 Table 2 shows the distribution by region of net long term resource flows of FDI and portfolio equity investment to developing countries in 1998 and 1999 In fact the distribution of equity investment flows may be even more concentrated than these figures would suggest and the World Bank finds that in 2000 85 per cent of total portfolio equity investment flows to developing countries was accounted for by just four countries Brazil China Mexico and Turkey [19]

C THE DETERMINANTS OF FOREIGN PORTFOLIO INVESTMENT

29 The determinants of foreign portfolio investment are less well researched than those of FDI[20] Nonetheless the principal motivations of foreign portfolio investment are considered to be expectations of high yields (capital gains and/or interest and dividends) and reduced risk through portfolio diversification As noted earlier this contrasts with the motivation behind FDI which is considered to lie primarily in a desire to expand the parent company s commercial activities

30 The increase in foreign portfolio investment in developing countries in the 1990s particularly the emerging market economies is attributed to a number of factors the liberalization of financial markets internationally which has allowed capital to move more freely and cheaply between countries sustained high growth rates sounder economic fundamentals and the liberalization of capital markets in many emerging market economies favourable international macroeconomic conditions marked by low interest rates and ample liquidity in the industrialized countries the institutionalization of savings in the industrialized countries and the increase in professional asset management which has helped reduce operating costs for financial transactions and progress in communications and information technology which has allowed cheaper quicker and more accurate processing of information by asset managers on a much wider range of countries and companies than in the past

31 On the basis of these developments it is believed that portfolio investors based in the industrialized countries have been more willing to invest in developing countries and economies in transition In addition in the 1990s portfolio investors have been encouraged to do so in order to diversify their portfolios and help increase the risk adjusted returns on their investments [21]

32 Once a decision has been taken to invest in emerging markets as a group specific country determinants will influence the actual allocation of funds UNCTAD suggests that individual host country determinants of foreign portfolio investment fall into two groups economic determinants and policy/regulatory determinants [22]

33 Economic determinants are a reflection of the general health of the economy the potential for firms to earn profits and the potential to obtain a high return on fixed income investment According

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[19] *Ibid* p 47

[20] For a discussion see John H Dunning and John R Dilyard Towards a general paradigm of foreign direct and foreign portfolio investment and Mira Wilkins Two literatures two story lines is a general paradigm of foreign portfolio and foreign direct investment feasible? *Transnational Corporations* Vol 8 No 1 April 1999

[21] See UNCTAD/GDS/DFSB/5 (23 June 1999) pp 18 22 for a description of the extension of the single market capital asset pricing model to include investment in emerging markets as a strategy to lower the risk adjusted returns of an investment portfolio and for a discussion of why there are doubts that this strategy has worked in practice

[22] *Ibid* p 16 18

to UNCTAD investors will typically focus on the following factors[23] high economic growth rate exchange rate stability macroeconomic stability level of foreign exchange reserves health of domestic banking system stock and bond market liquidity and real interest rates Some of these factors (e g stock market liquidity) will be of more importance to equity investors and others (e g real interest rates) to fixed income investors

34 The main policy and regulatory determinants according to UNCTAD s survey are ease of repatriating dividends and capital domestic capital gains tax stock and bond market regulation quality of domestic accounting and disclosure standards speed and reliability of the settlement system availability of domestic custodians and brokers and degree of investor rights protection UNCTAD states that these are factors over which host governments have the most direct control and that while it is not possible to isolate any single factor as being the most important some tend to carry more weight than others For example the degree of investor rights protection and the ease of repatriating dividends and capital are often cited as being watched closely by potential investors as are efforts that are being made in emerging markets to meet higher standards of corporate governance

D FDI AND FOREIGN PORTFOLIO INVESTMENT

35 FDI and foreign portfolio investment display several elements of complementarity both in a direct commercial sense and in terms of the advantages that the host country derives from attracting foreign investment

36 Most FDI involves various foreign financial transactions over and above the initial investment Examples are equity capital contributions made by the parent company subsequent to the initial investment and intercompany debt transactions involving borrowing and lending between the parent company and its subsidiaries If capital markets are well developed in the host country FDI will have the choice of conducting at least some of these financial transactions at arms length through local markets for equity and debt securities rather than solely on the basis of the subsidiary parent company relationship This can create a risk that by competing for scarce capital to support its operations FDI will crowd out domestic enterprises in the host country from local capital markets Access to foreign portfolio investment flows can help reduce that risk

37 Like FDI foreign portfolio investment supplements domestic savings in developing countries and provides for a higher rate of capital formation to support growth and development than would otherwise be possible Foreign portfolio investment does not bring with it the management know how technology and intangible assets that are associated with FDI However nor does it involve any loss of control of ownership Its potential benefits for developing countries are generally considered to lie in its contribution to adding liquidity to domestic capital markets increasing their efficiency and raising financial and corporate standards These contribute to enhancing the business environment in recipient countries[24]

38 By injecting liquidity foreign portfolio investment helps to increase the availability of financing for local enterprises and to reduce the cost of capital which increases their competitiveness Inter alia this can assist the start up and expansion of locally owned enterprises that establish backward and forward linkage activities related to the operations of FDI as well as locally owned enterprises that compete directly with FDI for a share of the domestic market

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[23] Based on the results of an UNCTAD questionnaire reproduced in UNCTAD/GDS/DFSB/5

[24] See UNCTAD Expert Meeting on Portfolio Investment Flows and Foreign Direct Investment *Commission on Investment Technology and Related Financial Issues* Foreign Portfolio Investment and Foreign Direct Investment Characteristics Similarities Complementarities and Differences Policy Implications and Development Impact TD/B/COM 2/EM 6/L 1 July 1999 pp 7 12

39 As liquidity increases, capital market turnover also increases and price volatility is likely to be reduced thus attracting more investors and encouraging firms to use capital markets to raise funds through issues of financial instruments Foreign portfolio investment can help improve the standards of local capital markets as foreign investors generally demand high quality information transparency and disclosure as well as legal protection for minority shareholders and bondholders and they demand adequate market and trading regulations Foreign portfolio investment can also encourage the development of other financial intermediaries and ancillary services in recipient countries such as investment management and financial advisory services accounting auditing and market information services and credit rating agencies This can help strengthen the financial infrastructure increase transparency in financial transactions, deepen the process of financial intermediation and improve corporate governance

40 More generally by contributing to the development of a better domestic business environment in the host country particularly the development of the local financial infrastructure and the deepening of capital markets foreign portfolio investment can help attract new FDI including through M&A activity

E CONCERNS OF HOST COUNTRIES

41 According to UNCTAD the main concern of recipient countries is the potentially destabilizing effects of volatile foreign portfolio investment flows The main concern of low income developing countries, on the other hand is their limited access to flows of foreign portfolio investment as well as FDI [5]

42 From an accounting point of view foreign portfolio investment represents both a foreign asset (the initial capital inflow) and a foreign liability (the periodic payment of dividends and interest and the eventual repatriation of the original capital) It is difficult to say anything at a general level about how assets and liabilities will evolve over time since their relationship is dependent in part on the overall growth and development of the host economy but in normal circumstances there is no prima facie reason to believe that foreign portfolio investment need become an unsustainable burden on a recipient country's balance of payments situation For example the initial capital inflow may be used to generate a future stream of foreign exchange earnings that is well in excess of the financial liabilities associated with it and even if the original investment instrument matures or is sold on the domestic capital market at some point the proceeds may be re invested in the recipient country rather than being repatriated

43 In general equity investments may pose less of a potential burden on the recipient country s balance of payments than bond (debt) instruments Equity investments do not mature and are therefore not subject to redemption they are priced in domestic currency terms as long as they are issued and traded on the domestic stock market so that the foreign investor shares in any exchange rate risk which may occur and they are subject not only to possible capital gains but also losses depending on the performance of the domestic enterprise so that the foreign investor shares in the operating risk too In contrast debt securities do mature they typically have a fixed payment due at maturity which is independent of the commercial fortunes of borrower and they may be denominated in foreign currency

44 It has been suggested in addition that while equity holders can withdraw their funds in the event of a domestic financial crisis this can be done typically only by incurring large capital losses so that equity investments may be less prone to contributing to capital flight However evidence on this point appears to be mixed The World Bank notes, for example, that in the three financial crises of the 1990s – Mexico East Asia and Russia – mutual funds (which represent some of the most

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[5] *Ibid* Agreed Conclusions pp 1 5

significant investments in emerging markets) withdrew large sums of money and contributed to the loss of liquidity but the World Bank also cites a study that draws opposite conclusions from the available empirical evidence [26]

45 Separately UNCTAD has suggested that different degrees of potential volatility can be associated with different kinds of foreign portfolio equity investment [27] The least volatile seem to be venture capital investments investments placed through large institutional investors (i e through country funds) seem to be less volatile than investments made directly through the local stock market also closed end investment funds seem to be less volatile than open end investment funds The highest degree of volatility is associated with direct portfolio equity investments in the local stock market managed by retail investors who tend to invest more speculatively UNCTAD notes that the issue of volatility does not arise in the case of investment flows in the secondary market for depositary receipts since the trading activity is conducted on foreign exchanges and does not affect the flow of funds in and out of the local stock market

