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FOREIGN DIRECT INVESTMENT AND DEVELOPMENT
IN A GLOBALIZING WORLD ECONOMY

Current international arrangements governing foreign direct investment

Report by the UNCTAD secretariat

Given the importance of foreign direct investment (FDI), the question of international arrangements dealing with FDI has become a prominent issue on the international policy agenda. The purpose of this report is to lay out the extent to which FDI issues have been covered at the bilateral, regional and multilateral levels and to draw a number of lessons from past experiences.

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INTRODUCTION

1. Foreign direct investment (FDI) has become more important than trade in terms of delivering goods and services to foreign markets, and it is the principal mechanism for organizing production internationally. Consequently, the question of international arrangements for FDI has become a prominent issue on the international policy agenda. Recent developments in this respect have included the proliferation of bilateral and regional investment agreements, the inclusion of certain trade-related FDI issues in the Uruguay Round agreements and the actual beginning of negotiations on a Multilateral Agreement on Investment at the OECD.

2. The purpose of this report is to lay out the extent to which FDI issues have been covered at the bilateral, regional and multilateral levels and to draw a number of lessons from past experiences. The discussion will be continued in the *World Investment Report 1996*, with a presentation of various policy approaches towards the further evolution of international arrangements governing FDI; an identification and analysis of key issues that, judging from existing international investment instruments, one could reasonably expect to be addressed in the further development of international arrangements on FDI; and a review of relevant fora. This report is exploratory in nature and is meant to contribute to an informal dialogue on the issues involved.

I. CURRENT INTERNATIONAL ARRANGEMENTS FOR FOREIGN DIRECT INVESTMENT

3. It is widely recognized among policy-makers around the world that the potential benefits of FDI for economic development and growth can far exceed the potential costs. In fact, FDI is perceived as a key vehicle to obtain foreign technology, managerial skills and other vital resources; to integrate into international marketing, distribution and production networks; and to improve the international competitiveness of firms and the economic performance of countries (UNCTC 1992; UNCTAD-DTCI, 1995). Consequently, governments strive to create a favourable climate to attract FDI, by establishing an enabling framework, knowing, however, that other factors (such as market size, growth and macroeconomic stability) carry the principal weight in investors' locational decisions. Governments have done so through the liberalization (UNCTAD-DTCI, 1994, ch. VII) of their national FDI regimes by reducing or eliminating restrictive measures on entry and establishment, local ownership and control requirements, discriminatory operational conditions and screening or authorisation procedures. Many have also adopted or agreed to general standards of treatment -- including national treatment, most-favoured-nation and fair and equitable treatment, and treatment according to international law -- and provided specific guarantees in key areas such as the transfer of funds, expropriation and dispute settlement. Increasingly, moreover, governments are paying attention to ensuring the proper functioning of the market, for instance, through the adoption of competition rules, consumer and financial reporting standards. These trends, which are part of a broader liberalization process encompassing all types of international transactions, are, in turn, an extension of the general tendency to pursue market-oriented policies, as a means to achieve greater economic efficiency. For most developed countries, this represents a continuation, deepening and expansion of their historically liberal approach to FDI. For many developing countries and transition economies, however, the liberalization of FDI policies means a dramatic change from the more interventionist development models of past decades (UNCTAD-DTCI, 1996a, introduction).

4. To influence the locational decisions of foreign investors in an increasingly open and highly competitive global environment, governments have sought to attract FDI with various promotional measures. Among these, incentives programmes of various types are offered to encourage FDI into certain industries, activities or locations (e.g. regions), often in exchange for performance requirements. Some of these programmes are directed specifically at foreign investors, others are addressed to local as well as foreign investment (e.g. regional development incentives), while, for particular investments considered of special importance to the country, incentives are often negotiated on an *ad hoc* basis. Though aimed at facilitating FDI, incentives can be market-distortive in ways similar to incentives to trade. In

this respect, FDI incentives do not contribute to a more liberal FDI regime (UNCTAD-DTCI, 1996b).

5. These trends at the national level have created a greater degree of policy convergence among developed and developing countries. However, while the trend towards liberalization and facilitation of FDI in national regimes is pervasive, it is, by no means, uniform: considerable differences exist in national policy regimes that reflect a diversity of national priorities, concerns and objectives (UNCTAD-DTCI, 1994, chapter VII). Independent of any differences, there is the overarching recognition of the obligation of foreign investors to comply with the national laws and regulations of the countries in which they operate.

