CHAPTER 22

Trade and investment

Background: discussions in GATT/WTO on trade and investment

The General Agreement on Tariffs and Trade (GATT) came into existence some 50 years ago. It is important to recall that it was negotiated on the basis of the trade provisions of the Havana Charter, which contained chapters on foreign direct investment and restrictive business practices. These, however, were not included in GATT. The Havana Charter did not become operational because of the failure of the United States to ratify it.

The question of including in the text of GATT investment provisions was raised soon after GATT became operational. In the 1955 Review, a Resolution on International Investment for Economic Development was adopted, which recognized that an increased flow of capital into countries in need of investment from abroad, particularly into developing countries, would facilitate the attainment of the objectives of the General Agreement. It recommended that countries in a position to provide capital for international investment, and those which desired to obtain such capital, should use their best endeavours to create conditions to stimulate the international flow of capital. These included providing security for existing and future investment, the avoidance of double taxation, and facilitating the transfer of earnings of foreign investments. It urged GATT member countries to enter into consultations or participate in negotiations directed to the conclusion of bilateral and multilateral agreements on these matters.

In the years that followed, GATT extended the scope of its rules, initially confined to measures applied by governments at the border, to internal policy measures. Even though the new rules adopted in the 1970s during the Tokyo Round of negotiations in such areas as subsidies, technical specifications and government procurement aimed primarily at the removal of barriers to trade, some of them are also relevant to the competitive conditions which foreign investors face. For instance, as is explained in detail later in this chapter, the rules developed in the area of subsidies are applicable to some aspects of the incentives provided by governments to attract foreign investment.

Another important development in the work of GATT has been the gradual evolution of international rules governing the treatment of foreign companies. Originally, GATT rules imposed obligations on governments only in respect of foreign goods. They were not concerned with the treatment of foreign persons, legal or natural, operating in their territories, the issue at the heart of investment policy. The General Agreement on Trade in Services and the Agreement on Trade-Related Aspects of Intellectual Property Rights, negotiated in the Uruguay Round, impose important obligations on governments regarding the treatment of foreign nationals or companies within their territories. In addition the Agreement on Trade-Related Investment Measures, also negotiated in the Uruguay Round, requires governments not to place conditions on investors, such as local content requirements, that are inconsistent with the provisions of GATT.

Taking into account these developments, as well as the important role which foreign direct investment (FDI) now plays in the globalizing world economy, it was decided at the 1996 Singapore Ministerial Conference to establish a Working Group on the Relationship between Trade and Investment. Its mandate is to examine the relationship between trade and investment, it being understood that the creation of the Working Group is without prejudice to the issue of whether multilateral disciplines on investment should be established within the framework of WTO. The Singapore Ministerial Declaration provides that any decision to launch negotiations on investment disciplines in WTO would require explicit consensus. Thus, the work taking place in the Group is intended to be an educational process and not a negotiation.

FDI: its importance and impact; existing agreements and WTO provisions

Growing importance of FDI

Foreign direct investment (FDI) is an important driving force in globalization, which characterizes the modern world economy. The escalating flow of FDI, which has been accompanied by rising foreign portfolio equity investment, underscores the increasingly major role played by transnational corporations (TNCs) in the economies of both developed and developing countries. The liberalization of FDI regimes particularly by developing and transition economies, which in the past restricted FDI flows, and the steps they have taken to promote it have more than doubled annual global flows over the past decade; the flows to developing countries have increased more than fivefold (see table below).