46 There are well established reasons to expect foreign portfolio investment in general to be more variable and footloose than FDI and the data support that conclusion For example UNCTAD has calculated that the relative variance of foreign portfolio equity flows is four times higher than that of FDI [28] Separately UNCTAD found from a survey of 29 countries for the period 1990 98 that the values of the coefficients of variation were highest for the category 'other investment' (primarily bank loans) in 16 countries they are the highest for foreign portfolio investment in 9 countries and for FDI in only 4 countries of which two were Kuwait and Saudi Arabia whose results were clearly skewed by the effects of the gulf war [29] Comparing the coefficients of variation of portfolio equity securities and portfolio debt securities UNCTAD found that debt securities were more variable than equity securities in 19 cases out of 29

47 The fact that foreign portfolio investment is found to be more variable than FDI because portfolio investors generally have a shorter time horizon and are able to liquidate their investments more easily does not necessarily imply that it is inherently volatile The difference between variability and volatility is in practice mainly one of degree but volatility carries with it also the notion of large more frequent and unpredictable changes in the volume of capital inflows and outflows Clearly when this happens it can destabilize the domestic investment environment and be highly detrimental to growth development and macroeconomic management in the host country[30] Sudden and significant changes in foreign investment can undercut monetary fiscal and exchange rate policies They can also affect the availability of finance and consequential changes in its cost and in asset prices which makes investment planning difficult Large capital inflows create excess liquidity in the domestic financial system which can encourage asset bubbles and increase speculative investments while outflows drain liquidity from the system and can threaten the viability of otherwise perfectly sound investments

48 It is not coincidental that the 1990s saw emerging market economies register a sharp increase in inflows of foreign portfolio investment and some of these economies experience serious financial crises Clearly the behaviour of foreign portfolio investors contributed to both the timing and the amplitude of the financial crises At the same time it would be simplistic to draw the conclusion that

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[26] World Bank Global Development Finance 2001 p 47 and footnote 12

[27] UNCTAD World Investment Report 1997 p 111

[28] *Ibid*

[29] UNCTAD/GDS/DFSB/5 p 26

[30] For an analysis of the causes and effects of portfolio investment volatility see UNCTAD The Growth of Domestic Capital Markets Particularly in Developing Countries and Its Relationship with Foreign Portfolio Investment (TD/B/COM 2/EM 4/2 19 March 1998) and Foreign Portfolio Investment Implications for the Growth of Emerging Capital markets (UNCTAD/GDS/GFSB/4 9 September 1998) and World Bank Global Development Finance 2001 pp 71 76

financial crisis is an inevitable consequence of allowing increased flows of foreign portfolio investment By and large it seems likely that most categories of foreign portfolio investors (other than perhaps those operating at the most speculative end of the market) are as averse to volatile capital market conditions as are the governments and private enterprises of recipient countries, and that both have an equal interest in seeing regulatory measures taken, and policies put in place to limit volatility [31]

F FOREIGN PORTFOLIO INVESTMENT IN INTERNATIONAL INVESTMENT AGREEMENTS

49 While examples exist of bilateral investment treaties which apply only to foreign direct investment[32] such treaties typically use a more comprehensive "asset based" definition which states that investment means every kind of asset including traditional property rights, rights in companies claims to money and titles to performance intellectual property rights and concessions and similar rights [33] Examples of this definition can be found in several submissions to the Working Group[34] This asset based definition of investment covers portfolio investment in an item which includes debt and equity security interests in companies and which does not make the treatment of equity securities as investment dependant upon whether equity holdings confer a controlling interest on the foreign investor [35] Though it has been suggested that the broad definition of investment must be seen in the light of the fact that in most such treaties binding obligations are limited to the post establishment treatment and protection of investment a similarly broad definition including portfolio investment appears in bilateral investment treaties that provide for application of non discrimination obligations to the pre establishment phase

50 Notwithstanding the inclusion of portfolio investment in the broad asset based definition of investment bilateral investment treaties are not designed as instruments aimed at the removal of impediments to cross border portfolio capital flows In this respect such treaties differ from instruments aimed at the liberalization of capital movements between residents and non residents such as the OECD Code of Liberalization of Capital Movements One important obvious difference between bilateral investment treaties and international instruments aimed at the liberalization of capital movements is that bilateral investment treaties do not impose obligations upon countries with respect to outward investments by their own investors In addition most bilateral investment treaties do not provide for obligations regarding the admission of inward foreign investment [36]

51 Virtually all bilateral investment treaties contain provisions that guarantee the right of transfer of funds related to covered investments Such provisions normally specify the kinds of transfers that benefit from this right the type of currency in which the transfer is guaranteed the timing of the

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[31] For a discussion of policy options to address volatility see World Bank *op cit* and UNCTAD/GDS/DFSB/5 pp 38 39

[32] See for example UNCTAD *Bilateral Investment Treaties in the Mid 1990s* p 33 (referring to the definition of investment in the bilateral investment treaty between Denmark and Lithuania as every kind of asset connected with economic activities acquired for the purpose of establishing lasting economic relations between an investor and an enterprise)

[33] The scope of the definition is sometimes limited by provisions stating that covered investments must be made in accordance with the domestic law of the host state See e g Bilateral regional plurilateral and multilateral agreements Note by the Secretariat 26 January 1998 para 6 and Communication from India WT/WGTI/W/71 13 April 1999 para 4

[34] Communication from Japan WT/WGTI/W/92 24 October 2000 para 7 See also communication from India WT/WGTI/W/71 13 April 1999 para 4 and communication from Australia WT/WGTI/W/80 16 June 1999 para 1

[35] See for example Rudolf Dolzer and Margrete Stevens *Bilateral Investment Treaties* (1995) p 28 UNCTAD *Bilateral Investment Treaties in the Mid 1990s* (1998) p 33 and UNCTAD *Scope and Definition (1999)* p 19

[36] See UNCTAD *Transfer of Funds* (2000) pp 28 29

transfer and the applicable exchange rate[37] As discussed in a recent UNCTAD study the main kinds of transfers covered by these provisions are (i) the outward transfer of amounts derived from or associated with protected investments[38] (ii) the outward transfer of amounts arising from a host country's performance of other investor protection obligations under an agreement and (iii) the inward transfer of amounts to be invested by a foreign investor[39] These provisions are often qualified by exceptions and limitations notably in respect of taxation reporting requirements in relation to currency transfers adjudicatory proceedings and enforcement of creditor rights In some cases provision has been made for limitations of the right of free transfer on account of balance of payments problems[40] It would appear however that this is not typical A detailed analysis of 335 bilateral investment treaties found that about one fifth of the treaties dealt with balance of payments problems in provisions that allowed for the transfer of large sums in instalments extending over a period of between three to five years[41] Another source states that [o]nly few recent BITs contain a clause admitting the right of a contracting party to restrict the transfer of any payment connected with a covered investment in exceptional financial or economic circumstances affecting its balance of payments[42] The recent UNCTAD study on Transfer of Funds notes that 'only a very small proportion of the nearly 1 800 bilateral investment treaties in existence specifically allow for temporary balance of payments derogation[43]

52 It should be noted that bilateral investment treaties concluded by Chile contain provisions that permit the parties not to allow the transfer of capital during a period of one year after the date of entry Similarly the investment provisions of the Canada Chile Free Trade Agreement contain an annex in which Chile reserves the right to take certain measures for the purposes of preserving the stability of its currency These pertain *inter alia* to the maintenance by Chile of requirements that transfers of proceeds from the sale or liquidation of an investment not take place until the expiry of specified periods of time and the application by Chile of a reserve requirement on investment from Canada other than foreign direct investment and on foreign credits relating to an investment

53 Among the regional investment agreements that are similar in scope and content to bilateral investment treaties only a small number contain safeguard clauses for balance of payments problems Prominent examples are the NAFTA and the Treaty on Free Trade between Colombia Mexico and Venezuela[44]

54 Questions pertaining to the possible adverse balance of payments or financial implications of certain kinds of investment flows have been addressed more explicitly in the context of international rules on the liberalization of capital movements Thus for example Article 7(c) of the OECD Code of Liberalization of Capital Movements provides that

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[37] See generally UNCTAD *Bilateral Investment Treaties in the Mid 1990s* (1998) pp 75 81 and UNCTAD *Transfers of Funds* (2000) pp 30 38

[38] This category comprises returns on investment proceeds from the sale or liquidation of all or any part of the investment payment under a contract including a loan agreement and earnings and other remuneration of personnel engaged from abroad in connection with an investment

[39] This includes transfers made to develop and maintain an existing investment and in the case of agreements that contain requirements regarding the admission of investment transfers made for the purposes of making an investment

[40] UNCTAD *Bilateral Investment Treaties in the Mid 1990s* (1998) p 79

[41] Mohammed Khalil Treatment of Foreign Investment in Bilateral Investment Treaties *Foreign Investment Law Journal ICSID Review* Vol 7 No 2 Fall 1992 pp 339 383 pp 360 361

[42] Giorgio Sacerdoti *Bilateral Treaties and Multilateral Instruments on Investment Protection* (1997) p 363

[43] UNCTAD *Transfer of Funds* (2000) p 36

[44] UNCTAD *Transfer of Funds (2000)* p 37 and OAS Trade Unit *Investment Agreements in the Western Hemisphere A Compendium* (1997) p 12

'If the overall balance of payments of a Member develops adversely at a rate and in circumstances, including the state of its monetary reserves which it considers serious that member may temporarily suspend the application of measures of liberalisation '

Article 7(b) of the Code provides that

If any measures of liberalisation taken or maintained in accordance with the provisions of Article 2(a) result in serious economic and financial disturbances in the Member states concerned that member may withdraw those measures '

