UNITED
NATIONS

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United Nations
Conference
on Trade and
Development

Distr.
LIMITED

TD/B/ITNC/L.1/Add.2
27 April 1995

Original: ENGLISH

COMMISSION ON INTERNATIONAL INVESTMENT
AND TRANSNATIONAL CORPORATIONS
Twenty-first session
Geneva, 24-28 April 1995

DRAFT REPORT OF THE COMMISSION ON INTERNATIONAL INVESTMENT AND TRANSNATIONAL CORPORATIONS ON ITS TWENTY-FIRST SESSION

Held at the Palais des Nations, Geneva,
from 24 to 28 April 1995

Rapporteur: Mr. W. Haynes (United States of America)

Addendum

ANNEX

Summaries of informal panel presentations

GE.95-51454

Annex

SUMMARIES OF INFORMAL PANEL PRESENTATIONS

Panel on the international frameworks for foreign direct investment

1. The purpose of this panel was to inform the Commission on developments in discussions or negotiations elsewhere on the international framework for foreign direct investment. The instruments discussed were the APEC non-binding investment principles; the ongoing work at OECD to develop a Multilateral Investment Agreement; and the Uruguay Round Agreements relating to foreign direct investment.

2. Mr. R.P. Napitupulu, Deputy Chairman for Planning, Investment Coordination Board of Indonesia, spoke about the APEC Non-binding Investment Principles which had been endorsed in December 1994. The set of principles included provisions on transparency, non-discrimination between source economies, national treatment, investment incentives, performance requirements, expropriation and compensation, repatriation of funds, settlement of disputes, entry and sojourn of personnel, avoidance of double taxation, investor behaviour and removal of barriers to capital exports. The 1995 APEC Ministerial Meeting would discuss further how these principles could be implemented in order to achieve the goal of free and open investment in the region, including the preparation of a plan of action.

3. Mr. Geiger, Deputy Director for Financial, Fiscal and Enterprise Affairs of OECD, explained that negotiations on a Multilateral Investment Agreement were likely to be launched at the 1995 Ministerial Meeting. This initiative responded to a need felt by many countries that the existing international legal framework for foreign direct investment was inadequate to deal with the exponential growth in FDI in recent decades and with the increasing importance of transnational corporations in a globalized economy. While there were many agreements and instruments dealing with FDI, they did not amount, even together, to a cohesive, comprehensive and multilateral framework for FDI. OECD, explained Mr. Geiger, seemed the appropriate forum for these negotiations, because it could build on OECD achievements (including the Codes of Liberalization and the Declaration on International Investment and Multinational Enterprises, among others). He said there was a need for new disciplines in the investment area, particularly on privatization and restrictive business practices, provisions engaging subnational authorities, and settlement of disputes. Consequently, it seemed that an instrument of foreign direct investment encompassing the more advanced norms presently envisaged in the area of liberalization, protection and settlement of disputes and assuring a balance of commitments would gather the necessary

political support. The key elements of such a framework were: liberalization obligations (including national treatment before establishment, non-discrimination and procedures to advance further liberalization); protection obligations, including general and specific norms for the treatment of foreign investors, such as guarantees on expropriation and transfer of funds; a mechanism for the settlement of disputes, including differences between States and private investors from other States; and the possibility of accession by non-OECD member countries. Thus, while the agreement was to be negotiated among OECD countries only, it would be open to accession by non-member countries able to meet the obligations of the agreement. Moreover, he noted there was an ongoing process of consultations with non-member countries to ensure that the views and concerns of these countries were fully taken into account in the negotiation process. To that end, Mr. Geiger advised that OECD was also looking to strengthen cooperation and develop synergies with other international agencies also dealing with FDI, such as WTO, the World Bank and UNCTAD.

4. Mr. Adrian Otten, Director of the Intellectual Property and Investment Division of the World Trade Organization, noted that WTO was gradually evolving rules in the area of FDI. The Uruguay Round Agreements contained a number of instruments directly related to FDI aimed at improving the investment climate around the world, as they liberalized access to markets and opened up new possibilities for FDI. The most important agreements relevant for FDI were the Agreement on Trade-related Investment Measures, the General Agreement on Trade in Services, the Agreement on Trade-related Aspects of Intellectual Property Rights, the Agreement on Government Procurement, and the Subsidies Agreement. Concerning expansion of negotiations on FDI issues, the policy question was not whether it would take place but when. There were commitments written into some of the new agreements dealing with FDI to review the existing rules within five years of WTO entering into force.