Foreign direct investment inflows, 1986-1997
(in billions of United States dollars)

Economies	1986-1991 (Annual average)	1992	1993	1994	1995	1996	1997
World	**159.3**	**175.9**	**217.6**	**24**	**3331.1**	**337.6**	**401**
Developed countries	129.6	120.3	138.9	141.5	211.5	195.4	233
Developing countries	29.1	51.1	72.5	95.6	105.5	129.8	149
Africa	2.9	3.1	3.6	5.7	5.1	4.8	4.7
Latin America	9.5	17.6	17.2	28.7	31.9	43.8	56.1
Asia	16.4	29.6	51.2	60.7	67.3	80	86.9
Central and Eastern Europe	0.65	4.4	6.1	5.9	14.2	12.3	18.4
Least developed countries	0.8	1.5	1.7	0.8	1	1.9	1.8

Source: UNCTAD, *World Investment Report 1998 Trends and Determinants* (United Nations Publication, Sales No. E.98.II.D.5).

Origin and direction of FDI flows to developing countries

Origin

Investment in most host regions of the developing world is dominated by three developed countries/areas. The European Union is the source of most investments in Africa and Europe, Japan in Asia, and the United States dominates investment in Latin America.

A few developing countries (such as China, India, the Republic of Korea and Singapore in Asia, and Argentina, Brazil and Chile in Latin America) have in recent years also become FDI sources, particularly for developing countries in their respective regions.

Direction

FDI flows are directed mainly to a few developing countries. For instance, taking the four-year period 1993 to 1997, of the total FDI flows to developing countries, about a third went to China. The next largest recipients were Mexico, Singapore, Brazil, Malaysia and Indonesia. Overall, 20 developing countries, mostly the more advanced among them, received about 90% of the total FDI flow to developing countries. All the remaining developing and least developed countries received barely 10% of the total. The 48 least developed countries received 1.4% of the total flow to the developing world.

Forms of FDI

Foreign direct investment generally takes two forms: greenfield, or investment in new production facilities, and mergers and acquisitions (M&As).

Cross-border M&As have been on the rise in recent years; they accounted for about half of the total flow of FDI in 1997. Though most M&As are taking place among companies in the United States and Europe, the phenomenon is also noticeable in some developing countries and in transition economies, particularly where State enterprises are being privatized.

Beneficial impact of FDI on host countries: transfer of technology

Among the reasons for the change in the attitude of many developing and transition countries to FDI is the belief that it can be an important channel for technology transfer, with technology broadly defined as including not only scientific processes, but also organizational, managerial and marketing skills.

FDI is often associated with secondary benefits through the diffusion of technology to firms in the host country. This diffusion may be deliberate, such as when technology is licensed by the affiliate to a domestic firm, or it may take the form of a technological spillover which occurs when the activities of the multinational firm yield benefits for local economic agents beyond those intended by the multinational.

FDI may also produce other unintended efficiency-enhancing effects, such as when local rivals are forced to upgrade their own technological capabilities as a consequence of competitive pressure from the local affiliate of the TNC. In the United States, for example, the entry of Japanese automobile manufacturers into the local market via FDI caused the major domestic automobile producers (themselves multinational firms) to upgrade their own products and to increase the efficiency of their domestic production facilities. This has benefited all consumers in the United States, whether they purchased Japanese or American automobiles. There is considerable evidence that similar benefits occur in developing countries. FDI from the Republic of Korea, for example, contributed to the development of a locally owned garment-exporting industry in Bangladesh.

In many circumstances, FDI may result in a greater diffusion of know-how than other ways of serving the market. While imports of high-technology products, as well as the purchase or licensing of foreign technology, are important channels for the international diffusion of technology, FDI provides more scope for spillovers. For example, the technology and productivity of local firms may improve as foreign firms enter the market and demonstrate new technologies and new modes of organization and distribution, provide technical assistance to their local suppliers and customers, and train workers and managers who may later be employed by local firms. Foreign subsidiaries may themselves conduct research and development activities aimed at adapting the parent firm's innovation to local conditions. Clearly FDI leads to more extensive personal interaction with foreigners and exposure to new ways of doing things than does trade.

FDI and anti-competitive practices

FDI, by increasing the 'contestability' of markets (i.e. flexibility for entry or exit by firms) generally results in increased competition. In certain situations however consumers and users in the host countries may not benefit from such investment through lower prices and better quality goods and services, if the TNC investing in the country is able to charge monopoly prices by securing a dominant position. (*See* also chapter 23.)