55 In addition the Code provides that Members may lodge reservations when a new item is added to the list of capital movements covered by the Code and when an obligation relating to an item is extended or begins to apply to a Member The Code also provides that in respect of certain transactions included in a List B' members may reintroduce restrictions at any time The coverage of this List B is currently limited to financial operations of a short term nature According to the UNCTAD study on Transfer of Funds this generous treatment of these transactions is attributable to their potentially adverse impact on the macroeconomic and balance of payments stability of OECD members [45]

56 Similarly liberalization of capital movements within the context of the European Community has also been accompanied by certain safeguards regarding certain kinds of capital movements Thus the Council Directive adopted in June 1988 on the liberalisation of capital movements by 1 July 1990 allowed for the application of restrictions of limited duration in respect of capital movements identified in an annex to that Directive where short term capital movements of exceptional magnitude impose severe strains on foreign exchange markets and lead to serious disturbances in the conduct of a Member State s monetary and exchange rate policies being reflected in particular in substantial variations in domestic liquidity [46]

[45] UNCTAD *Transfer of Funds* (2000) p 22
[46] Council Directive 88/361/EEC OJ No L 178 8 7 1988 p 6

ANNEX

Table 1

Capital market commitments to developing countries by type of flow, 1991 2000
(US$ billions)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total of which	76 9	80 1	115 7	135 5	173 3	236 4	315 8	189 5	185 5	236 4
Bond issuance	11 0	20 1	50 1	45 7	52 6	97 6	114 3	73 0	70 3	77 2
Bank lending	61 3	54 0	57 5	72 8	112 7	125 2	179 1	107 8	94 0	124 4
Equity placement	4 6	6 0	8 1	17 0	8 0	13 7	22 4	8 6	21 1	34 8
of which China	0 0	0 7	1 9	2 6	0 9	2 1	9 4	1 1	3 3	21 2

Source World Bank Global Development Finance 2001 Table2 6

Note For bond and equity flows commitments typically translate almost immediately into disbursements however for bank lending commitments are often disbursed over more than a year

Table 2

Net Private Capital Flows to Emerging Markets, 1992-99
(US$ billions)

	1992	1993	1994	1995	1996	1997	1998	1999
Emerging markets								
Total net private capital inflows	112 6	172 1	156 3	226 9	215 9	147 6	75 1	80 5
Net foreign direct investment	35 4	59 4	84 0	92 6	113 2	158 6	143 5	149 8
Net portfolio investment	56 1	84 4	109 6	36 9	77 8	52 9	8 5	23 5
Bank loans and other	21 0	28 3	57 3	97 4	24 9	44 0	76 7	92 5
Africa								
Total net private capital inflows	4 0	1 8	2 9	10 9	7 5	16 7	11 5	14 8
Net foreign direct investment	0 6	1 9	2 3	2 2	4 8	7 4	5 2	9 5
Net portfolio investment	1 8	1 0	2 0	1 4	1 3	3 7	4 3	4 4
Bank loans and other	6 4	4 7	1 4	7 3	1 4	5 6	2 0	0 9
Asia								
Total net private capital inflows	20 8	57 4	65 6	104 9	104 1	1 4	42 6	27 0
Net foreign direct investment	15 7	53 9	47 1	46 6	53 1	55 5	58 3	49 9
Net portfolio investment	9 0	21 8	11 8	14 2	12 9	3 5	17 9	5 6
Bank loans and other	3 9	1 7	4 7	44 1	38 1	60 4	82 9	71 5
Five crisis affected Asian countries[1]								
Total net private capital inflows	29 0	31 8	56 1	74 2	65 8	20 4	25 6	24 6
Net foreign direct investment	7 3	7 6	8 8	7 5	8 4	10 3	8 6	10 2
Net portfolio investment	6 4	17 2	9 9	17 4	20 3	12 9	6 0	6 3
Bank loans and other	15 5	7 0	17 4	49 2	37 1	43 6	28 2	41 1
Europe								
Total net private capital inflows	6 5	27 4	1 8	48 8	26 7	52 2	16 3	18 0
Net foreign direct investment	5 1	6 7	6 1	14 6	14 4	20 3	21 7	24 2
Net portfolio investment	2 5	12 4	21 5	14 6	19 6	25 3	0 7	6 6
Bank loans and other	0 8	8 4	25 8	19 7	7 4	11 4	6 1	12 8
Middle East								
Total net private capital inflows	33 7	22 5	18 6	9 1	5 6	14 6	19 9	20 6
Net foreign direct investment	0 2	3 5	5 4	4 6	1 4	2 3	2 0	2 6
Net portfolio investment	12 7	5 1	7 6	3 8	3 0	3 3	6 7	7 3
Bank loans and other	20 8	13 6	5 6	0 8	1 2	9 0	11 2	10 8
Western Hemisphere								
Total net private capital inflows	55 6	66 8	49 4	55 1	72 1	85 5	70 0	54 1
Net foreign direct investment	13 9	13 4	23 1	24 7	39 5	53 1	56 1	63 6
Net portfolio investment	50 3	44 0	66 7	5 0	41 0	19 2	14 7	10 6
Bank loans and other	11 4	9 4	40 4	25 5	8 4	13 2	0 8	20 1
Current account								
Emerging markets	72 7	110 5	73 8	112 5	96 0	77 4	49 5	21 5
Africa	10 0	11 2	11 5	16 5	7 0	7 4	20 0	16 8
Asia	3 6	13 2	4 4	50 4	38 5	18 0	114 9	103 1
Europe	6 6	14 5	5 8	3 1	20 0	29 4	23 6	6 6
Middle East	25 1	25 4	11 5	5 7	7 8	5 4	32 2	4 1
Western Hemisphere	34 5	46 0	52 2	36 8	38 5	64 1	88 6	54 2
As percent of emerging markets GDP								
Direct investment	0 7	1 0	1 4	1 4	1 6	1 9	2 1	2 1
Portfolio investment	1 1	1 5	1 9	0 6	1 1	0 7	0 1	0 3
Bank loans and other	0 4	0 5	1 0	1 5	0 4	0 6	1 1	1 3

Source IMF *International Capital Markets* September 2000

[1] Indonesia Korea Malaysia Philippines and Thailand

WORLD TRADE ORGANIZATION

WT/WGTI/W/104
12 June 2001

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Working Group on the Relationship between Trade and Investment

Original English

COMMUNICATION FROM JAPAN

The following communication dated 11 June 2001 has been received from the Permanent Mission of Japan

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INVESTMENT RULES FOR DEVELOPING POLICIES

I INTRODUCTION

1 It has been pointed out in the Working Group (WG) meetings to date that Foreign Direct Investment (FDI) has a positive effect on development[1] The economic benefits that FDI can bring about for the host country can be specified in particular capital transfer transfer of technology and management know-how increased employment the fostering of a skilled labour force and the access to international production networks and access to foreign markets by the industries of host countries These economic benefits play a very large and important role in modernisation of the national economy and in the acceleration of economic growth in the host countries

2 In order that FDI can effectively contribute to the economic development of the host country it is necessary to consider two separate aspects

3 First is that FDI itself should be enhanced The primary decision making factors for FDI include market scale market growth potential a stable macroeconomic environment political stability and labour quality and costs in a host country (Refer to the Communication from UN Conference on Trade and Development[2] Further important conditions in addition to the above mentioned include the predictability of various rules such as legislation concerning investment the tax system and conditions governing business activities No matter to what degree there is an appealing market scale and latent growth potential in cases where there is an unpredictable risk of change it would be impossible for investors to predict stable management after investment and therefore investors actively seek to avoid active investment activities in such cases

4 Second is how to effectively link the recipient of investment to domestic economic growth In other words in this process the positioning of direct inward investment in the domestic development policies of the host country is an important factor In order that through investment activities production the expansion of employment the expansion of procurement a relative effect on related industries and a ripple effect to the regional economy can all be ultimately linked to economic growth in host countries balanced investment rules and development policies are required according to the developmental stage of each host country

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[1] WT/WGTI/W/65 WT/WGTI/W/38

[2] Communication from UNCTAD WT/WGTI/W/77

5 From this viewpoint the following modalities for investment rules and development policies should be considered One of the main aims of International Investment Agreements is to establish an investment environment that basically protects and promotes FDI and heightens stability predictability and transparency In order to maximise the promotional effect of FDI through International Investment Agreements what is absolutely required to the greatest extent possible is discipline in agreements and investor predictability should be sought Furthermore International Investment Agreements that concern developing countries are concluded with the expectation that the resulting investment will contribute to economic growth in the investment host country Accordingly there are many cases in which the preambles of Agreements clearly state the promotion of economic and social development as their most important objectives

6 However in order for developing countries to achieve economic development it is important for the country concerned to implement its own appropriate development policies Accordingly for the investment host country in the conclusion of an International Investment Agreement it is of great interest to ensure that a structure is put in place to ensure sufficient flexibility in the adoption of necessary development policies Of course as the EU has pointed out[3] it is important to avoid the risk of pushing the notion of the extent to which flexibility is applicable too far as this could cause confusion with the right to discriminate

7 From the above perspective when we consider overall the current existing International Investment Agreements investment-related agreements and the number of WTO Agreements we can see evidence of efforts that have been made to achieve balance between discipline and flexibility as evidenced by such agreements as the General Agreement on Trade in Services (GATS)

