Economics Division Working Papers

Development Issues

Investment liberalisation and market forces: the new OECD initiative

David Robertson

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School of Pacific and Asian Studies ANU

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n.a.	**Not applicable**
..	**Not available**
-	**Zero**
.	**Insignificant**

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An earlier version of this paper was presented at an OECD Workshop on Foreign Direct Investments in Wellington, in April 1995.

Abstract

Organization for Economic Cooperation and Development (OECD) Ministers' decision to begin negotiations in the OECD to establish a multilateral agreement on investment (MAI) aims to replace existing OECD investment instruments with a multilateral framework for liberalisation of investment regimes, protection of investments and effective settlement of disputes. When finalised the multilateral agreement on investment will be open for non-OECD countries to join, and during the negotiations some non-OECD countries will be consulted.

Restricting the negotiations to OECD countries is justified on grounds of its existing investment instruments and its dominant position in international investment flows. The shares of dynamic non-OECD economies in investment flows are increasing, however. In addition, other international agencies have become involved in rulemaking on investment flows. The World Bank and several regional trading blocs have taken steps to coordinate investment policies. The World Trade Organization (WTO) has to administer provisions affecting international investment included in several Uruguay Round agreements (GATS, TRIMs, TRIPs). Negotiation of an investment agreement in the WTO would allow global participation.

This paper attempts to evaluate the OECD proposal and to compare it with some alternative approaches.

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*i*nvestment liberalisation and market forces: the new OECD initiative

As trade liberalisation and financial market deregulation have progressed, attention has been focused on establishing orderly liberalisation of investment regimes with effective dispute settlement procedures. Multilateral attempts to liberalise investment flows so far have either been non-binding or restricted to specific sectors or regions. Most liberalisation has resulted from unilateral deregulation directed to promoting economic growth by attracting capital funds, technology and human capital into an economy.

Since 1991, the Organization for Economic Cooperation and Development has been pursuing 'a new phase of work aimed at elaborating a multilateral agreement on investment' (OECD 1995b:24). A report presented to Ministers in May 1995 resulted in a mandate to begin negotiations in the OECD aimed at reaching a multilateral agreement on investment (MAI) by May 1997 (OECD 1995b). The intention is that once an MAI is agreed to, it should be open to non-OECD governments to join. With this in mind the OECD has already held meetings with the five countries who are candidates for OECD membership and the dynamic non-member economies (OECD 1995a). The declared objective is to achieve a legally binding agreement with enforcement procedures covering liberalisation, investment protection and dispute settlement mechanisms, while providing a satisfactory balance of commitments. The OECD is proposed as a suitable forum for the negotiations because it has an existing framework of agreements on investment and because most foreign direct investment flows still take place among the OECD countries.

The OECD-MAI proposal is an attempt to bring together various efforts to liberalise foreign investment. In fact, strong links between trade and investment through international financial transactions produce forces for liberalisation that are generating progress on several fronts. The case for a unifying MAI to be negotiated in the OECD in consultation with non-OECD countries is by no means obvious, given the rapid changes occurring in the international economy. Although using the OECD to negotiate the MAI would avoid the creation of a new international institution, it might make non-OECD countries suspicious of having the OECD draw up a new multilateral agreement on investment.

There are alternatives, however. The World Bank has a long-standing interest in investment issues (Shihata 1993). Since January, the World Trade Organization (WTO) also administers provisions affecting investment flows from several Uruguay Round agreements. Moreover, market pressures arising from the internationalisation of production and markets are a powerful force for liberalisation of investment regimes which do not require formal inter-governmental agreements. The formal OECD approach is likely to raise mixed feelings in non-OECD economies.

Investment rules in the OECD

The Codes of Liberalisation of Capital Movements and Current Invisible Transactions were adopted in 1961 when the OECD was established. They cover most international transactions other than merchandise trade. These codes are legally binding decisions of the OECD. They require member governments to notify exceptions to the codes' provisions and policy changes, and to be subject to periodic reviews by OECD committees. The codes capture and secure any liberalisation.

In 1976, OECD investment instruments were formalised in the Declaration and Decisions on International Investment and Multilateral Enterprises which comprises of

- a national treatment instrument providing that OECD members should treat foreign-controlled enterprises no less favourably than domestic enterprises in like circumstances
- guidelines for multinational enterprises to establish voluntary standards of conduct expected by OECD governments
- an instrument on investment incentives and disincentives to encourage transparency, consultation and review
- an instrument for consultation when conflicting requirements are imposed on multinational enterprises by OECD governments.

In 1986, an amendment was introduced making the national treatment principle part of the Capital Movements Code. The amendment also introduced rights of establishment for multinational enterprises.