FDI and foreign portfolio equity investment

FDI involves decisions to invest in another country by establishing subsidiaries, affiliates or joint ventures. Recent years have also witnessed a rise in the flow of funds for foreign portfolio equity investment (FPEI). By contributing to, or participating in, the equity capital of firms, both FDI and FPEI can enhance the development of the enterprise sector in host countries. There are however important differences in regard to both the motivation for the two types of investments and the short- and long-term impact which they could have on the economies of the host countries.

In principle, FPEI is distinguished from FDI by the degree of management control that the foreign investor exercises on a venture. An investment is normally considered FDI when it involves an equity capital stake of 10% or more[32] of the ordinary share of the incorporated enterprise or its equivalent for an unincorporated enterprise. Portfolio equity investors usually provide financial capital by purchasing shares of a company without any involvement in the company's management. The type of investors is also different. While FDI investors are firms engaged in the production of goods and services, portfolio equity investors are more often either financial institutions, institutional investors (such as pension funds, insurance companies or investment trusts) or individuals who are mainly interested in the financial returns on their investments.

These differences highlight the major contrast between the motivations for FDI and FPEI. In making FDI, TNCs are interested in ensuring that the inputs they need or the final products which they manufacture are produced in the most efficient way and at the lowest cost. They are therefore more influenced in their decisions by the long-term effects the investment can have on the competitiveness of the corporation as a whole and the returns from the capital invested and the technology provided. The overriding motivation for investment by portfolio equity investors on the other hand is their participation in local earnings through capital gains and dividends. Their interest in the long-term fortune of the enterprises is limited.

32 The IMF *Balance-of-Payments Manual* states that FDI is investment that reflects the objective of a resident entity in one economy to obtain a lasting interest in an enterprise resident in another economy, and that the 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 on the management of the enterprise. The concept of lasting interest was not defined by IMF in terms of a specific time-frame, and the more pertinent criterion adopted was that of the degree of ownership in an enterprise. A percentage of 10 or above of ownership was often deemed to reflect a lasting interest.

FPEI flows therefore tend to be volatile. Investors try to liquidate investments by selling their equity positions in secondary markets if their profits are declining or the prices of their equity holdings are falling. TNCs on the other hand tend to take a more long-term view of their investments; even in a crisis situation, they may be reluctant to liquidate their share in the equity of their affiliates, where 'sunk' costs are high and the production of the affiliate is interlinked with their international production.

In practice, the difference in the degree of volatility between FPEI and FDI may not be as marked as described above and depends on the mechanism used for channelling the portfolio investment. The portfolio funds are often invested by venture capital companies, which provide equity capital for new companies at the start-up stage; they are often closely involved in managing them, either directly or indirectly, by providing advisory services. Although their overriding motive is to achieve capital gain, venture capital investors often wait several years before selling their equity stakes.

Government measures to promote investment

Relaxation of regulatory regimes

The last two decades have witnessed the widespread liberalization of laws and regulations on foreign investment, especially in developing countries and transition economies. In most cases, this liberalization of foreign investment policies has been part of a market-oriented reform of economic policies involving trade liberalization, deregulation and privatization. The measures taken include:

- Simplification of screening requirements for approving inward FDI;
- Opening up industries to foreign investment;
- Minimizing restrictions on foreign equity participation;
- Encouraging foreign investors to take interest in the privatization process and in infrastructure development (two areas which need heavy capital and technological investments).

Grant of investment incentives

In addition, almost all countries provide incentives to attract FDI. These take the following three forms:

- Financial incentives, involving the provision of funds directly to the foreign investor by the host government, for example, in the form of investment grants and subsidized credits.
- Fiscal incentives, designed to reduce the overall tax burden for a foreign investor. To this category belong such items as tax holidays and exemptions from import duties on raw materials, intermediate inputs and capital goods.
- Indirect incentives, designed to enhance profitability for the investor in various indirect ways. For example, the government may provide land and designated infrastructure at less-than-commercial prices. Or it may grant the foreign firm a privileged market position, in the form of preferential access to government contracts, a monopoly position, a closing of the market for further entry, protection from import competition or special regulatory treatment.