8 In the case of formulation of a comprehensive agreement on investment in the WTO system the issue of balance between discipline and flexibility is also of great importance In particular there is a great diversity of developmental stages among WTO members and many differences in a variety of aspects such as economic conditions legal and administrative systems infrastructure regulations and technical standards Of course there are also differences among countries concerning the priority that is placed on development policies Accordingly the modalities for ideal rules could by ensuring that the circumstances in the host country are adequately reflected in an appropriate balance between the rights and obligations of both the investor and the investment host country through an agreement would thereby maximising the benefits to investor and investment host country From this perspective appropriate flexibility should be pursued that allows each Party to consider the developmental stages and development policies of each country

9 The issue of flexibility in International Investment Agreements is a very important one that has been taken up for discussion on many occasions in the Working Group meetings In the process of building up some common understanding regarding investment rules this issue should be deliberated adequately In this regard the submissions from India[4] and the EU[5] in 2000 and the UNCTAD documents pertaining to International Investment Agreements submitted in 1999[6] serve as great resource materials for reference in discussions

10 With reference to the various discussions and papers that have been contributed to the Working Group meeting process thus far the following is an attempt to list with examples the various points into which study should be deepened concerning flexibility in International Investment Agreements This paper will also analyse what response should be made to existing investment and investment-related agreements and the various WTO Agreements It is hoped that this paper will serve as a future reference for discussions

[3] WT/WGTI/W/89
[4] WT/WGTI/W/86
[5] WT/WGTI/W/89
[6] WT/WGTI/W/77

11 This submission is intended not to bind the stance of Japan but to illustrate some issues for further discussions in this Working Group There could be other important elements to be deliberated regarding flexibility than those raised in this paper and we have no intention to exclude the discussion on these points

12 From the standpoint that an International Investment Agreement should be designed in a compatible manner with development policies of developing countries concerned we would like to show some options for consideration

II CONSIDERATION GIVEN TO DEVELOPMENT POLICIES IN EXISTING AGREEMENTS

13 There is much consideration being given to development policies in the existing agreements or rather the methods of providing flexibility The first method of consideration given to development policies is to reflect the overall spirit of an agreement For example in many agreements reference of consideration to development policies is made in the preamble or in the objectives A second method is to consider development policies in individual provisions This method consists of two main concepts These are to either a) through the establishment of exceptions or permission of reservations to alleviate or exempt entirely developing country obligations or b) through the provision of grace periods for developing countries provide ample time for implementation A third method is to impose discipline and at the same time to promote support to enhance capacities to realise this It is of course self evident that flexibility is not necessary provided by any of these means exclusively but rather by a variety of combinations of their use

1 Preamble and Objectives

14 As is stated in the UNCTAD paper[7] the Preamble or Objectives of an Agreement provide an interpretation of the Agreement and encapsulate in a few paragraphs the overall spirit of the Agreement Accordingly the concept for the development elements of an agreement as described in the preamble or objectives can offer a certain orientation for the overall objectives and interpretation of the agreement

15 In actual fact examples of this kind can be found in the WTO Agreements such as GATS and the Agreement of Trade Related Investment Measures (TRIMs Agreement) that include the many developing countries that are signatories to such agreements In such agreements due consideration is given to development in the preamble, and the objective of economic development is stated In this way the interpretations of the provisions in the main text of the agreement become the ones given due consideration in their developmental aspects

16 There are two concrete types of description One of these is the general description of recognizing and taking into account the difficulties and special needs that are directly facing developing countries or/especially least developed countries Another type of description is that seen in the preamble to the TRIPS Agreements which is in a style that refers to flexible domestic legal implementation (ANNEX (A))

[7] WT/WGTI/W/77

2 Definition

17 The definition of investment is an important element that stipulates the scope of factors covered under the discipline of investment rules The paper prepared by the secretariat[8] summarises the discussions that have been held in the Working Group concerning the definition In addition Japan has also conducted its own analysis of the definition in the existing International Investment Agreements[9]

18 The definition of investment in the existing agreements is of the type laid out below

19 Firstly there is the definition that can be found in many of the agreements concluded in recent years This definition incorporates every kind of asset related to corporate activities bringing into the broad scope of the definition portfolios and the acquisition of intellectual property rights

20 Secondly there is a pattern in which investment is broadly defined with specified areas excluded from the definition Examples of this approach can be seen in the North American Free Trade Agreement (NAFTA) which form a source of reference when considering the scope of investment rules narrowed down into a specific framework

21 There is a third narrow definition that limited to FDI and excludes portfolio investment and real estate investment Enterprise based standards taking into account the establishment of a permanent relationship and the effect to business management Although the Balance of Payments Manual of the International Monetary Fund (IMF) and the benchmarks of the Organisation for Economic Co operation and Development (OECD) (ANNEX (B)) are not agreements in themselves, they illustrate standards and definitions for such FDI

22 In GATS a stipulation is adopted concerning the provision of services through a commercial presence in the territory of any other Member (Article I 2(c)) This covers FDI in service areas (ANNEX (C))

23 When considering a definition in a possible multilateral investment rules building on the existing agreements a definition could be selected from three categories

(i) The first category is the adoption of enterprise based standards such as those definitions laid out by the IMF and the OECD Code of Liberalisation of Capital Movements which limit the scope of investment from the outset

(ii) The second category is to first define investment under a broad scope after which by either broadly acknowledging short term capital movements regulation or by excluding short-term speculative capital flows can basically give each county s regulations some room for manoeuvre

(iii) The third category offers a compromise between the first two categories by responding to the elements of the agreement and changing the application scope of a definition and the method of application For example a broad definition is used concerning protection articles which while on the one hand broadly protecting investments narrowly define the scope of national treatment of pre establishment which provoke strong concern among developing countries

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[8] WT/WGTI/W/76
[9] WT/WGTI/W/92

24 It is of the greatest importance that all Parties adopt a common definition of investment otherwise investors may lose their predictability Accordingly it is necessary to either ensure that each country does not use its own discretion interpretation of a definition and to see to it that in discussions of a definition, there is an adequate balance with each country s development policies

3 Transparency

25 As Japan has already pointed out in the previous paper[10] there is the need for internal systems to be revised in response to the policy needs of each country with globalisation of economy and development of Information Technology From the standpoint of investment expansion, equal importance should be given to the need for transparency in these systems and also for transparency in their formulation and the revision processes Through such transparency in addition to the predictability of such systems being enhanced it would be possible to avoid discretionary or unnecessary systemic revisions

26 The obligation to ensure transparency in the existing WTO Agreements appears on several levels such as the publication of regulations (GATT Article X) the establishment of enquiry points (GATS Article III Paragraph 4) notification to the WTO (TRIMs Article 6) the ensuring of transparency of licensing procedures (GATS Article VI Paragraph 3) and prior public notification (TBTs Article 2 9) The level of obligations to ensure transparency are determined in response to the coverage of measures and the actual obligations imposed on Member countries by each agreement

27 In addition there is an example remaining in the transparency provision of an agreement the basis to allow developing countries a grace period with due consideration to their capacities in implementation (GATS Article III Paragraph 4) (ANNEX (4))

4 Non-discriminatorv (National Treatment)

28 One of the most important principles of the WTO agreements is the principle of National Treatment whereby investors are entitled to receive treatment in the host country equal and fair to the treatment received by companies of that country It is important that this principle be adequately reflected in a possible investment agreement However in a number of countries in particular developing countries due to a variety of developmental stages and a variety of economic and social conditions it is necessary to establish individual development policies that provide special treatment to domestic companies and industries Therefore it is imperative for developing countries to ensure a balance between national treatment principles and their development policies

29 As a means to ensure such flexibility there are two main methods that can be employed The top-down approach (the negative list method) and the bottom up approach (positive list method)

30 The top-down approach is one that compiles a negative list with exceptions to liberalisation while in principle it is stipulated that the Member country provides national treatment for investors of other Member Examples such as this can be found in NAFTA

31 On the other hand the bottom up approach adopts the compilation of a positive list of sectors to be liberalised For example this approach has been adopted in GATS [11] For each country especially the developing countries lists are only made for those sectors in which liberalisation is possible and those sectors which represent exceptions to liberalisation or for which a grace period is necessary before liberalisation can be achieved do not have to be included in a list Therefore it could be said that this is an approach to give due consideration to the development policies of developing countries with regard to flexibility (ANNEX (5))

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[10] WT/WGTI/W/87
[11] WT/WGTI/W/96

32 In whichever of the above mentioned approaches are used by adopting certain reservations to the principle of non-discrimination it is possible to progressively implement various obligations in discipline while maintaining a balance with development policies

5 Performance Requirement

33 With the intention of heightening the economic effect of investment in host countries there are cases where performance requirements are imposed on investors There are currently various debates over the economic effect of performance requirements[12] [13] Already through the TRIMs Agreement performance requirements have been regulated as being in contravention of Articles III and XI of GATT and one of the important issues for investment rules is how and in what way performance requirements should be treated No matter how performance requirements are handled in a possible investment agreement it is a fact that they have endowed a good deal of flexibility in the existing investment agreements

34 There are three types of disciplines on performance requirements that can be observed in the existing rules (a) An approach that does not make clear the stipulations regarding performance requirements (b) An approach that regulates a certain scope of performance requirements (c) An approach that partially accepts incentive related performance requirements but regulates a broad scope of performance requirements The TRIMs Agreement itself aims for performance requirement regulation

(a) An approach that does not make clear PRs-related stipulations

35 Early BITs and the ASEAN Agreement for the Promotion and Protection of Investments do not clearly stipulate performance requirements

(b) An approach that regulates a certain scope of performance requirements

36 In the TRIMs Agreement PRs that are subject to regulation are illustrated as local content requirements trade balancing requirements foreign exchange restrictions and export restrictions (ANNEX (6)) In addition the GATS has relations to PRs for its provisions on the market access include some measures that correspond performance requirements in International Investment Agreements (ANNEX (7))