6. Looking back at developments over the past half-century, it is striking how the number of instruments dealing with FDI has increased and how their substantive coverage has become broader. At the same time, there have been sharp swings in the prevailing attitudes of countries towards FDI, from protection, to restrictions and control, to facilitation and liberalization (Sauvant and Aranda, 1993; Sornarajah, 1994; Muchlinski, 1995), although there were often considerable discrepancies between the pronouncements countries made, including at the multilateral level, and the practices they followed.

7. The origins of international arrangements governing FDI can be traced back to the rules of customary international law developed between the eighteenth and twentieth centuries and inspired in the main by the values and legal traditions of Europe and the United States. Their twin foundations were the principles of State sovereignty and exclusive territorial jurisdiction, on the one hand, and the legal doctrine of State responsibility for injuries to aliens and their property, on the other. The international law of foreign investment has alternated between emphasis on each of these foundations. At the end of the nineteenth century, prevailing perceptions of the doctrine of State responsibility were challenged by the Latin American States, which developed their own international law approach to the treatment of foreign investors, generally known as the Calvo doctrine. Its main tenets were: (a) that, under international law, States are required to accord to aliens the same treatment as that afforded to their own nationals under national law; both discrimination against aliens and the grant to them of privileges not available to nationals are thus condemned; (b) claims by aliens against the host State (particularly those based on contracts) must be decided solely by the domestic courts of that State; and (c) diplomatic protection by the State of the investor’s nationality can be exercised only in cases of direct breach of international law and under restrictive conditions.

8. Efforts to create conventional multilateral rules for FDI started as early as the 1940s in the framework of the Havana Charter (unless otherwise indicated, all instruments referred to in this chapter are contained in UNCTAD-DTCI (1996a), *International Investment Instruments: A Compendium*, which also contains a summary examination and review of the instruments). But it soon became obvious that the positions of countries on FDI at that time were too far apart to allow consensus. Even within the OECD, a proposal for a comprehensive agreement to protect FDI in the 1960s did not come to fruition, and only a few multilateral initiatives dealing with specific aspects of FDI protection during that period materialised.

9. At the regional level, certain groupings began to introduce and implement common liberalization rules for FDI already in the 1960s, mainly within the OECD and in the context of regional efforts to promote free trade and economic integration, particularly with the creation of the European Economic Community in 1958. Economic integration efforts -- especially efforts that are far advanced -- are a special case since investment rules in such contexts are typically part of a wider set of rules and, therefore, allow trade-offs that may not be possible elsewhere. To protect investment between developed and developing countries (mainly against the risk of expropriation), bilateral investment treaties began to be concluded during that time.

10. During the 1970s, and in the context of concerns over the impact of transnational corporations (TNCs), developing countries imposed widespread controls, restrictions and conditions on FDI entry and operations. This trend

was also reflected in some regional instruments of the time (e.g. in the Decision 24 of the Andean Pact) while, at the multilateral level, efforts during that period concentrated -- mainly at the instance of developing countries, but also of trade unions and consumers -- on the formulation of standards of behaviour for TNCs. Lengthy negotiations on a Code of Conduct on Transnational Corporations and a Code on the Transfer of Technology eventually did not lead to agreed instruments. But other multilateral instruments dealing with specific issues were concluded, such as, for example, the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy. Already in the 1980s, some efforts within the United Nations that focused on developing standards to ensure the proper functioning of markets, notably the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices and the Guidelines for Consumer Protection, were successfully concluded.

11. Although many international instruments relevant to FDI exist, many have only a limited effect, and only the most dynamic of them (i.e., those that have continued to evolve and adapt or that address current concerns) are active components of the present international arrangements for FDI. In recent years, the development of international rules on FDI has proceeded mostly at bilateral and regional levels. Multilateral negotiations and agreements are also expanding; but, so far, those successfully concluded relate to sectoral or to specific issues only (UNCTAD-DTCI, 1996a; Brewer and Young, 1996).

12. This report looks at bilateral, regional and multilateral agreements on FDI in terms of the various levels at which they presently function and their main elements. In addition, investment standards elaborated by private institutions -- notably business organizations, trade unions, professional associations, consumers and other interested groups -- have, to some extent, also influenced the construction of international FDI rules, but they are not reviewed here.