The existing system of instruments allows free movements of direct investment between members, transparency of regulations, deregulated foreign exchange markets and peer review to ensure standstill and to encourage roll-back of restrictions. OECD governments retain the right to protect national security and public order, subject to monitoring and review.

While the OECD investment instruments have encouraged liberalisation of many kinds of restrictions affecting financial and capital transactions, recent OECD reviews have persuaded member governments of the inadequacy of dealing with issues such as investment protection, dispute settlement and reciprocity in liberalisation of investment restrictions. Hence attention is given to establishing a new mechanism for liberalisation within the OECD.

Interestingly, the negotiating schedule for the MAI does not feature behaviour guidelines for international enterprises. When demands were made for a 'GATT for investment', the intention was to establish rules of behaviour for foreign investors rather than to liberalise foreign investment (Goldberg and Kindleberger 1970). Although tension between foreign subsidiaries and host governments has eased, there is still potential for conflict, and many non-OECD countries would wish to see this covered by the MAI.

Other investment agreements

Aspects of national investment policies have been subject to negotiations in many international agencies in recent years, and this experience is relevant to discussions about the OECD's proposal. The prospects for an MAI with comprehensive membership may be improved by understanding these other negotiations. Outside the OECD four types of international negotiations affecting foreign direct investment have taken place.

Investment in the WTO

The successes and failures of the Uruguay Round negotiations on investment-related issues are revealing. Trade-related investment measures (TRIMs) were included in the Punta del Este Declaration (September 1986) at the insistence of OECD countries in the face of opposition from many developing countries. At that time arguments were made for the TRIMs' negotiations to cover a wide range of investment issues including rights of establishment, national treatment and investment incentives and performance requirements. When the Uruguay Round negotiations were completed in December 1993, the TRIMs agreement merely reaffirmed existing GATT disciplines relating to national treatment (Article III) and the prohibition of quantitative restrictions (Article XI). Moreover, the agreement might be regarded as retrograde because it recognised that countries were in violation of GATT obligations, and gave them time to establish conformity (2, 5 or 7 years, depending on level of economic development). This standstill and eventual roll-back applies only to requirements on local content, trade balancing and foreign exchange balancing. Export performance requirements were not addressed because of opposition from some developing countries; and towards the end of the negotiations, several OECD countries who had adopted investment incentives decided not to press their case on export requirements.

Enthusiasm for reviewing trade-related investment measures declined as the Uruguay Round negotiations progressed (Low and Subramanian 1995). Article 9 of the TRIMs agreement, however, requires that the operation of this agreement shall be reviewed within five years after the WTO's entry into force. In particular, an assessment will be made of the need for provisions on investment and competition policy. This foreshadows extended powers for the WTO on investment issues.

The General Agreement on Trade in Services (GATS) provides a framework that includes several provisions affecting investment policies. The nature of trade in services often requires location in the country of sale. Non-discrimination applies to trade in services, subject to notified sectoral exceptions. National treatment and right of establishment provisions in the GATS represent a step towards liberalisation of investment for service industries. The liberalisation is limited, however, by the positive list approach adopted, in which each contracting party has to nominate sectors covered by these provisions. Reciprocity plays a major part in determining which service industries should be subject to GATS. Negotiations are continuing over major sectors (financial services, maritime shipping and telecommunications) in an attempt to achieve balanced concessions in the eyes of major participants. The GATS provisions on market access (rights of establishment and national treatment) create a potential anomaly between treatment of investment in service sectors and in goods industries. Once again enthusiasm for complete liberalisation of trade declined as the negotiations progressed. But the OECD countries have a major interest in service industries as their comparative advantage shifts away from manufacturing, suggesting that renewed efforts to liberalise trade in services (including investment policies) will occur (Sauvé 1994).

The Trade-related Aspects of Intellectual Property (TRIPs) agreement is indirectly significant for investment liberalisation because intellectual property rights are a major element in multilateral enterprises' armoury of assets exploited through foreign investment (Casson 1979). Because the WTO's new protection of property rights reduces uncertainties, it will promote foreign direct investment in developing economies and encourage joint ventures and other forms of corporate participation. Intellectual property rights provide an ownership advantage to multinational enterprises.

The Understanding on rules and procedures governing the settlement of disputes is relevant to investment because it applies to all WTO agreements. The authority to settle disputes between governments has been increased by imposing time-schedules, an Appellate Review Body, introducing majority voting in the General Council (when meeting as the Dispute Settlement Body) and allowing cross-sector retaliatory action to be taken. It remains to be seen how effective the new dispute settlement mechanism will be. Nevertheless, the investment provisions in TRIMs and GATS should be enforceable.