Imposition of performance requirements

A number of countries, particularly the developing ones, impose performance requirements in order to ensure that the investment made conforms to their national objectives and priorities. These, *inter alia*, require foreign investors:

- To produce a certain percentage of the inputs used in the final product in the host country (local content requirement);
- To export a given level of goods or services; and
- To achieve a given level of research and development in the country.

Bilateral, regional and multilateral investment instruments

Bilateral investment treaties

The desire of governments to facilitate FDI flows is also reflected in the dramatic increase in bilateral investment treaties for the protection and promotion of investment during the 1990s. As of 1 January 1997, there were 1,330 such treaties involving 162 countries as compared to 440 treaties in the beginning of the decade.

Nearly 62% of these treaties are between developed countries and developing countries. The developed countries that have been active in negotiating such treaties with developing countries include France, Germany, the Netherlands, the United Kingdom and the United States. The treaties focus on protecting the interests of investing companies from expropriation, compensation for losses due to armed conflict or internal disorder, and the transfer of payments. The definition of investment used broadly covers both FDI and foreign equity portfolio investment. Some treaties provide for the extension of national treatment. Such provisions, requiring parties not to extend less favourable treatment to foreign investors than that accorded to domestic investors, apply only after local production or commercial presence in the host country has been established as a result of investment. Only a very limited number of agreements provide for the extension of national treatment at entry of investment.

Developing countries have also begun to conclude bilateral investment treaties with one another. In 1997, 11% of all such treaties were among developing countries. The countries which are active in concluding such treaties, mainly with other developing countries in their respective regions, are Algeria, Chile, China and the Republic of Korea. This development reflects the emergence of firms from developing countries as outward investors.

Regional arrangements dealing with investment issues

In addition to these bilateral investment treaties, arrangements have been adopted to promote foreign investment on a regional basis under regional cooperation arrangements. The regional agreements containing provisions for the non-discriminatory treatment of foreign investors include the Treaty of Rome establishing the European Economic Community, the Agreement on the European Economic Area and the Agreements establishing ASEAN, MERCOSUR and NAFTA. Many of these Agreements provide for the extension of national treatment to foreign investment at both the pre-entry and post-entry stages.

Multilateral agreement on investment

Although several efforts were made in the past to develop a binding multilateral instrument containing comprehensive substantive rules on foreign investment, none were successful. More recently, negotiations were held among OECD countries on developing a comprehensive multilateral agreement on investment (MAI). Although these negotiations were held among OECD member countries, they had declared that the resulting agreement would be open for accession by other countries. The draft agreement aimed at imposing obligations on member countries to extend non-discriminatory treatment to foreign and domestic investors in both the pre-establishment and post-establishment phase by applying the national treatment principle; to abolish performance requirements; and to discipline the use of investment incentives by the application of the three basic principles – MFN, national treatment and transparency.

The negotiations have however ended without accord being reached on the draft text of the agreement because of the serious differences among participating countries on the inclusion of special provisions on labour, environment and cultural industries.

Box 57 lists some multilateral investment instruments that are now in force. Of these, the instruments that impose binding obligations are narrow in scope and do not establish substantive norms, while the instruments that set forth substantive norms are non-binding.

Box 57

Existing multilateral foreign investment instruments

Within the World Bank Group, two multilateral instruments of a legally binding nature specifically relating to foreign investment have been concluded. One is the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, which was concluded in 1965 and entered into force in October 1966. It establishes facilities for the resolution of disputes between investors and States through conciliation and arbitration in the International Centre for the Settlement of Investment Disputes (ICSID).