A. Bilateral level

13. At the bilateral level, key investment concepts, principles and standards have been developed through the conclusion of treaties for the protection and promotion of FDI (bilateral investment treaties -- BITs). Their distinctive feature for present purposes is their exclusive concern with investment. Introduced four decades ago, these treaties have remained virtually unchanged in their format, and the issues they address continue to be among the most important for FDI. They usually begin with declarations on the importance and beneficial role of FDI for development. Typically, BITs contain broad -- even open-ended -- definitions of foreign investment, inclusive of non-equity forms, different types of investment assets and most aspects of the life of an investment; many extend to portfolio investment. Investors covered are companies and individual nationals of one of the contracting parties, although the application of BITs is often restricted to investors who have real links with one of the two States involved. While they encourage governments to facilitate and welcome FDI, they avoid, in general, a direct regulation of the question of right of establishment, referring this matter to national laws (thus implicitly recognizing the right of governments to regulate entry of FDI); an exception to this general approach is found in BITs signed by the United States which extend the national and most-favoured-nations (MFN) treatment standard to the entry and establishment of foreign investors (Vandevelde, 1992, 1993). Most BITs also do not explicitly address ownership and control issues. On the other hand, some types of operational restrictions are covered. In particular, some BITs prescribe the admission of senior foreign personnel involved in an investment. However, only a few BITs (those signed by the United States, as well as some Canadian and French BITs) prohibit performance requirements. Most BITs prescribe -- separately or in combination -- national treatment, MFN and fair and equitable treatment, and treatment according to international law. Of these standards, MFN is prescribed more often than national treatment, although an exception is usually provided for membership in regional integration agreements. National treatment itself is typically stated in broad and general terms, but, often, is qualified by a number of exceptions. In addition, BITs prescribe specific standards of investment protection on particular key issues, notably the transfer of funds, expropriation and nationalization and the settlement of disputes between a treaty partner and investors of the other

State. By providing protection, BITs seek to promote FDI; yet, they seldom provide for pro-active promotion measures by home countries. Finally, in view of their purpose, BITs do not deal with broader issues related to the proper functioning of markets.

14. On the other hand, the similarity in both the structure and substantive coverage of BITs should not conceal that differences in the strength of provisions do exist, to accommodate specific country concerns.

15. Intended to promote investment between the treaty partners through the protection of investment, BITs are considered important signals concerning a country’s investment climate (Salacuse, 1990). At the same time, BITs entered into by developing countries do not disregard the special development needs of individual treaty partners: they emphasize the importance of FDI for economic development; they generally recognize the effect of national law on FDI; and they contain exceptions or qualifications to some general principles (e.g. exceptions from national treatment for strategic industries and balance-of-payments qualifications to the principle of free transfer of funds).

16. The network of BITs is expanding constantly. Some two-thirds of the nearly 1,160 treaties concluded up to June 1996 were concluded during the 1990s (172 in 1995 alone), involving 158 countries. Originally concluded between developed and developing countries, recently more and more BITs are between developed countries and economies in transition, between developing countries and between developing countries and economies in transition.

17. Other important principles developed at this level, but separately from BITs, relate to the avoidance of double taxation. Double taxation occurs when income and capital of firms operating (broadly defined) in more than one tax jurisdiction is considered as taxable in more than one jurisdiction (Muchlinski, 1995). To avoid or resolve such conflicts, bilateral treaties for the avoidance of double taxation of income and capital have been concluded in great numbers between countries from all regions and at different levels of development. For example, the member States of the European Union had concluded over 740 double taxation treaties as of June 1996 (IBFD, 1996). In the treaties, the parties agree to observe certain rules for the allocation of tax revenue between the jurisdictions involved and seek to address instances of taxable income that is not taxed in either jurisdiction. Most of these treaties are based on two model conventions, one prepared by the United Nations and the other by the OECD. The OECD model has generally been used in treaties concluded between developed countries, while the United Nations model generally serves as a model for agreements involving developing countries.

18. Recently, some developed countries have also completed a number of cooperation, notification and information-exchange agreements in the area of competition policy with their principal trading partners (e.g. Germany with France; Australia with New Zealand; Australia, Canada, the European Union, Germany and Japan, each with the United States). They deal with notification and enforcement issues, but do not establish common substantive principles, standards or obligations. They could, nevertheless, be taken as a preliminary step towards the development of broader cooperation efforts to enforce national rules dealing with international business transactions (European Commission, 1995).

19. Bilateral investment treaties do not address investment-trade interrelations, with the principal exception being provisions that deal with performance requirements. These interrelations, however, are reflected in a number of bilateral free trade and integration agreements concluded by a number of countries during the 1980s, notably between Australia and New Zealand, as well as between Canada and the United States (which later was renegotiated to include Mexico and became the NAFTA), which share the characteristics of their regional counterparts discussed below.

B. Regional level

20. At the regional level, the mix of investment issues covered is broader than that found at the bilateral level, and the operational approaches to deal with them are less uniform, reflecting, among other things, differences in

interest and needs, level of development and visions of future development trajectories.