Enthusiasm to tackle investment issues declined as Uruguay Round negotiations progressed. This may have been due to fatigue from prolonged negotiations and a desire to reach agreement. But attitudes to investment issues also changed as liberalisation of foreign direct investment became more widely accepted.

The World Bank Guidelines

The World Bank group gained approval of guidelines on the legal treatment of foreign investment in 1992 after several frustrated attempts. Earlier efforts had established the International Centre for Settlement of Investment Disputes (1966) and the Multilateral Investment Guarantee Agency (1988), which attempted to deal with specific aspects of differences arising between governments and investors. Various committees were also established by the Development Committee to review international investment issues during the 1980s. The World Bank's Guidelines, adopted by the Development Committee in September 1992, represented a comprehensive treatment of the legal aspects of foreign investment. As the chair of the World Bank working group remarked 'the successful outcome was…the product of changing realities and perceptions about foreign investment and the benefits it can bring…' (Shihata 1993:11).

The World Bank group opted for drafting a non-binding set of common rules of conduct rather than a negotiated convention which would require national ratification. This soft law option offered an immediate result, and encouraged adoption of processes moving countries towards legally binding rules by building the rules into national laws and bilateral and multilateral agreements. This represents the transformation by usage into customary law. Negotiations with various interested groups of businesses and governments revealed many differences in emphasis. The guidelines when adopted contained many phrases introduced to meet specific concerns, and certain differences did not have to be resolved which a convention would have otherwise required. These differences included: developing countries' concerns about reciprocity; procedures to be followed when seeking compensation; exceptions to non-discrimination for regional trade agreements; and compliance by provinces or states within a Federation.

The World Bank Guidelines are based on comprehensive surveys of existing legal instruments and practices (bilateral, multilateral and national agreements). The Guidelines are a balanced approach to the promotion of foreign direct investment and the legitimate interests of host countries, with particular attention paid to developing countries' difficulties. The Development Committee expressed the hope that the Guidelines would facilitate improved practices with respect to foreign investment.

Regional investment agreements

With the completion of the single market in 1992, the European Union took steps to liberalise investment flows between the member states. For investments involving third countries, liberalisation was left to individual members based on best endeavours. Since the second stage of the European Monetary Union treaty came into effect in 1994, however, capital movements (including direct investment) between members and third countries must be coordinated by the European Commission. The extent of this coordinated approach is unclear, although the uncertainties surrounding the European Monetary Union itself suggest that national policies will prevail. Disputes over local content in products from foreign-owned factories and their eligibility for EU treatment in trade indicate the kinds of problems faced by foreign investors in the European Union.

The investment provisions in the North American Free Trade Agreement (NAFTA) go further than any other agreement in terms of coverage, intensity and dispute settlement. Provisions on national treatment and non-discrimination apply to investment, services and financial services, with investment defined to include portfolio and real estate transactions. These rules are intended to establish an integrated regional production system which recognises links between investment decisions and trade, competition policy, services and intellectual property rights. (NAFTA has significant exclusions which discriminate against third countries including rules of origin, access to certain subsidies and trade remedy laws, which could act as incentives for foreign direct investment inflows). NAFTA's investment provisions were put in place by liberalisation of policies by Mexico, Canada and the United States before 1992. This allowed rationalisation of production in the region.

The United States is pursuing a mixed strategy of regional and bilateral approaches to liberalise investment policies. The communiqué from the Summit of the Americas (Florida, December 1994) proposed progressive elimination of barriers to investment as well as trade in its proposal for a free trade area of the Americas. Since 1980 many bilateral investment treaties have been initiated by the United States.

The most recent attempt to establish an investment code was made by the Asia Pacific Economic Cooperation (APEC). The code is intended to facilitate foreign investment flows by achieving greater consistency of rules applied by Asian-Pacific economies. The aim was a voluntary, non-binding set of guiding principles, given the economic and political diversity within APEC. Most APEC governments have relaxed their restrictive policies on foreign investment in the 1990s. Liberalisation by China, Indonesia and Mexico forced other countries to follow, for fear of falling behind in economic development. Internationalisation of production has expanded intra-industry trade within APEC, which provides an incentive to attract foreign direct investment (Robertson 1995). The spread of unilateral deregulation of financial markets also increased pressures for reform of investment policies.

The experts' group who drew up APEC's voluntary principles recognised that legal and regulatory differences between countries as well as diversity of economic development had to be taken account of. One of the objectives of the group was to achieve greater transparency and predictability for investors by extending the scope of national treatment.