(c) An Approach that partially accepts incentive related performance requirements but regulates a broad scope of performance requirements

37 Although NAFTA prohibits a broad scope of performance requirements illustrating 7 PRs 4 PRs out of them are allowed when they are incentive related (ANNEX (8))

6 Dispute Settlement

38 It is vital that in the International Investment Agreements solution procedures are clearly stipulated in the case of dispute in relation to the implementation of obligations of the agreements among contracting Parties In particular if any dispute were to be dealt with by only the states/parties concerned there is a risk that such a settlement could reflect the individual circumstances and political and economic situation of those states/parties It is therefore important to have fair dispute settlement rules with a high degree of transparency that can be seen by a large number of neutral states within the WTO framework

[12] WT/WGTI/W/82

[13] Foreign Direct Investment and Development Theodore H Moran Institute for International Economics December 1998

39 Articles relating to dispute settlement in the existing International Investment Agreements can be divided into two categories regarding the concept of their standing (eligibility of party) First is an approach that recognises conflict between investors and states and places great importance on the protection of the rights of the investor A second approach is a point of view that limits dispute settlement to that between states only The general position adopted in the WTO Agreements is the latter case and the GATS also only stipulates rules for inter state dispute settlement At the same time NAFTA incorporates the former approach covering both investor state and inter state disputes

40 The administering bodies of WTO Agreements are state parties and even if an investment agreement were to be set out it would be inappropriate to recognise private individuals as having a standing in dispute settlement Otherwise there would be a high possibility of a sharp increase in lawsuits being filed by investors creating a large burden for Member governments From the point of view of flexibility stipulations are made to pay special consideration to least developed countries in dispute settlement procedures in WTO Agreements (ANNEX (9))

41 This paper has thus far set out a case for flexibility aimed at reducing obligations in rules and others in (1) the preamble and objectives and in substantive provisions from (2) to (6) The following points (7) and (8) lay out a concept that provide flexibility in taking into account developing countries concerning the implementation of rules

7 Flexible Treatment of Developing Countries Obligations in Implementation, etc

42 From the point of view of finding a balance in disciplinary and developmental aspects it is important to find a way to realise the implementation etc of the agreements In the implementation of the existing WTO rules flexibility is given to the developing countries obligations of which two concrete means can be seen First is the establishment of a grace period which allows developing countries to improve their capacity Second are examples in which there is flexibility in the special initial treatment of states concluding agreements

43 Examples of the former grace period measure can be found in Article 5 Paragraph 2 of the TRIMs Agreement and Article 65 Paragraph 2 and Article 66 Paragraph 1 of the TRIPS Agreements (ANNEX (10)) In the TRIMs Agreement developing countries are given grace periods of five years and least developed countries a period of seven years and the TRIPS Agreement does likewise stipulating periods of five and 11 years respectively Cases of the latter example include GATS (Article 4) and the TBT Agreement (Article 12 8) (ANNEX (11)) In addition stipulations are made that take into account the economic and developmental situation of developing countries Such flexibility in implementation etc in combination with flexibility in the rules themselves are important elements when developing countries respond to international rules and rationalise them with their own development policies

8 Technical Assistance

44 There are no doubts that FDI has a positive effect on economic growth and development in host countries This kind of development can further be expected to invite further investment in a positive growth cycle It is for this reason that it is important to promote investment liberalisation while bearing in mind the need to strike a balance with the development policies of host countries However in developing countries resources such as human systems legislation etc are insufficient for implementation and there are cases where the introduction of rules cannot be promptly dealt with In such cases to encourage obligations it is important for developed countries to provide appropriate assistance based on its past experiences without lowering the standards of the rules In the existing WTO Agreements GATS (Article 25) and TRIPS (Article 66 2 and Article 67) make provisions for technical assistance to ensure flexibility in developing countries responses to such situations (ANNEX (12))

9 Activities of Investors in the Host Countries

45 The importance of striking a balance between investment rules and development policies has already been stated but it is actually the multi-national enterprises (MNEs) that work as the investors and undertake the economic activities in this balance It is imperative that both the rights of investors and their obligations should be considered

46 Accordingly one approach could be to consider articles concerning investor activities as a factor for flexibility in the investment rules

47 One option would be to incorporate as a reference any guidelines for investors in the investment rules Although as was pointed out in an EU paper[14] international agreements are unable to directly impose obligations on companies and it is appropriate to treat it as firmly non-binding

III CONCLUSION AND FUTURE POINTS FOR DISCUSSION

48 As we have seen in the existing International Investment Agreements and investment related agreements and in the existing WTO Agreements provisions have already been formulated that take into consideration developmental aspects This trend is particularly noticeable in the WTO Agreements When deliberating a possible Investment Agreement in the future while taking into account articles of the existing agreements it should be also possible to formulate flexible rules in a manner that respects development policies

49 The following lists the possible choices regarding what kind of flexibility should be pursued in the compilation of rules and the actual provisions of the International Investment Agreements While several points of view can be reflected in a flexible approach further discussion is necessary The list laid out below enumerates a number of elements including those that have not been discussed in this paper These elements are of course also very important and cannot be ignored

50 (Modalities for compilation of rules and actual provisions)

- Preamble and Objectives

Confirmation the importance of domestic development policies flexibility of discipline and technical assistance etc

- Composition of Schedules

In addition to Most Favoured Nation exemptions(MFN) impose limits and conditions on market access (MA) and national treatment (NT) (in both negative and positive lists)

Exceptions concerning pledges in specified areas

- Exemption or lowering of obligations

Grace periods progressive implementation and relaxation of commitments

Making exceptions for measures that deal with emergency situations

- Permissibility of performance requirements necessary for development

- Technical and financial assistance

[14] WT/WGTI/W/81

- Consideration of developmental aspects in dispute settlement procedures

- Others

Competition policies

Measures by governments of developed countries to promote increased FDI in developing countries and other measures

ANNEX

(1)

Agreement Establishing The World Trade Organization (Preamble)

Recognizing further that there is need for positive efforts designed to ensure that developing countries and especially the least developed among them secure a share in the growth in international trade commensurate with the needs of their economic development

GATS (Preamble)

Wishing to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalisation and as a means of promoting the economic growth of all trading partners and the development of developing countries

Desiring to facilitate the increasing participation of developing countries in trade in services and the expansion of their service exports including inter alia through the strengthening of their domestic services capacity and its efficiency and competitiveness

Taking particular account of the serious difficulty of the least developed countries in view of their special economic situation and their development trade and financial needs

Agreement on TRIMs (Preamble)

Desiring to promote the expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners particularly developing country Members while ensuring free competition

Taking into account the particular trade development and financial needs of developing country Members particularly those of the least developed country Members,

Agreement on TRIPS (Preamble)

Recognizing also the special needs of the least developed country Members in respect of maximum flexibility in the domestic implementation of laws and regulations in order to enable them to create a sound and viable technological base

(2)

OECD Code of Liberalisation of Capital Movements

Direct investment investment for the purpose of establishing lasting economic relations with an undertaking such as in particular investments which give the possibility of exercising an effective influence on the management thereof

1 Creation or extension of a wholly owned enterprise subsidiary or branch acquisition of full ownership of an existing enterprise
2 Participation in a new or existing enterprise
3 A loan of five years or longer

(3)

GATS (Article 28(d))

Commercial presence means any type of business or professional establishment including through

i) the constitution acquisition or maintenance of a juridical person

or

ii) the creation or maintenance of a branch or representative office within the territory of a Member for the purpose of supplying a service

(4)

GATS (Article 3)

1 Each Member shall publish promptly and except in emergency situations at the latest by the time of their entry into force all relevant measures of general application which pertain to or affect the operation of this Agreement International agreements pertaining to or affecting trade in services to which a Member is a signatory shall also be published

2 Where publication as referred to in paragraph 1 is not practicable such information shall be made otherwise publicly available

3 Each Member shall promptly and at least annually inform the Council for Trade in Services of the introduction of any new or any changes to existing laws regulations or administrative guidelines which significantly affect trade in services covered by its specific commitments under this Agreement

4 Each Member shall respond promptly to all requests by any other Member for specific information on any of its measures of general application or international agreements within the meaning of paragraph 1 Each Member shall also establish one or more enquiry points to provide specific information to other Members upon request on all such matters as well as those subject to the notification requirement in paragraph 3 Such enquiry points shall be established within two years from the date of entry into force of the Agreement Establishing the WTO (referred to in this Agreement as the WTO Agreement') Appropriate flexibility with respect to the time-limit within which such enquiry points are to be established may be agreed upon for individual developing country Members Enquiry points need not be depositories of laws and regulations

(5)

GATS (Article 17 1)

In the sectors inscribed in its Schedule and subject to any conditions and qualifications set out therein each Member shall accord to services and service suppliers of any other Member in respect of all measures affecting the supply of services treatment no less favourable than that it accords to its own like services and service suppliers

(6)

Agreement on TRIMs

Article 1 Coverage

This Agreement applies to investment measures related to trade in goods only (referred to in this Agreement as TRIMs)

(7)

GATS (Article 16)

2 In sectors where market-access commitments are undertaken the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory unless otherwise specified in its Schedule are defined as

(d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for and directly related to the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test

(8) NAFTA

Article 1106 Performance Requirements

1 No Party may impose or enforce any of the following requirements or enforce any commitment or undertaking in connection with the establishment acquisition expansion management conduct or operation of an investment of an investor of a Party or of a non-Party in its territory