21. The main objective typically pursued at this level -- and chronologically the first to be tackled -- is the liberalization of restrictions to entry and establishment of FDI, followed by the elimination of discriminatory operational conditions. Protection aspects have been added more recently. At this level, FDI liberalization proceeds mainly on the basis of a gradual elimination of existing restrictions, a system of reporting on existing regulations and changes thereof to ensure transparency of measures and monitoring mechanisms to follow up on the implementation of schedules for further liberalization. A pattern is emerging in present regional agreements in which one instrument consolidates an expanded set of issues of liberalization and protection, while procedures for the gradual elimination of restrictions are strengthened and provision is made for the settlement of investment disputes, including between investors and host States. But there are also a number of agreements that do not go that far, e.g. the OECD Codes of Liberalisation of Capital Movements and Current Invisible Operations, the OECD Declaration on International Investment and Multinational Enterprises and related decisions, and the APEC Non-binding Investment Principles. Some important aspects such as insurance, shipping and sectoral issues have been dealt with in separate instruments.

22. Most regional instruments are legally binding, although there are exceptions (e.g. the OECD Guidelines and the APEC principles). The definition of investment varies considerably, depending on the overall purpose and context of the agreement. For example, NAFTA, the Investment Agreement among ASEAN countries and the Protocol on intra-MERCOSUR Investment contain broad definitions of investment and investors similar to those used in BITs. The OECD Codes, on the other hand, cover most international financial transactions.

23. Right of entry and establishment is increasingly being granted in many pertinent regional agreements. In particular, the OECD Code of Liberalisation of Capital Movements and NAFTA contain provisions in this respect, although signatory countries have typically exempted a number of industries or activities from these basic principles. Exceptions are dealt with through the use of negative lists which identify measures that are contrary to the core liberalising provisions in the agreement. At the other end of the spectrum in terms of strength are the APEC principles, which call for best efforts in this respect.

24. In terms of operational conditions, performance requirements have received limited attention at this level, although NAFTA goes beyond most bilateral or other regional instruments by prohibiting a number of performance requirements, whether imposed on NAFTA or non-NAFTA investors (Gestrin and Rugman, 1996). Admission of foreign senior personnel in relation to an investment is now increasingly addressed. Incentives have also been covered under some regional agreements, notably in the OECD Declaration and related Decision; sometimes they are addressed indirectly, either under performance requirements related to the conferral of benefits (NAFTA), or under competition rules (e.g. in the European Union).

25. With respect to standards of treatment and protection after entry, most regional agreements that contain them, follow very closely the content and structure of BITs: they prescribe general standards (typically national treatment, MFN, fair and equitable treatment and treatment in accordance with international law), as well as specific high protection commitments, mainly on expropriation. In addition, most regional agreements dealing with either liberalization or protection standards, or with both, now include the free transfer of all investment-related funds, subject to some standard exceptions (e.g. related to bankruptcy laws and balance-of-payments safeguards). As with BITs, compliance with these standards and principles can be enforced in local courts under most national jurisdictions, or through international arbitration. Provisions on investor-State settlements of disputes are now being increasingly included in regional agreements. These are designed to permit arbitration proceedings through either the International Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID) (Broches, 1972), or the UNCITRAL rules or similar mechanisms, once national

means of resolving a dispute have been waived or exhausted, and after amicable means have not succeeded in settling the dispute.

26. Other important issues dealt with at the regional level are transfer of technology, competition, environmental protection, taxation, conflicting requirements, and standards for the conduct of TNCs in relation to, e.g. disclosure of information, employment and labour relations, science and technology and illicit payments.

27. Moreover, the structure of the most advanced regional free trade and integration agreements (NAFTA, European Union) reflects more and more the interrelations between investment, trade, services, intellectual property rights and competition policy. In particular, the NAFTA provisions on services reflect the continuum that exists between activities conducted on a cross-border basis and those carried out through an established presence (Gestrin and Rugman, 1994). Overall, NAFTA provisions on FDI go a step further than OECD in addressing more advanced integration issues; but they fall short of those of the European Union (Brewer and Young, 1995a). These variations among regional instruments partly reflect the fact that negotiations that address a wide range of issues also allow for trade-offs across issues. Hence, BITs tend to be significantly more uniform in terms of their treatment of investment issues than regional agreements.