APEC's non-binding investment principles are intended to be applied in a non-discriminatory manner to all countries, in keeping with open regionalism (Elek 1992; Yamazawa 1992). It is not a regional investment agreement. The intention is to facilitate investment liberalisation through unilateral changes. As such there should be reciprocity between the APEC Principles and the World Bank Guidelines; however there is no cross-referencing between them. For the OECD members of APEC this creates three overlapping agreements on foreign investment policies—not to mention their participation in regional arrangements.

Bilateral investment treaties

Several major OECD countries with significant investments abroad pursue bilateral investment treaties as a means to reduce barriers in potential host countries. Although they may result in discrimination in terms of national treatment or rights of establishment, such bilateral treaties do open the door. The United States pursues a coordinated bilateral/regional strategy to raise international investment standards step by step. The World Bank has estimated that 600 bilateral investment treaties exist (EU Commission 1995).

The relationship between bilateral treaties and the multilateral agreement on investment is important because of its relevance for non-discrimination and reciprocity. Any multilateral liberalisation of investment regimes will depend on satisfactory definitions of these fundamental requirements for bargaining to remove restrictions.

Lessons from recent experience

The attention given to foreign investment since the sharp upturn in international financial flows in the mid-1980s shows there is major interest in establishing a more liberal, transparent and predictable regime for foreign investors. Government efforts have been dispersed among several alternative approaches taken in different institutions, however, with little attempt to recognise progress along different paths. The evidence discussed suggests that when sovereignty becomes an issue it is difficult to get governments to agree. Commitments to liberalise policies seem to falter at national frontiers.

There is widespread agreement that a new free-standing institution (for example, a GATT for foreign investment) is not necessary to promote liberalisation of the investment regime (McCulloch 1991; Julius 1994). The obvious instruments for seeking global agreements are the World Bank and the WTO, because of their comprehensive memberships and because each has already reached some agreements affecting investment policies. On the other hand the OECD has had more experience with liberalisation mechanisms and is more capable of reaching agreements. Its members still account for most foreign direct investment flows (Table 1).

Investment policies in non-OECD countries have been markedly liberalised since 1990, mostly in the form of unilateral decisions by governments to promote economic growth. Since financial deregulation took hold early in the 1980s, outward and inward foreign direct investment has become difficult to monitor. The integration of product markets through trade liberalisation has been facilitated by foreign direct investment flows, and governments have been struggling to liberalise controls and regulations to match market-driven resource flows. If present trends continue, national economic self-interest and unilateral removal of border restrictions will go a long way to establish liberal investment regimes. Regional trade blocs such as APEC and NAFTA tend to coordinate members' policies, although there is a danger that different standards and definitions adopted in different regional blocs could impede progress toward a multilateral agreement (Cable and Henderson 1994). Bilateral investment treaties sought by the OECD countries also increase the openness of investment policies.

As with trade liberalisation, some sectors are likely to lag behind the general liberalisation of investment for domestic political reasons. For example, unrelenting trade protectionism in textiles, clothing and agriculture is similar to the persistence of foreign investment restrictions in sectors such as domestic transport and the media. These sensitive sectors will require international negotiations to achieve reciprocal liberalisation at some stage—transport and the media are already the subject of specific negotiations in the General Agreement on Trade in Services which will require attention to be given to investment policies.

Some OECD countries (such as Australia and France) still maintain restrictions against foreign investment, usually on so-called sensitive sectors. Governments trying to resist the general trend towards liberalisation of investment policies will come under pressure to relax foreign investment screening, not only from potential foreign investors but also from their own companies wishing to invest overseas. Obtaining access to overseas markets is likely to depend on perceived reciprocity of access (equal treatment). Firms planning to invest overseas will exert pressure on screening and investment restrictions at home, just as exporters led the attack on import protection during GATT negotiations. Moreover, deregulation of financial markets means that foreign direct investment flows represent only a small fraction of all transactions crossing the foreign exchanges.

Table 1 Foreign direct investment, 1981–93 (US$ billion)

A. Investment inflows

	Cumulative	Flows of foreign direct investment							
Host economy	1981–90	1985	1986	1987	1988	1989	1990	1991	1992
OECD total, comprising	794	37	65	109	128	159	159	111	89
North America	377	18	37	63	62	71	52	18	8
EC 12	328	13	18	35	52	73	87	66	69
Other OECD	80	4	8	9	10	14	19	17	12
Non-OECD	229	14	14	24	28	27	31	39	52
Latin America	83	6	5	9	9	6	9	15	18
South and Southeast Asia total, comprising 6 DAEs	76	2	4	8	10	1	13	13	16
China	19	-	-	-	-	3	3	4	-
World total	1,023	54	81	133	158	195	205	161	157