(a) to export a given level or percentage of goods or services

(b) to achieve a given level or percentage of domestic content

(c) to purchase use or accord a preference to goods produced or services provided in its territory or to purchase goods or services from persons in its territory

(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment

(e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings

(f) to transfer technology a production process or other proprietary knowledge to a person in its territory except when the requirement is imposed or the commitment or undertaking is enforced by a court administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement or

(g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market

2 A measure that requires an investment to use a technology to meet generally applicable health safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f) For greater certainty Articles 1102 and 1103 apply to the measure

3 No Party may condition the receipt or continued receipt of an advantage in connection with an investment in its territory of an investor of a Party or of a non-Party on compliance with any of the following requirements

(a) to achieve a given level or percentage of domestic content

(b) to purchase use or accord a preference to goods produced in its territory or to purchase goods from producers in its territory

(c) to relate in any wav the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment or

(d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings

4 Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage in connection with an investment in its territory of an investor of a Party or of a non-Party on compliance with a requirement to locate production provide a service train or employ workers construct or expand particular facilities or carry out research and development in its territory

5 Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs

6 Provided that such measures are not applied in an arbitrary or unjustifiable manner or do not constitute a disguised restriction on international trade or investment nothing in paragraph 1(b) or (c) or 3(a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures

(a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement

(b) necessary to protect human animal or plant life or health or

(c) necessary for the conservation of living or non-living exhaustible natural resources

(9)

<u>DSU</u> *(Article 24 1)*

At all stages of the determination of the causes of a dispute and of dispute settlement procedures involving a least developed country Member particular consideration shall be given to the special situation of least-developed country Members In this regard Members shall exercise due restraint in raising matters under these procedures involving a least developed country Member If nullification or impairment is found to result from a measure taken by a least-developed country Member complaining parties shall exercise due restraint in asking for compensation or seeking authorization to suspend the application of concessions or other obligations pursuant to these procedures

(10)

<u>Agreement on TRIMs</u> (Article 5 2 3)

2 Each Member shall eliminate all TRIMs which are notified under paragraph 1 within two years of the date of entry into force of the WTO Agreement in the case of a developed country Member within five years in the case of a developing country Member and within seven years in the case of a least developed country Member

3 On request the Council for Trade in Goods may extend the transition period for the elimination of TRIMs notified under paragraph 1 for a developing country Member including a least developed country Member which demonstrates particular difficulties in implementing the provisions of this Agreement In considering such a request the Council for Trade in Goods shall take into account the individual development financial and trade needs of the Member in question

<u>Agreement on TRIPS</u> (Article 65 2)

A developing country Member is entitled to delay for a further period of four years the date of application as defined in paragraph 1 of the provisions of this Agreement other than Articles 3 4 and 5

(11)

<u>GATS</u> *(Article 4)*

1 The increasing participation of developing country Members in world trade shall be facilitated through negotiated specific commitments by different Members pursuant to Parts III and IV of this Agreement

(a) the strengthening of their domestic services capacity and its efficiency and competitiveness inter alia through access to technology on a commercial basis

(b) the improvement of their access to distribution channels and information networks

and

(c) the liberalization of market access in sectors and modes of supply of export interest to them

2 Developed country Members and to the extent possible other Members shall establish contact points within two years from the date of entry into force of the WTO Agreement to facilitate the access of developing country Members service suppliers to information related to their respective markets

(a) commercial and technical aspects of the supply of services

(b) registration recognition and obtaining of professional qualifications and

(c) the availability of services technology

3 Special priority shall be given to the least-developed country Members in the implementation of paragraphs 1 and 2 Particular account shall be taken of the serious difficulty of the least developed countries in accepting negotiated specific commitments in view of their special economic situation and their development, trade and financial needs

Article 19 2

The process of liberalization shall take place with due respect for national policy objectives and the level of development of individual Members both overall and in individual sectors There shall be appropriate flexibility for individual developing country Members for opening fewer sectors liberalizing fewer types of transactions progressively extending market access in line with their development situation and when making access to their markets available to foreign service suppliers attaching to such access conditions aimed at achieving the objectives referred to in Article IV

<u>*Agreement on Technical Barriers to Trade*</u> *(Article 12 8)*

Accordingly with a view to ensuring that developing country Members are able to comply with this Agreement the Committee on Technical Barriers to Trade provided for in Article 13 (referred to in this Agreement as the Committee) is enabled to grant upon request, specified time limited exceptions in whole or in part from obligations under this Agreement When considering such requests the Committee shall take into account the special problems in the field of preparation and application of technical regulations standards and conformity assessment procedures and the special development and trade needs of the developing country Member as well as its stage of technological development which may hinder its ability to discharge fully its obligations under this Agreement The Committee shall in particular take into account the special problems of the least developed country Members

<u>*Agreement on The Application of Sanitary and Photosanitary Measures*</u> *(Article 10 3)*

With a view to ensuring that developing country Members are able to comply with the provisions of this Agreement the Committee is enabled to grant to such countries upon request specified time-limited exceptions in whole or in part from obligations under this Agreement taking into account their financial trade and development needs

(12)

<u>*GATS*</u> *(Article 25)*

1 Service suppliers of Members which are in need of such assistance shall have access to the services of contact points referred to in paragraph 2 of Article IV

2 Technical assistance to developing countries shall be provided at the multilateral level by the Secretariat and shall be decided upon by the Council for Trade in Services

<u>*Agreement on Technical Barriers to Trade*</u> *(Article 11 1 2)*

1 Members shall if requested advise other Members especially the developing country Members on the preparation of technical regulations

2 Members shall if requested advise other Members especially the developing country Members and shall grant them technical assistance on mutually agreed terms and conditions regarding the establishment of national standardizing bodies and participation in the international standardizing bodies and shall encourage their national standardizing bodies to do likewise

<u>*Agreement on The Application of Sanitary and Photosanitary Measures*</u> *(Article 9 1 2)*

1 Members agree to facilitate the provision of technical assistance to other Members especially developing country Members either bilaterally or through the appropriate international organizations Such assistance may be inter alia in the areas of processing technologies research and infrastructure including in the establishment of national regulatory bodies and may take the form of advice credits donations and grants including for the purpose of seeking technical expertise training and equipment to allow such countries to adjust to and comply

with sanitary or phytosanitary measures necessary to achieve the appropriate level of sanitary or phytosanitary protection in their export markets
2 Where substantial investments are required in order for an exporting developing country Member to fulfil the sanitary or phytosanitary requirements of an importing Member the latter shall consider providing such technical assistance as will permit the developing country Member to maintain and expand its market access opportunities for the product involved

Agreement on TRIPS (Article 66 2 67)
66 2 Developed country Members shall provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least developed country Members in order to enable them to create a sound and viable technological base
67 In order to facilitate the implementation of this Agreement developed country Members shall provide on request and on mutually agreed terms and conditions technical and financial cooperation in favour of developing and least developed country Members Such cooperation shall include assistance in the preparation of laws and regulations on the protection and enforcement of intellectual property rights as well as on the prevention of their abuse and shall include support regarding the establishment or reinforcement of domestic offices and agencies relevant to these matters including the training of personnel

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13 June 2001

MEETING OF THE WTO WORKING GROUP ON THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT

GENEVA 13-14 June 2001

Recent work undertaken within UNCTAD's work programme on international investment agreements

by

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UNCTAD

DITE/IPCB/IA/PUB/2001/8

Chairperson, distinguished delegates, ladies and gentlemen,

Thank you very much for this opportunity to update the Working Group on UNCTAD s activities within the work programme on investment policies and international investment agreements, since your last session in March 2001

The most important activity of course, has been the convening of the Third United Nations Conference on the Least Developed Countries, held in Brussels from 14-20 May 2001 At the Conference a number of concrete deliverables were announced in the area of investment and enterprise development which were supported financially by different donors These deliverables are aimed at assisting LDCs in enhancing their productive capacity the bedrock of their sustained economic growth and development and the basis of their expanding trade Growth in LDCs requires, in addition to official development assistance, enterprise development and especially investment, including foreign investment, in particular of the kind that brings employment, technology, skills, and access to markets and diffuses these assets through backward linkages to host economies Therefore the deliverables which have been developed in consultation with LDCs, reflect UNCTAD's experience of providing technical assistance in the areas of investment and enterprise development, and have benefited from symposia held with LDCs in Oslo (at the end of January 2001) and Bonn (in March 2001)

The various deliverables form part of an *International Investment Initiative for LDCs* announced at the Conference The Initiative combines the investment-related parts of the Programme of Action negotiated by governments for the Conference with a number of flagship projects that were launched at the time of the Conference thanks to concrete commitments having been obtained

The heart of this inititative is a multi-agency technical assistance programme on *Facilitating FDI in LDCs* by UNCTAD, the World Bank Group (MIGA FIAS) and UNIDO, which will in a pilot phase include five LDCs *Investment Policy Reviews* will be undertaken in four to five LDCs and assistance will be extended to a number of LDC investment promotion agencies including for the purpose of good governance in these institutions

Another programme is assisting LDCs in participating as effectively as possible in discussions and negotiations of *IIAs*, including intensive training seminars negotiation of bilateral treaties and double taxation treaties

Two programmes will be implemented together with the International Chamber of Commerce (i) *Investment Guides* for a number of LDCs (ii) *Investment Advisory Council* which will bring together senior government and corporate leaders to advice LDC Governments on issues related to investment