5. Professor John Kline from Georgetown University perceived at least three purposes for building up the international framework for foreign direct investment: to expand consensus on or country coverage of existing investment principles; to break new policy ground on new investment-related issues; and to lock in and prevent back-sliding on recent liberalizations, many undertaken unilaterally. A patchwork approach to the construction of an international framework for FDI based on existing building blocks was not undesirable. In the field of international investment, it was not yet known what type of structure or pattern was needed. The subject itself was still evolving, and definitions were changing as enterprises used more types of low-equity or non-equity investments and forged diverse international corporate alliances. The number of transnational enterprises had grown exponentially, while the firms’

characteristics had become more diverse. Thus the best approach for now might be an inclusive and non-hierarchical one, drawing on experience and expertise and perspectives from many institutions (OECD, WTO, APEC, NAFTA, UNCTAD, World Bank).

Panel on recent developments in international investments and transnational corporations

6. Ms. S. Ostry, Chairperson, Centre for International Studies, University of Toronto, said that foreign direct investment had given rise to deeper integration. Following the FDI recession of 1991 and 1992, the recovery had been characterized by an emphasis on FDI flows to East Asia, and some developing countries had become significant home countries. The period since the Second World War had been characterized by three phases in the evolution of the international economy and associated institutional frameworks. The first phase had consisted of the successful attempt to reduce barriers to trade between countries through the General Agreement on Tariffs and Trade. The second phase had consisted of the liberalization and reform of the international financial system in the 1970s, partially in response to the significant impact of petro-dollar movements upon Western financial and currency markets. The third phase in the evolution of the global economy towards deeper integration consisted in the enormous increases in FDI flows and stocks beginning in the mid-1980s. This increase had been propelled by increased global competition, the revolution in information technologies and growth in high-technology and services industries. The essence of the third phase had been the ubiquitousness of TNCs, which had served as vehicles for trade, foreign direct investment, and two-way flows of technology. Strategic alliances had also constituted an important feature of the third phase due to the growing costs and risks associated with research and development combined with the imperative for continued innovation for TNCs to maintain market share in an increasingly competitive global economy. This gave rise to the issue of the potential marginalization of smaller countries resulting from their limited "strategic partnering capabilities" in TNC research and development alliances.

7. Deep integration had had profound policy implications, and the World Trade Organization constituted an important new beginning for the continuation of a rules-based multilateral system. Progress in reforming IMF and the World Bank would also be important.

8. One of the central features of the third phase was the intrusiveness of deeper integration into spheres traditionally considered as residing in the "domestic" domain and closely associated with issues of national sovereignty.

9. To date, regional and bilateral forums had been the most active loci for attempts to resolve these issues. However, if a multilateral, rules-based system was to be maintained, it would ultimately have to be WTO where these issues should be resolved. However, she added that UNCTAD would be well suited to serving as a source of analytical support for WTO, given its expertise in investment issues and its wider membership.

10. With regard to the apparent marginalization of Africa, that problem could relate to the marginalization effect of deeper integration, associated with weak "strategic partnering capabilities". Finally, product-cycle-type characterizations of international patterns of production seemed inappropriate within the context of deep integration, and the East Asian experience highlighted the need for a perspective based upon the concept of the "production-system cycle" instead.

Panel on incentives and foreign direct investment

11. The panel discussed the pros and cons of offering incentives to foreign investors and the related question of competition among countries in offering incentives to attract FDI.

12. Mr. Trevor Nuttal from Arthur Andersen noted a growth in FDI incentives. More incentives were now aimed at attracting FDI which could provide employment, encourage technology transfer and promote exports. There was also a clear move towards granting discretionary incentives. He cited a number of examples of major investments which had received incentives. However, in all these cases, the incentives, big as they might have been, were not the key factor in deciding the location of the FDI project between the competing countries. There was also the question of bidding between regions within a country, and even within cities. It was clear from the foregoing that there was a need to increase cooperation at the national and international levels. Of particular importance was cooperation in the collection of data, as well as the need to increase transparency on eligibility conditions and to set ceilings on the amounts of incentives. The experience on the latter was positive, as in general most incentives within the European Community stayed well within the ceilings established by the European Commission.