B. Investment outflows

	Cumulative							Percent world total
Home country	1981–90	1988	1989	1990	1991	1992	1993	1993
United States	33	14	34	24	33	33	50	25
United Kingdom	37	37	35	19	16	16	26	13
France	-	14	19	35	24	31	21	11
Germany	20	13	18	29	22	16	17	9
Japan	37	34	44	48	31	17	12	6
Total	-	112	150	155	126	113	126	64
Percent of world total	-	-	-	-	66	66	65	-

Sources: United Nations Conference on Trade and Development (UNCTAD), Division on Transnational Corporations and Investment, 1994. *World Investment Report 1994: transnational corporations, employment and the workplace*, United Nations, New York; OECD, 1995. *Foreign Direct Investment: OECD countries and dynamic economies of Asia and Latin America*, OECD, Paris.

The issue of ownership and control of corporations is a vexed one. Control is variously defined as owning from 10 to 50 per cent of company shares in different countries. With nominee holdings not included, defining control becomes a difficult exercise. From an efficiency perspective the ownership question has little relevance because there are too many alternative methods of investment financing. In terms of domestic politics, however, ownership usually dominates exchanges over foreign investment policies. Whether an MAI would help to resolve these differences, or merely highlight them, is difficult to foretell.

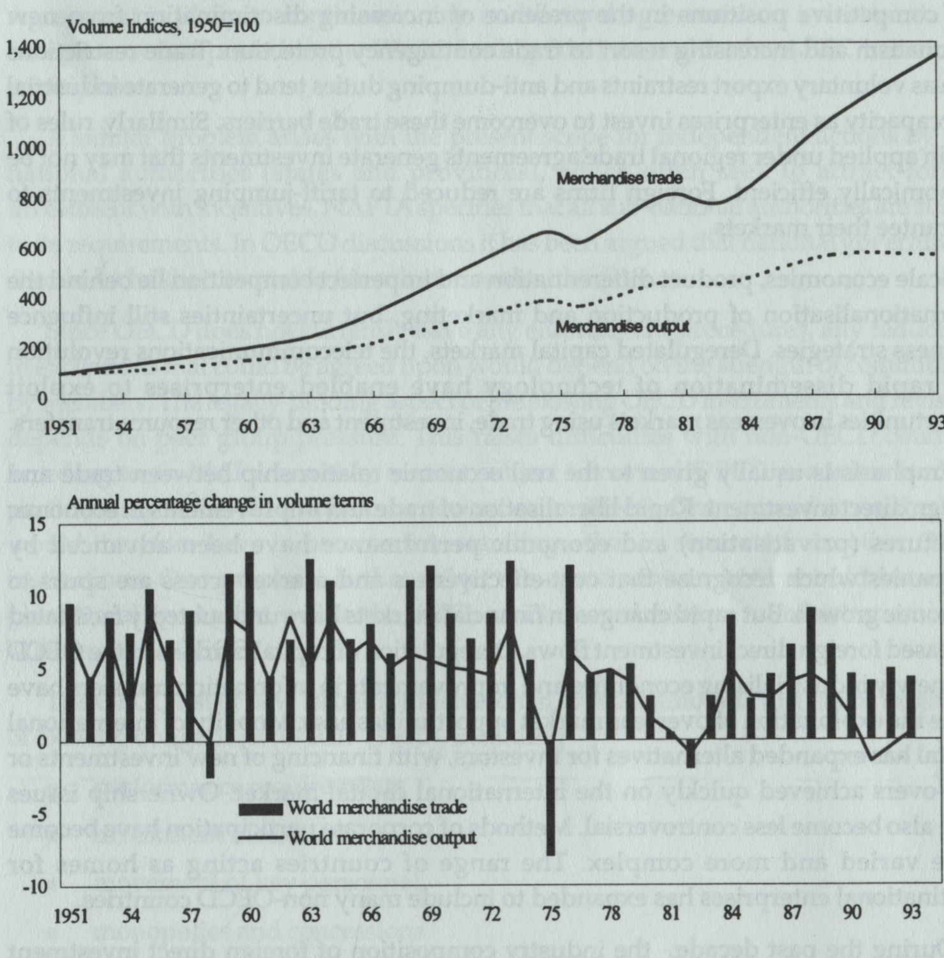
If the forces at work in the market are allowed to resolve themselves, a comprehensive investment agreement will be reached as a matter of course. If investment screening is eliminated, so-called national interests built into investment policies could be incorporated into domestic laws, policies and regulations and applied without discrimination to domestic and foreign investors alike (that is, national treatment). This might raise questions about differences in competition policies (anti-trust), national monopolies, privatisation and so on, which are issues already on OECD's new trade agenda (Feketekuty 1992).