The other agreement concluded under the auspices of the World Bank Group is the Convention Establishing the Multilateral Investment Guarantee Agency, which was concluded in 1985 and which entered into force in April 1988. Based on a belief that the flow of foreign investment to developing countries can be facilitated and promoted by alleviating concerns related to non-commercial risks, the principal aim of the Multilateral Investment Guarantee Agency is to provide a multilateral investment insurance mechanism as a complement to national, regional and private investment insurance schemes. The Convention also contemplates a role for the Agency with regard to substantive standards for the treatment of investment. Under Article 12(d) of the Convention, the Agency must, in guaranteeing an investment, satisfy itself, inter alia, as to "the investment conditions in the host country, including the availability of fair and equitable treatment and legal protection for the investment". Article 23 of the Convention deals with investment promotion and stipulates that, in addition to research and technical assistance activities, the Agency is to facilitate the conclusion of agreements among members of the Convention on the promotion and protection of foreign investment.

Substantive multilateral norms for the treatment of foreign investment are contained in the non-binding Guidelines on the Treatment of Foreign Direct Investment, developed in the World Bank Group following an April 1991 request by the IMF-World Bank Development Committee for the preparation of a report on "an overall legal framework which would embody the essential legal principles so as to promote foreign direct investment". The Guidelines were "called to the attention" of the members of the World Bank Group by the Development Committee in September 1992 "as useful parameters in the admission and treatment of private foreign investment in their territories, without prejudice to the binding rules of international law". They differ in two main respects from the work initiated in 1977 in the United Nations on a Code of Conduct for Transnational Corporations. First, they cover only general principles to guide governmental behaviour toward foreign investors; rules of good conduct for foreign investors are not included. Second, they do not purport to represent a codification of customary international law in regard to the treatment of foreign investment, but rather to formulate generally acceptable international

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standards which support the objective of promoting foreign investment. The five sections of the Guidelines address the scope of application, the admission of foreign investment, standards of treatment of foreign investment, expropriation and unilateral alterations or termination of contracts, and settlement of disputes.

Mention should also be made of other multilateral instruments that are somewhat different in scope but are nevertheless relevant in this context. Several United Nations General Assembly Resolutions adopted in the 1960s and 1970s include provisions on foreign investment mainly with a view to affirming certain rights of host States. Matters relating to social policy have been dealt with in the (non-binding) ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy which was adopted in 1977 and took effect in 1978. The Declaration contains principles commended to governments, employers' and workers' organizations of home and host countries and to multinational enterprises.

Source: WTO, *Annual Report 1996*, vol. 1, *Special Topic: Trade and Foreign Direct Investment*.

WTO provisions

As noted earlier, a number of provisions in WTO law deal with trade-related investment issues. Some of these are listed below.

Agreement on Subsidies and Countervailing Measures

The Agreement on SCM defines the concept of 'subsidy' and establishes disciplines on the provision of subsidies. In the three categories of investment incentives described earlier, viz. fiscal incentives, financial incentives and indirect incentives, a few types of measures would constitute subsidies as defined in the Agreement on SCM. That is, they can involve a financial contribution by a government or public body, and confer a benefit. (*See* chapter 8.)

Agreement on Trade-Related Investment Measures

The Agreement on TRIMs prohibits countries from using five types of trade-related investment measures (such as local content requirements) which are considered inconsistent with the provisions of GATT 1994 on national treatment (Article III) and those prohibiting the use of quantitative restrictions (Article XI).

All countries maintaining trade-related investment measures that were inconsistent with the provisions of the Agreement were required to notify them within 90 days of the coming into operation of the Agreement. In regard to such notified measures, developing countries are given a transition period of five years (i.e. up to 1 January 2000) to eliminate them. A longer period of seven years (i.e. up to 1 January 2002) is provided to least developed countries for this purpose.

The limited coverage of the Agreement on TRIMS led countries to stipulate that its operation should be reviewed in five years. The Agreement provides that any such review should also consider complementing its provisions with provisions on investment and on competition policy. (*See* chapter 13.)