28. The countries involved in most regional agreements share similar levels of development and outlook on FDI matters -- which, however, may well conceal divergent needs and interests. Consequently, the question of providing for special treatment to certain partners on account of different levels of development arises less often than in the case of bilateral or multilateral arrangements. When it does arise, as, for example, in the case of NAFTA (Gestrin and Rugman, 1996) and ECT, the approach to development tends to be similar to that followed at the multilateral level, i.e., through exceptions, derogations, safeguards and the phasing of commitments. The case of APEC -- which also involves developed and developing countries -- is somewhat different. The principles stated therein are not legally binding commitments and only require best efforts. That in itself allows for discretionary application while keeping with the spirit that inspires them.

29. Finally, some regional groups have also developed common regimes for investment in and from third countries. The European Union, for example, has formulated investment principles aimed at promoting European Union investment towards the ACP States in the Lomé IV Convention. Provisions for the free movement of capital, right of establishment and common competition rules are now included in association agreements with Central European countries. The bilateral agreements that are being negotiated with the former republics of the Soviet Union and the Mediterranean countries include some of these provisions. Another example of a common regional approach to third-country FDI is the Protocol on Protection and Promotion of Investments Originating in Non-member States of MERCOSUR which follows the structure and substance of BITs.

C. Multilateral level

30. At the multilateral level, as noted, most pertinent agreements relate to sectoral or to specific issues, moving in, as it were, on central FDI concerns from the outside. These include:

(a) **Services.** Foreign investment in this sector is now regulated in the General Agreement on Trade in Services (GATS), which covers the supply of markets through the market presence of foreign service suppliers. Some general principles (transparency and, subject to a one-off list of temporary derogations, MFN treatment) are applicable to all services industries. Market-access and national treatment obligations depend on specific commitments contained in national schedules, which are to be progressively enlarged in coverage and depth through further negotiations. The Agreement also contains a number of annexes providing for additional rules in specific industries (Croome, 1995; Sauvé, 1994, 1995a, 1995b; UNCTAD and World Bank, 1994; UNCTAD, 1994, ch. VII).

(b) **Performance requirements** are dealt with in the Agreement on Trade-related Investment Measures (TRIMs). However, this Agreement deals only with investment measures related to trade in goods. It forbids performance requirements inconsistent with Articles III (National Treatment) and XI (General Elimination of Quantitative Restrictions) of the GATT, including both mandatory restrictions and those linked to incentives. The Agreement contains an illustrative list of TRIMs deemed to be inconsistent with these articles, including local content requirements, trade-balancing requirements and export restrictions (UNCTC-UNCTAD, 1991; Low and Subramanian, 1995; Sauvé, 1994; UNCTAD, 1994, ch. VI).

(c) **Intellectual property rights.** The most comprehensive framework dealing with the protection of intellectual property at the multilateral level is the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement). Building on the existing groundwork of several intellectual property conventions, this Agreement lays down certain general provisions and basic principles regarding the protection of intellectual property rights, including national treatment and MFN requirements, as well as rules on substantive standards for the protection of specific categories of intellectual property rights, domestic enforcement procedures and international dispute settlement (Sauvé, 1994).

(d) **Insurance coverage** for political risks in developing countries is available for foreign investors under the Multilateral Investment Guarantee Agency (MIGA), an organization belonging to the World Bank Group. As a precondition for issuing a guarantee, the Agency must be satisfied that the investor complies with the laws of the host country and that these laws meet basic international standards (Shihata, 1992).

(e) **Settlement of disputes**. The issue of the settlement of investment disputes between private investors and host countries is specifically addressed in the Convention on the Settlement of Investment Disputes between States and Nationals of other States. Over the years, the International Centre on Settlement of Investment Disputes (ICSID), another World Bank Group institution, which administers the system of conciliation and arbitration established by the Convention, has increased its country membership substantially and has had a number of cases before it. References to the ICSID Convention or to other arbitration rules (e.g. UNCITRAL, ICC) can be found in various international instruments (Broches, 1991; Shihata, 1992).

(f) **Employment and labour relations.** This issue is covered by the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy. It contains principles recommended to governments, employers' and workers' organizations and to TNCs on employment, training, conditions of work and life, and industrial relations. In all these areas TNCs are called upon to assume a leading role in applying the best standards, usually those applying in their home countries, to labour conditions and relations in host countries.

31. Finally, the treatment of FDI is dealt with in the Guidelines on the Treatment of Foreign Direct Investment, developed by the World Bank. They are based on an exhaustive analysis of existing instruments and best practices. While they are not formally binding, the Guidelines represent a serious effort to reconcile the concerns of developing countries with the need to meet investors' demands in order to increase and maintain investment flows (World Bank, 1992a; 1992b).