The traditional view that trade and foreign direct investment were substitutes has given way to an assertion that they are complementary (Julius 1994). As production and marketing have become internationalised, intra-industry and intra-firm trade have increased (Robertson 1995). Increasing flows of foreign direct investment have been associated with growth of trade in manufactures. The increasing gap between growth rates of trade and output indicates the continuing integration of national economies through trade and investment growth (Figure 1). The growth differential between growth of merchandise trade and production growth has widened since 1986 when foreign direct investment began to increase strongly (GATT 1995).

Foreign direct investment is expected to generate international trade through imports of equipment, components, materials for production and exports once production is under way. Import-substituting investment may decrease trade, but with dismantling of trade barriers, tariff-jumping investment has become less significant. Logically, net trade would be expected to grow as new foreign investments come to maturity. But trade policy remains a determinant of investment decisions, and use of contingency protection measures by OECD countries and the revival of regionalism have played an important role in the distribution of foreign direct investment since 1986 (Table 1).

- Investment by the United States and Japan in the European Union increased when the single market Act was adopted. This was partly in anticipation of increased discrimination against third countries' suppliers after 1992; equally, some investors were attracted by the prospect of faster economic growth once the internal market integration was completed (Hufbauer 1990).

Figure 1 Long term trends of world merchandise trade and output, 1951–93 (percent)



Source: GATT, 1995. *International Trade 1994*, GATT Secretariat, Geneva.

- European Union and Japanese investment in the United States increased after the 1985 depreciation of the US dollar made United States assets cheaper in foreign currency terms; the United States has became a major recipient of foreign investment flows in the period 1986–90 (Table 1).
- Despite rapid growth in investment flows to East Asian economies since the late 1980s, the share of world foreign direct investment directed to these economies only increased in line with their increasing share of world production (OECD 1995a). China's reforms, including relaxation of investment rules, has a large share of world investment flows in recent years.

The distribution of foreign direct investment since 1986 therefore suggests that rather than being an autonomous change or a response to relaxation of inward investment policies, multinational enterprises have sought to safeguard their markets and competitive positions in the presence of increasing discrimination from new regionalism and increasing resort to trade contingency protection. Trade restrictions such as voluntary export restraints and anti-dumping duties tend to generate industrial overcapacity as enterprises invest to overcome these trade barriers. Similarly, rules of origin applied under regional trade agreements generate investments that may not be economically efficient. Foreign firms are reduced to tariff-jumping investments to guarantee their markets.

Scale economies, product differentiation and imperfect competition lie behind the internationalisation of production and marketing, but uncertainties still influence business strategies. Deregulated capital markets, the telecommunications revolution and rapid dissemination of technology have enabled enterprises to exploit opportunities in overseas markets using trade, investment and other resource transfers.

Emphasis is usually given to the real economic relationship between trade and foreign direct investment. Rapid liberalisation of trade and improvements in economic structures (privatisation) and economic performance have been advanced by companies which recognise that cost-effectiveness and market access are spurs to economic growth. But rapid changes in financial markets have undoubtedly facilitated increased foreign direct investment flows. Deregulation of capital markets in the OECD and newly industrialising economies and improvements in information transfers have made the exploitation of overseas market opportunities easy. Mobility of international capital has expanded alternatives for investors, with financing of new investments or take-overs achieved quickly on the international capital market. Ownership issues have also become less controversial. Methods of corporate participation have become more varied and more complex. The range of countries acting as homes for multinational enterprises has expanded to include many non-OECD countries.

During the past decade, the industry composition of foreign direct investment flows from OECD countries has shifted towards services and away from manufacturing.

Extending OECD obligations

The OECD Capital Movements Code poses a legal standstill on investment restraints; it requires member governments to notify exceptions to the Code's provisions to the relevant OECD committees and to undergo periodic reviews of policy. The national treatment principle added in 1986 requires that equal treatment should be applied progressively to foreign investors. Extending the objectives of these instruments would require members to reduce restrictions against inward direct investments. For the most part that would mean reducing the number of exceptions to these OECD agreements for public order, national security, industry exclusions and screening of foreign investment proposals. The exception to non-discrimination for regional trade and financial agreements such as European Union and North American Free Trade Agreement is likely to continue in any multilateral agreement on investment. This exception was repeated in the World Bank guidelines and in the APEC investment principles.

A similar problem arises with the present scope for independent actions by sub-national authorities (states and provinces), which often seek to attract foreign investment with incentives. NAFTA specifies that all sub-national authorities are subject to its requirements. In OECD discussions it has been argued that national governments should be held accountable for sub-national authorities.