Chair,

Let me now turn to the activities implemented since your last session in March 2001 within our work programme on IIAs Here, three events are noteworthy

First, UNCTAD has implemented another round of BITs negotiation facilitation events from 19-28 April in Dubrovnik, Croatia, within the framework of the Balkan Stability Pact This round involved Belarus, Croatia, Latvia, Malta, Moldova and Pakistan, and resulted in 8 BITs Belarus and Croatia utilized this round to also discuss a general trade agreement A report on this round of negotiations can be made available Like earlier rounds, the Croatia event was meant to provide a platform for developing countries to negotiate BITs with other interested countries, and among themselves UNCTAD does not participate in the negotiations as such

In this context it is noteworthy that 29 BITs negotiated during the round organized for francophone least developed countries (LDCs) that was held in Geneva from 24 January to 3 February 2001 were officially signed during the Third United Nations Conference on the Least Developed Countries in Brussels The signing ceremony, which took place on 18 May 2001, was presided over by Boutros Boutros-Ghali, Secretary General of the Organisation internationale de la Francophonie, and Rubens Ricupero, Secretary-General of UNCTAD

Second, the first intensive training course on issues in IIAs for francophone African countries This course is currently underway in Alexandria, Egypt, in cooperation with Senghor University and l'Agence pour la Francophonie Scheduled to last until 16 June 2001, the course

has brought together 21 participants and speakers from Northern African countries (as well as the People's Republic of Laos) For your information, we have made available (outside at the documents counter) a copy of the programme and curriculum for this course Please note that similar courses for anglophone Asia and for anglophone Africa are currently in their planning stage with the Asian course scheduled to take place in November this year

Third, UNCTAD has since your last meeting finalized work on the issues paper on *Host Country Operational Measures* The paper is available in xeroxed form outside at the documents counter As this subject is relevant to your current discussion, allow me to elaborate on its content in more detail

The paper deals with the vast array of measures implemented by host countries concerning the operation of established foreign affiliates Covering all aspects of an investment (such as ownership and control, hiring of personnel, procurement of inputs, sales conditions, etc), these measures (which usually take the form of restrictions or performance requirements) are meant to influence the location and character of FDI with a view to increase its benefits in the light of national objectives and to correct actual or perceived market distortions

Noting that HCOMs have rarely been considered as a separate issue in IIAs, the paper singles out the WTO Agreement on TRIMs as the only existing agreement specifically dealing with a number of HCOMs It notes that the more recent IIAs that regulate HCOMs tend towards the restriction of some of these measures However, the majority of IIAs, especially most BITs, adopt an approach to investment that does not explicitly address the use of operational restraints as a specific issue on its own

For its analysis, stocktaking and discussion of the development and economic policy considerations, the paper groups HCOMs into three categories and proceeds with discussing them in the context of some of their restrictions at different international levels

- First, measures that are explicitly prohibited at the multilateral level, i e by the TRIMs Agreement A number of interregional regional and bilateral agreements also explicitly

prohibit the same HCOMs (or where these agreements are in a draft form, envisage their prohibition) To use a traffic light analogy these are "red light" HCOMs i e measures that the international community as a whole (or, more precisely, as represented in the WTO) has agreed should not be employed (although not all countries feel comfortable with the implementation of this agreement)

- Second, additional measures that are explicitly prohibited, conditioned or discouraged by interregional regional or bilateral (but not by multilateral) agreements (or drafts thereof) These are "yellow light' HCOMs in the sense that negotiators of IIAs ought to be aware that some countries (or groups of countries) have indeed prohibited them in some IIAs Categorising these measures as yellow light HCOMs should not suggest that they are not as legally binding as the red light HCOMs Indeed both derive from instruments governed by international law, which, among the parties, create binding legal obligations The point of emphasis is that the red light HCOMs have, in terms of parties, a wider application

- And third, all other measures These are green light HCOMs Such measures are generally not subject to control through IIAs although their use may be subject to other international obligations, e g to apply national treatment

The paper suggests that countries negotiating international investment rules in the future need to take into account the TRIMs Agreement Negotiations – should they at all include HCOMs – are likely to pay special attention to yellow light" HCOMs However, the paper concludes that options go beyond either covering or not covering certain HCOMs For example the extent to which certain HCOMs are tied to certain conditions (e g incentives) or the legal nature of any coverage (e g best efforts clauses) can introduce some flexibility In fact even when it comes to the TRIMs Agreement, the paper identifies various options as to its further development

In all, the paper s analysis shows that the scope for an unconditional use of HCOMs has narrowed over the past two decades At the same time, the debate remains open as to which, how and under what circumstances HCOMs do or do not contribute to the development process

Ideally, therefore, any such regulation should be preceded by careful study and determination of the contribution by a specific HCOM to the development efforts of developing countries and how a certain flexibility can be maintained in IIA provisions related to their use in the interest of development

Chair,

Allow me to close my remarks with a reference to the forthcoming expert group meeting on "International arrangements for transfer of technology best practices for access to and measures to encourage transfer of technology with a view to capacity-building in developing countries especially in least developed countries The meeting scheduled for 27-29 June 2001, is expected to examine the coverage of agreements, particularly as regards the spread of provisions on transfer of technology, the effectiveness of their implementation (how are they operationalized?), and possible improvements in terms of what can be done to enhance their impact on transfer of technology The main questions are how to ensure the effectiveness of international arrangements for transfer of technology and capacity building and what are the best mechanisms for their successful implementation

To conclude, Chair I would like to emphasize that we welcome the opportunity to continue to share our experiences with this Working Group and to continue to make our expertise available if so desired

Thank you

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India

Annex I

DRAFT

Issues paper for Working Group in Trade and Investment Agenda Item B The Economic Relationship between Trade and Investment Benefits and Economic Impact of FDI

FDI FLOWS AND TECHNOLOGY TRANSFER

The possible role that foreign investment could play in aiding countries to achieve the goal of increased income, employment and output is now universally recognised Almost every country is engaged in autonomously liberalising their foreign investment regimes with a view to facilitating smooth flow of investment to their respective territories However, there has been a general reluctance among countries to leave the scene completely open to foreign investors While a large number of countries maintain formal screening procedures to regulate investment inflow, the reluctance to surrender all discretionary authority as regards entry and establishment is near universal This is largely because of the strong perception that investment inflows are not unmixed blessings and that investors cannot be expected to automatically fulfil their obligations diligently When some of the Members of WTO discussed the issue of a multilateral agreement on investment outside WTO, in OECD, this concern came out clearly in the open with the participating Members coming out with requests for exemptions one after another In fact, the nature and extent of exemptions sought by the participants led to the very abandonment of the negotiations The participants in the OECD process were all countries that had reached a certain level of development whose economic problems and concerns had largely transcended those of the large majority of the WTO Membership who are developing countries and LDCs It would, therefore, be naive to expect the latter group of countries to be unconcerned about the implications of any efforts that are aimed at eventual curbs on their ability to influence investment inflows into their territories

2 Foreign investment inflows are not homogeneous The economic effects of FDI, for example, differ substantially from those of portfolio investment The ripple effects created and the imprints left behind by FDI on the host economies differ substantially from those by portfolio investment Low income

countries with very limited technological capabilities and complementary production factors like skilled labour and managerial skills would be most comfortable with imported products that are ready for consumption However, imports have to be paid for This means these countries have to earn foreign exchange to pay for such imports Besides, there is the need for building domestic capabilities in areas of their potential comparative advantage so that these countries could eventually participate effectively in the global market place Developing countries, therefore, naturally seek foreign direct investment (FDI), in preference to other types of investment, which brings with it a bundle of production factors in the form of capital, technology, skilled manpower and managerial skills, these are expected to help ease constraints on their industrialisation and development, imposed by scarcities of capital, foreign exchange, technology, organisational and entrepreneurial resources Technology is perhaps the most crucial of them all from the point of view of development

3 The last decade has seen a veritable explosion in the total FDI flows, both in the absolute volume of the global flows and also as a share of the global output World FDI flows today are more than thrice the level of what they were in 1990, and some seven/eightfold their level in 1980 Going by the recent trends, especially manifested after the Asian crisis of 1997, the predominant channel of transferring the FDI funds has been through the merger and acquisition (M&A) mode, rather than in the form of greenfield investments Data from the World Investment Report (2000) indicates that the M&As today constitute about 85% of the total FDI flows the world over

4 Studies have confirmed the general apprehension that FDI inflows in the form of mergers and acquisitions (M&As) are in general of poorer quality as compared to greenfield FDI inflows, in terms of their domestic capital augmenting potential, spillover benefits, competition and efficiency'[1] This is because M&As do not always augment the stock of productive physical capital in the host country which would contribute to further growth It is to be noted that greenfield investment, by virtue of new entry, increases competition, while M&As most often lead to increases in economic concentration by reducing the number of active enterprises in the market

[1] Nagesh Kumar 2000 "Mergers and Acquisitions by MNEs Patterns and Implications pp 2851 8 August 5 Economic and Political Weekly