32. In addition, a number of issues covered at this level deal with the proper functioning of the market. Thus, for example, multilateral competition rules are established in UNCTAD's Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices; provisions on specific competition policy issues are also contained in the WTO agreements on trade in services and the protection of intellectual property. The WTO Agreement on Subsidies and Countervailing Measures deals with subsidies, including, in principle, with those that apply to FDI operations involving trade in goods. Non-discriminatory access to procurement by certain government entities is provided by the Agreement on Government Procurement which is one of

the WTO's plurilateral trade agreements. And United Nations standards for consumer protection have been developed in the Guidelines for Consumer Protection.

33. It is at the multilateral level that concern for development is most apparent. This is particularly so in the case of the GATS (box 1), TRIPS and TRIMs agreements, as well as the Restrictive Business Practices Set, where transitional arrangements are made that take into account the needs of developing countries. The World Bank Guidelines, too, are sensitive to development concerns, while insurance under MIGA is available particularly for projects in developing countries.

Box 1. The development dimension in the GATS

An important objective of the GATS is to promote development of developing countries. The second preambular paragraph reads as follows: "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 liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries", and the fifth preambular paragraph states: "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".

Countries agreed during the Uruguay Round that participation of developing countries should be based on the principle of relative reciprocity/development compatibility, and should not be seen as "special treatment" along the lines of GATT Part IV. Article IV of GATS commits members to facilitate the participation of developing countries in trade in services through negotiated specific commitments relating to the strengthening of their domestic services capacity, including through access to technology on a commercial basis, improved distribution channels and information networks and the liberalization of market access in sectors and modes of supply of export interest to them. Article IV also provides for the establishment of contact points to facilitate access to information on commercial and technical aspects of the supply of services, registration, recognition and obtaining of professional qualification, and the availability of service technology.

Article XIX of GATS calls for successive rounds of negotiations, aimed at achieving a progressively higher level of liberalization. Article XIX:2 provides that the process of liberalization will take place with due respect for national policy objectives and the level of development of individual parties, both overall and in individual industries. Appropriate flexibility is foreseen for individual developing countries for opening fewer industries, 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 it conditions aimed at achieving the objectives referred to in Article IV.

Article XIX:3 provides for an assessment of trade in services in overall terms and on a sectoral basis with reference to the objectives of GATS, including those set out in paragraph 1 of Article IV for the purposes of establishing negotiating guidelines.

Finally, by covering all factors of production, including the temporary movement of natural persons, the GATS opens opportunities for increased services exports from developing countries, an innovation of considerable importance to developing countries. Furthermore, by using a positive-list approach (i.e. market access and national treatment are subject to specific negotiations), each country can strategically negotiate the individual service industries or transactions that it is ready to open up (subject to specific conditions and limitations), in pursuance of long-term progressive liberalization.

II. LESSONS LEARNED

34. The future elaboration of FDI rules should take into account the lessons of the past in order to benefit from them. At the same time, it is difficult to draw definite conclusions, because many instruments -- especially many of those advancing the process of liberalization -- are of relatively recent date, are not always fully implemented and the real effect of their application is not always clear yet. Still, on the basis of the evolution and the present status of international FDI arrangements, a number of lessons may be drawn:

(a) **The evolution of international arrangements for FDI has followed and interacted with developments at the national level and reflects the priorities and concerns of a particular period.** In the days after the Second World War, FDI concerns related mainly to natural resources and key industries. With decolonization, the principal concern for host developing countries became how to regain control over their economies and natural wealth, in order to consolidate their political independence. These efforts were epitomized in the principle of permanent sovereignty over natural wealth and resources which, eventually, was widely accepted (Gess, 1964; Kemper, 1976). For foreign investors and their home countries, the main preoccupation was to protect their investments from political risks, especially from nationalization. In this climate, standards for protection of investment emerged, albeit on a bilateral basis and at the initiative of the capital exporting countries. Issues of entry and establishment were generally left to be regulated by national laws by both developed and developing countries. Such laws established in many cases restrictions, controls and conditions to the entry and establishment of FDI and to its operations, including on the repatriation of profits and capital; in many cases they also dealt with issues related to the need to ensure access to and transfer of technology. At the multilateral level, developing countries used their rising influence to assert their economic independence and sought to elaborate standards of behaviour for TNCs (Asante, 1989; Horn, 1980; Fatouros, 1993).