General Agreement on Trade in Services

The other important provisions on investment are contained in GATS. The Agreement recognizes that, unlike international trade in goods which takes place through cross-border movement, trade in services takes place through three other modes. One mode is the establishment of a commercial presence in the country where the service is to be provided. GATS further visualizes that countries may agree in trade negotiations to give commitments permitting foreign suppliers on a selective sector-by-sector basis to establish such commercial presence (e.g. by setting up a subsidiary or a branch). In making such commitments, it is open to a country to impose certain permitted conditions limiting market access or the extension of national treatment to foreign suppliers (e.g. limits on foreign equity participation).

There is a basic difference in the approach to providing rights to foreign investors under some regional and multilateral agreements and that adopted under GATS. The regional and multilateral agreements provide for what has come to be known as a 'top down' or 'negative list' approach. Countries are expected to agree to open up for FDI all sectors of industries – whether producing goods or service products – subject to a limited number of exceptions. GATS on the other hand, has adopted a 'bottom up' or 'positive list' approach. Countries are allowed to liberalize gradually and to specify during trade negotiations the service sectors in which they would be willing to grant foreign suppliers the right to establish a commercial presence and to invest. (*See* chapter 17.)

Agreement on Trade-Related Aspects of Intellectual Property Rights

Although the TRIPS Agreement does not directly address foreign investment, its provisions on minimum standards for the protection of intellectual property, domestic enforcement procedures and international dispute settlement are relevant to the legal environment affecting foreign investment (the definition of 'investment' in many intergovernmental investment agreements expressly includes intellectual property). (*See* chapter 20.)

Description of the main issues and points raised in the discussions in the WTO Working Group

Main issues raised

Against the background information provided in the preceding section on trends in FDI and on bilateral and multilateral agreements on investment, this section describes the main points made and the differing views expressed in the Working Group on the Relationship between Trade and Investment.[33] The basis for discussions in the Group is provided by the submissions of delegations and the analytical papers prepared by the Secretariats of WTO, UNCTAD and OECD. In order to provide a structure for its discussions, the Working Group drew up a work programme in its first meeting in June 1997 in the form of a "Checklist of Issues Suggested for Study". The checklist has four main themes:

- The implications of the relationship between trade and investment for development and growth;
- Economic relationship between trade and investment;
- Stocktaking and analysis of existing international agreements on investments; and

33 The Working Group was established in accordance with the Singapore Ministerial Declaration of December 1996.

- A number of questions relevant to assessing the advantages of a possible initiative in WTO to establish a set of multilateral rules on investment.

The paragraphs that follow attempt to give an overview of the points made and views expressed in the discussions under each theme. It is important to note that the overview is not comprehensive and may not reflect fully the emphases and nuances attached by the various delegations to the points they made.

Implications of the relationship between trade and investment for development and growth

The Group noted that the experience of a number of countries had demonstrated that FDI brought to the host country a package of tangible and intangible assets. The intangible benefits included technological innovations, managerial skills and human resource development. FDI also helped domestic industries to increase their efficiency by stimulating competition. These intangible benefits were considered far more important than FDI's contribution to capital formation, tax revenue and balance of payments.

Some delegations however pointed out that while FDI played an important positive role in transferring intangible assets to the recipient developing countries, these countries sometimes had to confront the negative effects of such investment. Examples of these negative effects were: restrictions on the activities of foreign affiliates imposed by parents in the context of technology transfer agreements; the risk facing some developing countries of becoming locations for simple assembly operations; instability of the trade balance and of the balance of payments on account of FDI, as illustrated by the recent experience of some countries in South-East Asia; the exercise of undue political influence by foreign firms; and the negative impact of foreign affiliates on domestically available financing and competition in the domestic market, including small and medium-sized enterprises.