13. Mr. J. Jegathesan, Deputy Director General of the Malaysian Industrial Development Authority, noted two different types of incentives: front-end financial incentives, which were given mostly by developed countries, and rear-end incentives, given mainly by developing countries. Countries offered incentives because every country was offering them. However, for an investor, incentives were the icing on the cake; the stronger the other policy conditions, the lesser the need to give incentives. A third compulsion was the tendency for developed countries to give incentives to prevent FDI from going out. There was a need to increase transparency, and to know more about what other countries were doing. An international convention on transparency in FDI incentives could be pursued within the United Nations.

14. Professor Donald Lecraw, from the Western Business School of the University of Western Ontario in Canada, explained that incentives were justified to cover the wedge between social and private rates of return for FDI projects which provided externalities to the local economy and thereby correct market distortions. In developed countries, where wages were high, incentives helped to maintain skilled employment. The problem was that, to get FDI and jobs, Governments sometimes had to pay more than was socially desirable. There were also political factors involved. With incentives given across the board, a main problem was subsidizing FDI that would have been made anyway. Steps to control the rise in FDI incentives included increased efforts to gather information, to improve transparency, and to improve upon the comparability of data on incentives.

Panel on the FDI impact of the Mexican crisis

15. This panel discussed the impact of the financial crisis on foreign direct investment in Mexico and on the behaviour of transnational corporations, and it drew lessons on the linkages between FDI and other forms of capital inflow, as well as implications for FDI as a form of capital inflow relative to other forms of capital flows.

16. Mr. Benito Bucay, a private industry consultant in Mexico and Chairman of the Mexican Foundation for Total Quality, observed that FDI, like any other kind of investment, was dependent upon a reasonably stable growth path of well spread prosperity. The economic reforms which Mexico had implemented since 1987 had attracted large inflows of FDI, peaking at $8 billion in 1994. However, this figure, though large, did not compensate for the $20 billion in outflows of portfolio investment. Investors normally assumed that direct investment was relatively independent of other kinds of foreign investment

flows, but the recent financial crisis had impacted adversely on equity investment: FDI in 1995 was likely to be less than half that in 1994. Nevertheless, there was no reason why those levels of inflows could not be attained in future years, as the economic fundamentals were sound and the access that NAFTA provided to the North American market remained a major magnet for transnational corporations.

17. One reason that the current financial crisis had been unanticipated was that the growing deficit on the current account due to rising imports had been seen as sustainable and a necessary counterpart of an excess in the capital account due to massive portfolio inflows. The health of the economy had not been doubted; however, in a few months the conventional wisdom had been reversed: capital inflows were now seen as having been poorly utilized on living expenses and on changing the production structure into one increasingly dependent on imports. The capacity to export was also reaching the limit, so that the current deficit would continue to expand as long as foreign capital remained available. Greater emphasis needed to be placed on the development of small and medium-sized enterprises in the future, to provide productive jobs for the large and growing labour force.

18. Mr. Kurt Unger Rubin, a researcher at the Economic Research Centre (Centro de Investigacion y Docencias Economicas) in Mexico, said that one consequence of the financial crisis was a change in the market orientation of firms in favour of exports as opposed to domestic consumers, who were cutting back on unnecessary consumption. The change was most immediate for industries and firms that were already well linked to export markets: these were industries dominated by TNCs such as automobiles, electronic equipment, chemicals (partly) and some services (tourism), as well as industries predominantly in the hands of national firms such as petrochemicals (plastics, steel, textiles and farm products). Most domestic companies were not able to switch from domestic production to exports without support measures to encourage innovation and productivity. There was thus a role for the State in the area of industrial policy, a role which was indispensable and complemented privatization and deregulation in an open economy.

19. Following the presentations by the experts, there was a full and wide-ranging discussion of the lessons to be drawn from the experience of Mexico for other countries as regards the interaction between different kinds of foreign investment and their impact on development.