In the 1980s, these trends were reversed, mainly as a result of the debt crisis in many developing countries (which made FDI a more desirable alternative to bank lending) and of the changing perceptions in these countries as to the role that FDI could play in the growth and development of their economies. As a result, laws and policies began to change dramatically in the direction of liberalization, protection and promotion of FDI, and continue to do so. Liberalization efforts in developed countries were also expanded and deepened during this period. At the same time, a shift in the development strategies pursued by governments, from highly protective import-substitution models (which, however, are not inconsistent with openness to inward FDI) to outward-looking policies emphasizing export-led growth, stressed the opportunities offered by FDI to establish linkages with globally-integrated production, distribution and marketing networks and led to a more coherent policy approach towards trade and investment. These changes are now being reflected in regional instruments, and in sectoral or issue-specific multilateral agreements.

Two lessons can be drawn from past pendular swings on FDI policies: one is that progress in the development of international investment rules is linked to the convergence of rules across countries; the other is that an approach to FDI issues that takes into account the interests of all parties and hence is to their mutual advantage, is more likely to gain widespread acceptance and, ultimately, is then more effective. In practice, this raises the question of how an appropriate balance of rights and obligations among the participating actors can be found. At the same time, international negotiations for FDI liberalization have further stimulated countries to introduce changes unilaterally in their national laws, even before such changes were required by international commitments, thus exemplifying the interaction between national and international rules.

(b) **Widespread recognition is emerging on the principal issues that need to be addressed internationally in the FDI area.** With the growing appreciation of the role of FDI in development and the convergence of

national attitudes in favour of market-oriented policies, a number of issues have moved from the national to the international level and have become standard substantive items in international discussions on FDI. At the same time, the extent to which, and the manner in which, these are at present incorporated in specific international instruments at the bilateral, regional and multilateral levels varies considerably, as does the strength with which they are addressed:

(i) General standards of treatment and protection applying after FDI establishment, notably national treatment, MFN and fair and equitable treatment, are widely reflected at the bilateral and regional levels; the same is true with respect to the free transfer of funds in relation to an investment.

(ii) Questions of entry and establishment for FDI and certain operational conditions (such as performance requirements and, indirectly, also incentives and managerial personnel restrictions), which typically aim at increasing market access, are presently addressed in a number of regional and multilateral agreements. These issues have received limited attention at the bilateral level where the general tendency is to leave matters of admission and operational conditions to be dealt with in accordance with specific national development objectives.

(iii) Certain protection standards, on issues such as expropriation and investor-to-state dispute settlement, are dealt with mainly at the bilateral and increasingly also at the regional level, while machinery for dispute settlement has also been established at the multilateral level.

(iv) Issues of corporate behaviour bearing on the proper functioning of markets, such as restrictive business practices (in the broader context of competition policy), consumer, labour and environmental standards, as well as illicit payments, are dealt with in a number of specific instruments, most of which are non-binding.

(v) Other issues, such as the promotion of FDI and conflicting requirements applying to foreign investors (within the broader context of conflicts of jurisdiction) have received so far limited attention in international instruments.

In a rapidly globalizing world economy, the list of substantive issues entering international FDI discussions is becoming increasingly broader -- both at the level of individual instruments and as a result of the proliferation of instruments concluded -- and may eventually include the entire range of questions concerning factor mobility. Issues that receive relatively little attention at this time may therefore acquire increased importance in the future.

(c) **So far, progress has been made gradually, helped by increasingly greater transparency and monitoring.** As regards the functional characteristics of present arrangements, there are, with many variations, also some common features:

(i) Progressive elimination of restrictions. Higher standards are being sought over time. In the case of the OECD, for example, it took 25 years from the adoption of the Liberalisation Codes until the right of establishment was confirmed.

(ii) Transparency of national regulation. Through the duty to report existing investment measures and relevant normative changes (e.g. GATS, NAFTA, OECD), regional and multilateral FDI instruments provide a mechanism to increase transparency of national regulations, thus contributing to a key aspect of a favourable investment climate.

(iii) Monitoring, follow up and dispute-settlement mechanisms. Bilateral, regional and multilateral instruments on FDI include procedures for

their implementation, after referring to ICSID. These can vary considerably in terms of their strength and the degree of authority delegated to the monitoring authorities, from the full-fledged settlement of disputes to consultation and peer reviews on issues relevant to the implementation and interpretation of a given agreement. In addition, bilateral treaties and an increasing number of regional agreements address the question of investor-State dispute settlement, and reflect increased acceptance of international arbitration. Implementation mechanisms are important to identify and resolve concrete problems and make an instrument effective.

A key lesson that emerges from these functional approaches is that implementing and strengthening standards is a lengthy process. The present regional and multilateral instruments have taken some time to be negotiated and need time to show fully their effects. But globalisation pressures and changing corporate strategies may encourage faster normative responsiveness in the future.