Since OECD does not currently have any enforcement procedures, any reductions in exceptions that could be agreed upon would depend on the strength of commitment by members. The legally-binding aspect of the existing OECD instruments and revisions depends on peer group pressure. This raises difficulties with non-OECD countries acceding to an MAI when they are not subject to normal OECD processes (such as participating in OECD Councils or review committees). Once agreed upon the MAI would therefore have to become free-standing—that is, separate from other OECD institutions. One proposal is that subject to agreement an MAI should become a plurilateral agreement within the WTO, which would remove administration of the MAI from the OECD.

The OECD list of new issues for inclusion in an MAI amounts to a major extension of existing obligations (OECD 1995b), including

- performance requirements
- investment incentives
- movement of key personnel
- monopolies and concessions
- privatisation
- corporate practices.

Some of these issues are already under consideration. For example the WTO has work-in-hand on performance requirements and incentives (TRIMs, GATS); corporate practices have been considered by the UN Commission on Transnational Corporations and received some attention in the GATS. Others require major interventions in national policies and sovereignty which extend beyond investment policies (such as migration policies and corporate law). Many issues are already being examined or are programmed to be by comprehensive international institutions.

Some strengthening of OECD instruments seems necessary to deal with pressures likely to be exerted by market forces. Seeking tighter inter-governmental agreements must include acceptance of effective principles of non-discrimination and reciprocal concessions and enforcement measures. Existing OECD investment instruments do not contain these necessary principles for bargaining, and an OECD negotiation is unlikely to grant a free ride to non-members in the present negotiating atmosphere. Extending liberalisation of investment policies will depend on some measure of reciprocity. Exhortations to liberalise investment policies are already present in economic analysis, but governments require evidence of mutual benefits from negotiations.

Two other objectives of the MAI are investment protection and dispute settlement. Most disputes involve investment protection which is usually provided under bilateral investment treaties. Most of these bilateral treaties, which establish a network of links centred on major OECD countries, designate the World Bank's International Centre for Settlement of Investment Disputes as the arbiter of disputes. The Centre is a forum for resolving disputes between investors and host governments. Despite the Centre's widespread acceptance, it has been called on to adjudicate only 23 cases in 30 years (Shihata and Parra 1995). Because of its lengthy and costly processes only large cases go to the Centre. Even so, its influence as a potential arbiter has probably encouraged resolution of disputes. Inter-firm disputes are usually resolved in national courts, although the International Chamber of Commerce has an arbitration court if necessary. Inter-governmental disputes may go to the International Court of Justice if alternatives are not found in international treaties.

International disputes over foreign investment are rare, and channels already exist for resolution. For a long time disputes concerned obtaining compensation for confiscation or nationalisation of foreign-owned assets. The International Centre for Settlement of Investment Disputes and Multilateral Investment Guarantee Agency were designed to deal with these problems. Now the problems related to allowing foreign participation in privatisation of state-owned enterprises concern the extent and costs of this participation.

Many aspects of investment policies spill over into the area of trade and domestic economic policies. Where disputes arise about incentives, subsidies, performance requirements, trade barriers and so on there is a strong case for using the new WTO dispute settlement procedures. Duplication of such specialised services is wasteful and having more than one adjudicator can only result in confusion. It would therefore seem appropriate if the MAI nominated the WTO dispute settlement mechanism to deal with investment disputes.

Liberalisation mechanisms

The instruments for progressing to an open, transparent regime for foreign direct investment are limited. In the OECD the principal lever to remove restrictions or to extend coverage (by reducing exceptions to non-discrimination or by expanding national treatment) has been peer group pressure applied through periodic reviews of national policies, notification of changes and monitoring. Like the GATT/WTO, the only sanctions against recalcitrants who withdraw concessions or retaliate are likely to do more harm to the complainant than to the offender.

In the past decade the main instruments for liberalisation of investment and trade have been market forces. Unilateral deregulation and increased transparency of policies have come from private sector demands on governments. Globalisation of marketing and production has created many alternative strategies for market access, of which foreign direct investment offers several. Multinational enterprises are profitable, and grow by exploiting market opportunities using tangible and intangible firm-specific assets to internalise returns from market opportunities (Casson 1979). In other words, profits and quasi-rents are earned from arbitrage in the presence of market or policy failures. Government regulations provide opportunities for arbitrage, as central banks found when foreign exchange rates were fixed. Most market failures in financial transactions have been eliminated by deregulation over the past decade. But financial deregulation and unilateral trade liberalisation have opened new opportunities to bypass trade and investment restrictions, and have weakened the influence of national policies, undermining monopolies and foreign investment screening.