Economic relationship between trade and investment

The degree of correlation between trade and investment

In the discussion on this issue, the Group noted that the empirical research on the relationship between foreign trade and investment flows had established that there was an overall positive relationship between the outward flow of investment and the exports of the home country. This was also true of the relationship between the inward flow of investment and the exports of the host country. The studies thus showed that trade effects were positive for both home and host countries. In the case of host countries, the trade impact was more pronounced in countries that followed open and liberal trade policies in order to encourage export-oriented growth, than in countries which still relied on import substitution for promoting economic growth.

However, the view was expressed that it would not be appropriate to place too much emphasis on complementarity between trade and FDI; it was also necessary to look at the effects of such investment on efficiency, employment and economic development. Furthermore, it was pointed out that there was a need to supplement studies of a general nature with more disaggregated analysis of the relationship between trade and investment in specific industries and service sectors.

The impact of investment policies and measures on trade

Under this item the Group discussed the possible impact which investment policies, particularly those relating to investment incentives and performance requirements, could have on trade and investment.

On *investment incentives*, it was stated that studies by international organizations had demonstrated that investment incentives were not a major determinant in location decisions by transnational corporations. In the last decade the use of incentives had increased and the types of incentives used had become more diversified. This had resulted in harmful competition among countries to attract FDI. The indiscriminate use of incentives could distort investment flows in favour of countries that could afford to finance incentives, but in the long run the use of incentives implied losses for all countries involved in such competition, ultimately leading to a transfer of resources to foreign investors. Moreover, incentives could distort international trade flows by artificially favouring production in certain countries to the detriment of countries that were not able to grant incentives, especially when production was destined for export. Empirical studies had also shown that investment incentives could distort the productive structure in host countries by favouring production in certain sectors. In addition, investment incentives entailed high administrative costs, were difficult to administer, and were often granted in a non-transparent manner.

Some delegations however pointed out that, notwithstanding arguments advanced in recent academic literature, investment incentives remained a useful policy instrument in the pursuit of development strategies. The argument that incentives were nothing more than a transfer of income from countries to firms and that the more intense the competition among host countries the greater the proportion of potential gains transferred to multinational enterprises failed to give due recognition to the fact that incentives were not intended to support enterprises that were not viable. Rather, they were geared towards attracting growth, income and employment-creating investment.

On *performance requirements*, it was argued that these requirements deprived enterprises of the flexibility needed to adapt to changing economic circumstances. Performance requirements and incentives created distortions not only in international markets but also in the domestic markets of host countries in so far as competition between different investors was distorted when investments made at different times were subject to different performance requirements and incentives.

However, a point was made that, while trade-related performance requirements, such as local content measures, had been demonstrated not to have positive effects, performance requirements relating to transfer of technology, the promotion of research and development, and the promotion of alliances between foreign and domestic firms generally had been shown to have positive effects. If applied in a market-friendly manner, performance requirements in regard to the transfer of technology and the conduct of research and development could also be viewed as indirectly contributing to the attainment of the objectives of competition policy, in so far as they facilitated access to technology by firms (including small and medium-sized firms), and to economic diversification.

On the *relationship between foreign investment and competition policy*, the point was made that an open and liberal FDI regime increased the prospects for new entry and thus for competition in specific markets. By facilitating the entry of new competitors, liberal investment rules prevented domestic oligopolies, eliminated local distribution bottlenecks and reduced the likelihood of cartels and monopolies.

But it was recognized that highly competitive foreign companies might, by displacing local competitors, acquire dominant positions in the domestic market and abuse these positions. The application of competition law and policy to mergers, acquisitions and joint ventures was therefore an important aspect of the interface between investment and competition policy.

The view was, however, expressed that, though competition would generally lead to greater economic efficiency and ultimately to economic growth and development, some developing countries could have reasons for limiting the pursuit of efficiency as an immediate objective. This arose from the need to take into account competing objectives, including development objectives and the promotion of small and medium-sized enterprises.