(d) **The interrelations between investment and trade are seen increasingly in a common framework.** Friendship, Commerce and Navigation treaties concluded immediately after the Second World War addressed a wide range of aspects of bilateral economic relations, including the entry and treatment of nationals of one party in the territory of another party, as well as trade, investment and exchange-control matters (UNCTC, 1988). This comprehensive approach, especially the need to integrate investment, trade and competition rules, was also manifested at the multilateral level in the Havana Charter. It was soon felt, however, that such broad agreements were difficult to negotiate. As a result, developed countries turned, in the 1960s, to specialized bilateral treaties, BITs, i.e., treaties with an almost exclusive focus on investment matters. More recently, however, driven by the logic of the requirements of firms to contest effectively international markets, the need to bring especially investment and trade matters together has asserted itself again, especially at the regional (e.g. NAFTA) and multilateral levels (Lawrence, 1996). The Uruguay Round of Multilateral Trade Negotiations was indeed the first time investment issues were introduced as part of the disciplines of the multilateral trading system (although, indirectly, investment-related issues had been dealt with for quite some time under, for example, the Subsidies Code and the Government Procurement Agreement). Trade and investment issues converged most markedly in the negotiations of GATS which defines trade in services as including four modes of supply, including the provision of services through commercial presence. The TRIMs Agreement, in fact, focusses on one aspect of the policy interrelationship between trade and investment. Possible future work on investment policy and competition policy may lead to even deeper policy integration. A major question at this juncture is the extent to which this new trend should be accommodated or encouraged through the development of concepts designed to capture the relationships between trade and investment and, to the extent that a more comprehensive approach is pursued, how to avoid the difficulties that caused countries to move away from Friendship, Commerce and Navigation treaties in the first place.

(e) **Development issues must be and can be addressed.** It was observed earlier that, for international agreements to be effective and stable, they need to take into account the interests of all parties, incorporate a balance of interests and allow for mutual advantage. This applies particularly to developing countries and, more generally, to agreements between countries at different levels of development. In particular, any agreement involving developed and developing countries must take into account the special importance of development policies and objectives. In fact, economic and social development is a long-standing and fundamental goal of the international community. This has been expressly recognized in a variety of international instruments, some of which have been dedicated exclusively to serve that end.

The development dimension can be addressed in international investment accords at all levels and in several fashions. Most FDI agreements begin

with at least hortatory commitments to promote FDI flows between signatory parties. Some, notably the Lomé IV Convention between the European Union and 68 African, Caribbean and Pacific States, provide for specific commitments to promote investment into these regions to accelerate their development. The TRIPS agreement commits governments to provide incentives to promote technology transfer to the least developed countries. Tax-sparing provisions have been included in taxation treaties with developing countries.

The development dimension is further addressed in FDI agreements by structuring the contents of the instrument in a manner that takes into account the special situation of the developing countries (UNCTC, 1990). Thus, provisions of an investment agreement can be negotiated or defined in such a way as to exclude from coverage certain areas or national policy instruments necessary for a country's development. Being a developing country has been a qualifying factor for being granted broad (or broader) exceptions or special treatment in a number of investment instruments (such as BITs, NAFTA and the RBP Code). Development or adjustment needs can also be addressed by granting longer transitional periods in the implementation of particular commitments (e.g. TRIMs, TRIPS, ECT, NAFTA). In fact, this device is also being used within developed country arrangements -- e.g. the OECD and the European Union -- to allow relatively less developed members time during which to strengthen their indigenous economic base and prepare them for a greater exposure to international competition. This approach to the development dimension has facilitated the participation of developing countries in the development of international instruments, while giving them flexibility to synchronize their liberalization steps with their development objectives.

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35. In conclusion, there has been progress during the past 50 years in the elaboration of international arrangements for FDI. Present arrangements are reflected in a variety of instruments of different geographical scope and with significant differences as to their substantive coverage, specific content, approach and legal nature. The instruments are neither exhaustive nor mutually exclusive. Although there has been a proliferation of international instruments covering a broadening set of issues, even taken together they do not add up to a coherent and complete international FDI framework. Besides, even when governments are prepared to agree to certain rules at the bilateral or regional level, they are not necessarily prepared to make the same commitments at the multilateral level.

36. In this respect it is useful to recall that the present national, bilateral, regional and multilateral approaches on FDI emerged partly as a result of the failure to conclude comprehensive multilateral rules in this field in the past. Over the past decade or so, however, there has been a certain convergence of FDI policies in the context of convergent development strategies. The new situation provides a different environment for discussions and negotiations and creates a new set of costs and benefits for various sets of international arrangements.

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