Most OECD governments and many middle-income countries recognise the mutual benefits and wealth-creating aspects of foreign direct investment flows. Unilateral liberalisation is progressing the principles written into recent multilateral investment agreements such as transparency, non-discrimination (with minimal exceptions), national treatment and market access (rights of establishment). By bringing investment policies into line with the trading system, governments are removing biases from corporate choices about how to service markets. With all means of market access open, corporate decisions will be more economically efficient from the point of view of importers and exporters of investment, goods and services.

The existing OECD investment instruments continue to play an important role in the liberalisation of investment flows. In view of the general movement towards liberalisation, OECD efforts might be turned profitably to closing outstanding gaps in those instruments, such as exceptions to non-discrimination and limits to national treatment. Adopting an agreed list of exceptions would be another step towards liberalisation. By drawing up a negative list of this kind the scope for expanding exceptions would not only be reduced among OECD countries but would also influence policies in non-OECD countries wishing to attract foreign investors.

Outsiders' perspectives on the OECD-MAI

The interests of non-OECD countries would seem to be best served by negotiations on investment liberalisation taking place in the WTO. The European Union Commission has expressed a preference for negotiations on investments to take place in the WTO (EU Commission 1995). Governments of European Union countries are in favour of the proposal because they speak independently in OECD communities, whereas the Commission is mandated to negotiate in the WTO. Although Uruguay Round negotiations made slow progress on investment issues, the provisions in GATS, TRIMs and TRIPs offer scope to extend WTO influence on investment. All non-OECD countries would be able to negotiate on new investment rules, whereas in the OECD proposal only selected non-OECD countries will be consulted; some OECD governments even oppose this limited consultation. The OECD investment committees are exploring different ways to extend participation.

The OECD negotiations on an MAI began immediately after the 1995 Ministerial Council meeting. They have to be concluded in two years. The rapid progress of market-driven liberalisation of investment policies will keep many countries—OECD members and non-members—ahead of the negotiations.

One disadvantage of negotiating an MAI in the WTO is that investment liberalisation could become entangled with other issues such as environment policies and labour rights. The GATT/WTO tradition is to allow cross-sector balancing of concessions to achieve reciprocity. OECD negotiations on an MAI would be limited to investment matters.

One major advantage for non-OECD countries might be that an MAI would tie OECD members to a formal agreement and prevent back-sliding from present positions. The United States introduced new conditions for access under its Generalized System of Preferences requiring developing countries to adopt specified standards on intellectual property rights and labour standards before tariff preferences are applied to their reports to the United States; similar threats on environmental standards have been mooted. The European Union applies selective treatment to ensure research and development incentives go to indigenous firms. The European Union's new Generalized System of Preferences scheme will grant additional preferences to countries who comply with International Tropical Timber Organisation standards for tropical timber management (OECD 1995c). Charges of social dumping against exports from Asia and Latin America may also influence potential investors in those areas (Charnovitz 1994).

Some OECD governments are concerned that a European Union–United States axis might dictate the outcome of MAI negotiations. Net capital importers such as Canada and Australia are reluctant to remove all regulations on foreign investment. They fear that the terms of an agreement will favour major foreign investors. These reluctant liberalisers may find more support from dynamic non-member economies than from other OECD members.

Many middle-income and developing countries will only be tempted to adopt an OECD-MAI if it contains guidelines for the behaviour of multinational enterprises protecting the interests of host economies. Such guidelines featured prominently in the 1976 OECD Declaration when OECD countries sought to preempt efforts to establish a UN code of conduct for transnational enterprises. As most governmental apprehensions about foreign investors have receded, such codes of behaviour have slipped off the agenda. The report of the Ministerial Council (OECD 1995b) suggests that the 1976 Guidelines could be included as an annex to the MAI. But the OECD guidelines will need to be reviewed and incorporated fully into the MAI to meet dynamic non-member economies' concerns.

OECD Ministers noted the need to take account of commitments in the WTO (OECD 1995b). One way to avoid conflict with other agreements would be to make the MAI a plurilateral agreement under the administration of the WTO like the Uruguay Round agreements on government procurement and trade in civil aircraft, dairy and bovine meat. These plurilateral agreements are open to signature by members of the WTO, but they are not part of the WTO's single undertaking adopted in the Uruguay Round Final Act in Marrakesh.

Many forces are working to liberalise foreign investment policies. The strongest are generated by market forces, as demonstrated by the rapid expansion of foreign direct investment flows and intra-firm trade. OECD governments are taking steps to introduce uniformity to the liberalisation process and to formalise dispute settlement procedures. On balance, streamlining presently dispersed efforts to establish rules for foreign investment should be beneficial. But this assessment shows that non-OECD governments are justifiably cautious about an OECD-determined MAI.

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