5 Even a successful M&A bid and its efficient implementation from the investors' point of view need not necessarily have a favourable impact on the economic development of the host country The main reason for this is that the objectives of the concerned multinational corporations (MNCs) and those of the host economies do not necessarily coincide The effects of the M&As, either directly or through linkages and spillovers, also depend on whether the investment is natural-resource-seeking, market-seeking, efficiency-seeking or created-asset-seeking In case the initial investment decision related to a merger or acquisition is taken on purely financial profitability considerations, without due regard for the economic benefits likely to accrue to the host country, the effects of such M&As cannot be expected to be beneficial for the host economy Chia Siow Yue et al[2] note that the "driving forces behind this M&A surge include increased corporate competition as a result of liberalisation in many host country regimes, and the need to consolidate international business in the face of falling corporate profit margins Recent declines in commodity prices and global over-capacity across a spectrum of industries have exacerbated this business consolidation trend" The motive-factor would also have an important bearing on the type and quality of the technology transferred It is important for the developing countries, therefore, to not only see 'whether' technology is being transferred, but also the 'nature' of such transfer The quality of the technology acquired cannot be ignored if one has to keep in mind the dynamic long-term development interests of the developing countries

6 One major reason why FDI is sought after by countries, especially developing countries, is that FDI generally brings with it the much needed state-of-the-art technology that developing countries lack However, available facts and figures do not vindicate this expectation of developing countries An analysis of the trends in global technology transfers indicates that the annual technology transfer payments are not growing at expected levels It is estimated that the technology transfer payments rose from $6 8 billion in 1976 to an estimated $64 4 billion in 1995 Providing for the OECD countries not reporting the technology receipts especially Switzerland's and emerging newly industrialising economies in Asia, the global magnitude of technology related

Chia Siow Yue et al 1999 East Asia and Options for WTO 2000 Negotiations on Investment pp 1 2 Paper presented at the World Bank PECC Trade Policy Forum Conference on East Asia and Options for WTO 2000 Negotiations Manila 19 20 July 1999

fees crossing national borders could well be to the tune of $68 billion Comparatively, annual global FDI flows rose from $22 billion to $315 billion over the same period[3] However, what is significant is that the growth rates recorded by FDI flows have been more impressive than those by technology transfer payments over the whole or any sub-period

7 These observations together suggest that the recent spurt in FDI inflows may not have been accompanied by technology transfers in the same proportion Further, and more striking, particularly for the developing countries, is the fact that while their share of FDI inflows has gone up, their share in global technology transfers has come down Dahlman et al[4] have also noted the relative slowdown in technology transfers to developing countries This is an alarming trend from the point of view of developing countries While it can be argued that the subsidiaries payments for the technology transferred from the parent companies is expected to be lesser in the case of M&As than in the case of greenfield investments, even then this trend definitely does not augur well for the developing countries who are generally dependent on the technology brought in by the foreign investors to give a boost to their economic activities

8 In this regard, Sanjaya Lall[5] makes a distinction between the 'know-how' and 'know-why' of technology transfer He first stresses that technology import is not a substitute for indigenous capability development, the efficacy with which imported technologies are used depend on the local efforts However, not all modes of technology import are conducive to indigenous learning Much depends on how the technology is packaged with complementary factors In general it has been observed that technology transfers within a MNC are very efficient for transferring know-how, but less so for transferring know-why In this, licensing or arm's length transactions are deemed to be more effective for generating local know-why, though they are more expensive in the short-term for accessing know-how Thus the type of investment that comes in would be of the type that supports 'assembly-led-

[3] Nagesh Kumar 1997 Technology Generation and Technology Transfers in the World Economy Recent Trends and Implications for Developing Countries" UNU/INTECH Discussion Paper 9702 pg 17 & 20
[4] 1995 The World Trading Environment pp 155 78 in Irfan Haque et al (eds) Trade Technologies and International Competitiveness Washington DC The World Bank
[5] 2000 Technological Change and Industrialisation in the Asian Newly Industrialising Economies" pp 13 68 in Kim and Nelson (eds) Technology Learning and Innovation Cambridge University Press

growth' and skill formation among workers With reference to Korea it has been noted[6] that labour intensive investment that came in textile, clothing and footwear sectors saw a rise in the export and also the manufacturing value-added by the labourers On the other hand, in the assembly-led investment in manufacturing units like telecommunications, furniture, pottery and other non-metallic mineral products etc exports and manufacturing value-added had, in fact, declined Therefore, as noted by Hattori, "although Korean companies accumulated a very high level of technology to operate new machines, they could not acquire technology and skill required for developing new machines Thus, while Korean engineers design new machines, the know-how required to produce high quality parts at low prices in the domestic market is not available for the production of these machines" It has been noticed that M&A type FDI accompanying MNCs has transferred a high level of 'operating and organisational' technology, which is very different from a high level of 'production technology' In the former case, the goods produced will have weak competitiveness except for price

9 As underlined in the UNCTAD series Paper on issues in International Investment Agreement, a clear distinction needs to be made between the learning of operational technology and the creation of new technology "FDI may be a very effective way of transferring new operating know-how but not necessarily of the innovation process that underlies the generation and upgrading of the technology It is widely accepted that TNCs tend to transfer the *results* of the innovation but not innovative capabilities themselves, at least to most developing countries the re-location of their research functions abroad is overwhelmingly to other developed countries This can lead to a "truncating" of the process of technology transfer and to a relegation of developing host countries to lower levels of technological activity (even when their industrial capabilities have reached a level at which, as in many newly industrialised economies, they are able efficiently to undertake advanced research-and-development work"[7] The above, therefore, makes it very clear that transfer of technology is not automatic Developing countries will need to retain policy discretion to persuade foreign investors to effectively transfer technology, even though it might involve 'higher cost' to these countries

[6] Tamio Hattori 1999 Vol 34(22) Economic and Political Weekly
[7] Pg 35 UNCTAD IIA Papers Series

10 There is also the debate regarding whether obtaining technology through FDI route is preferable to licensing and other similar arrangements As the UNCTAD paper cited above notes Japan and Korea relied heavily on licensing and other forms of acquisition of technology from TNCs, while Singapore mainly relied on FDI, attracting it into specified industries On the other hand, Taiwan made active use of both the routes

11 Gordon H Hanson[8] in a G 24 discussion paper notes that ' multinational firms concentrate in high-productivity sectors and that domestic plants in these sectors, while having high relative levels of productivity, experience even or negative growth in productivity relative to plants in other sectors Micro-level data, then, appears to undermine empirical support for positive net productivity spillovers from FDI, perhaps indicating that multinationals confine domestic firms to less profitable segments of industry" In this connection he quotes studies by Haddad and Harrison (1993) and Aitken and Harrison (1999) Haddad and Harrison, using data on Moroccan manufacturing plants for the period 1985-1989 found a weak correlation between plant total productivity growth and presence of foreign firms in the sector Aitken and Harrison (1999), using data on Venezuelan manufacturing for the period 1979-1989 found that productivity growth in domestic plants is negatively correlated with foreign presence in the sector

12 Evidence from the newly developing South-East Asian Tigers' experiences also indicates that the total productivity growth in these economies has been low in spite of the liberalisation and significant inflows of FDI which ought to have brought in newer technologies What this implies is that low technological capability might coexist with the capability to successfully use new technologies It must therefore be remembered that the simple act of high-technology production in any country does not ensure that efficient learning has occurred, and the latter depends on a host of other factors other than technology transfer per se Studies undertaken[9] also reveal that developing countries attract only marginal shares of foreign affiliate research, and much of what they get relates to production, adaptation and technical support (ie, know-how) rather than relating to innovation (know-why)

[8] Gordon H Hanson 2001 Should Countries Promote Foreign Direct Investment? p 14 G 24 Discussion Paper No 9 February 2001

[9] P 174 World Investment Report 2000

13 The extent of technology and management of know-how transfer by the MNCs depend to a large extent on their corporate strategy, for example, firms desiring to have a longer-term relationship with the suppliers (rather than those simply using the host country as a marketing/export base) will be more inclined to effect transfer the technology As pointed out in the World Investment Report, 2000, MNCs may restrict the access of particular affiliates to technology in order to minimise inter-affiliate competition It is noted that MNCs are more likely to licence older technologies from which they have already derived significant rents than newer technologies on which there are still relying for market leadership Further they may hold back the upgrading of the affiliate technology or invest insufficiently in host country training and R&D in accordance with their global corporate strategies Therefore, arguing that FDI inflows and economic liberalisation automatically facilitates technology transfer is being extremely naive

14 It is also important to underline that MNC presence through export-led FDI has mixed implications for the local technological activity in different economies In industrially advanced countries, MNC export activity can have significant inputs of indigenous content and design, and interact with and contribute to the local technological know-why base In low-wage, less industrialised countries, MNC exports are driven mainly by cheap labour, and have low levels of local technological content Between these two extremes, a number of combinations of MNC presence and technological activity are possible Even in cases of MNC-driven assembly activity, there may be scope for creation of local technological capabilities, but the learning tends to be concentrated in operational capabilities rather than in the know-why For this reason, even in the most liberalised countries, once allowed in, investors are induced to diffuse technologies locally Singapore[10] , for example, was also found to have used selectivity in a strong way to initially attract investors into targeted activities, and later to upgrade their technological content

15 The issue of technology is at the core of development debate Development on a self-sustaining basis has as its essential pre-condition development of technological capabilities and the ability to attract and absorb state-of-the-art technology Transformation from a stage of low technological

[10] Pg 39 S Lall 2000 op cit

development to this stage would not be possible except through transfer of technology However, the evidence as cited above, does indicate that left to market forces transfer and diffusion of technology may not materialise, especially in the case of developing countries This allows the inevitable conclusion that developing countries should preserve their right and ability to influence Foreign Direct Investment flows into their territories with a view to ensuring that it is accompanied by appropriate technology and that there is a sincere effort on the part of the investors to effect technology transfer so that productivity levels are enhanced and export capabilities augmented, which alone could assist in the increased participation of developing countries in the global market place

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