Stocktaking and analysis of existing bilateral, regional and international agreements

It was stated that bilateral investment treaties had an important advantage in that they could be tailored to the specific circumstances of the parties involved and could address specific concerns, such as development issues. They could also be concluded more quickly than regional or multilateral agreements and could improve bilateral economic and diplomatic relations. Like bilateral investment treaties, regional agreements on investment were also more politically feasible than multilateral agreements as they involved fewer participants and could be more precisely customized to address individual concerns.

Some delegations were however of the view that experience with bilateral investment treaties did not demonstrate that they were a major determinant of investment decisions. There was therefore little evidence to show that a multilateral framework based on such treaties would have a significant impact on investment flows. It was also argued that, more generally, there was little empirical evidence to suggest that location decisions were greatly influenced by the existence of investment agreements.

The other view was that there was no reason to expect an automatic correlation between the existence of bilateral investment treaties and the size of investment flows, given that such treaties were concluded by governments and not by private parties. Governments presumably negotiated such treaties for a variety of reasons, and it was possible to conceive of situations in which governments entered into negotiations on such treaties for long-term benefits without necessarily expecting short-term results.

It was further argued that the development of a comprehensive set of consistent multilateral rules binding on all WTO member countries would allow for a stable, transparent and consistent environment for firms operating in the global market, whatever their ownership structure or place of incorporation. The global application of broadly the same investment disciplines would remove for investors the complexity arising from the existing framework of bilateral and regional investment agreements and thus facilitate compliance. The adoption of such multilateral rules would provide the following additional advantages over bilateral agreements:

- While the negotiation of a bilateral investment agreement, especially an agreement between a developing country and a developed country might be affected by the unbalanced political and economic power relations between the countries in question, this risk was reduced in a multilateral negotiation.
- A multilateral approach could enable countries to take a progressive approach to liberalization.
- A multilateral agreement could resolve the problem of inconsistencies between bilateral investment agreements. Furthermore, a multilateral agreement on investment negotiated in WTO would ensure consistency of multilateral investment rules with GATS, the TRIMs Agreement and other WTO provisions.
- A multilateral agreement would also provide more scope for harmonizing rules and, since changes to the rules would need to be agreed by all parties, it would result in the greater predictability of rules.

Questions relevant to assessing the advantages of a possible initiative in WTO to establish a set of multilateral rules on investment

From among the questions discussed in the Working Group on the advantages of adopting in WTO a set of multilateral rules on investment, the issues raised on the definition of investment and the development implications of possible multilateral rules on investment are briefly noted below.

Definition of investment

In the discussion on the definition of the term 'investment' in a possible international agreement on investment, a number of delegations favoured an "asset-based definition" covering both direct and portfolio investment. It was suggested that the problems that could arise from the inclusion of portfolio investment could be addressed through exceptions and qualifications. Thus, including portfolio investment in a definition of investment in an agreement did not necessarily imply that all obligations of the agreement would apply to such investment.

Some delegations were of the view that the Working Group was established on the clear understanding that its work would be limited to FDI as such. The inclusion of portfolio investment in a definition might have certain policy implications that required further study, including the causes and direction of the volatility of portfolio investment flows and its impact on host economies.

Development implications of possible multilateral rules on investment

Another prominent theme in the discussions in the Working Group was how to reflect the development dimension in any multilateral set of investment rules.

It was argued that one way of doing this was to ensure, in drafting each element of any multilateral set of rules, that consideration was given to development implications.

Some delegations doubted whether the development orientation of a multilateral investment agreement could be ensured simply by adding the development dimension to each of its elements. One also had to look at the structure and design of the proposed instrument and the guiding objectives which determined its contents. In addition, it was necessary to deal with the basic issue of whether the very notion of a multilateral framework for investment *per se* was compatible with the need to preserve the ability of governments to pursue development strategies suited to the special problems of individual countries.

A view was expressed that it must be acknowledged that development was greatly dependent on investment. In the absence of an international discipline that would encourage the flow of investment, countries would find it difficult to attain development objectives.

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