Multilateral or Bilateral Investment Negotiations:

Where Can Developing Countries Make Themselves Heard?

Introduction

Since the Doha Ministerial Meeting in November 2001, investment has been firmly within the World Trade Organisation's work programme. Whether the discussions that are taking place now in the Working Group will lead to full-blown negotiations will be decided in Cancun in September, 2003. This will depend on the overall bargain that is struck between key proponents of an investment agreement, like the European Union (EU) and key dissenters like India, which represents a view more typical of many developing countries.

Historically, the developing world has asserted that it wants as much leeway to regulate cross-border investments as possible and have, hence, resisted international binding rules that would limit its operational scope, when dealing with foreign investors. However, despite this persistent resistance towards international rules on investments, the very same countries are, now, accepting similar rules on a unilateral, bilateral or regional level. The rapidly growing number of bilateral investment treaties (BITs) negotiated by developing countries exemplifies this, as does the increasing number of liberalised foreign investment regimes in developing countries.

Developed countries, on the other hand, have been pushing for investment agreements at all levels: bilateral, regional and multilateral. Particularly the European Union is pushing to begin negotiation on a multilateral investment agreement at the next WTO ministerial in Cancun, to take place in September 2003.

The question countries are facing is, if they want to liberalise their investment regimes, whether to do so on a unilateral or bilateral basis or go for negotiations of multilateral rules. This briefing paper, firstly, examines what the attitude of developing countries has been on the multilateral and bilateral levels, respectively. Secondly, it examines the pros and cons that a multilateral instrument would bring, as compared to the present situation.

Why Investment Agreements?

The idea of a state sovereignty implies that a state controls entry and exit over its borders and the activities that go on within its borders. In the sphere of investment, a state is therefore justified in screening and regulating investors. However, at the global level, liberal economic principles would suggest that the most efficient use of capital is achieved if capital is allowed to flow freely from place to place and country to country. The liberalisation of investment flows may help to achieve this efficient allocation of capital.

Agreements between countries on the treatment of foreign investment come about for two reasons. Firstly, the capital-exporting states want protection for the existing investments and market access for new investments abroad. Secondly, the capital-importing states want to send positive signals to investors that their investments will be safe and, by doing so, attract more foreign investment.

Investment agreements protect the investor from adverse interference by the host state, but investors are still subject to domestic regulation and may not receive favourable treatment in comparison to domestic investors, except in the case of a dispute, where the foreign investor usually gets the right to international dispute resolution mechanisms.

For states, however, the benefits do not come in the substance of the agreements, but rather, by the signing of the agreements. By signing up investment agreements countries can signal their attractiveness as safe investment destinations and increase investment flows. Foreign Direct Investment (FDI) can compensate for low levels of domestic savings or a foreign exchange gap. FDI is also believed to bring employment, new technologies and increased access to foreign markets.

Brief History of the Protection of Foreign Investment

Developing countries have, traditionally, resisted multilateral rules for the protection of foreign investment because of concerns that such rules constrain their ability to pursue their national development objectives.

This concern derives in part from the experience of colonisation in the eighteenth and nineteenth centuries, when foreign companies achieved positions of political power. In the case of India, the colonial government was controlled until the middle

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of the nineteenth century not by the British state but by a private enterprise – the East India Company. The power of these companies to force territories into exploitative 'agreements' was backed by the superior armed forces of the colonial powers, in shows of "gun-boat diplomacy". Full colonisation, as was the case in India, often followed in the steps of foreign trade and investment.

In the late nineteenth century, the Latin American states challenged the impunity of foreign companies with the *Calvo Doctrine*, which states that investors may only use domestic courts to settle investment disputes and that no state may intervene to enforce its citizens' private claims in a foreign state. The enunciation of this doctrine came at a time when nations in the region were trying to regain control of their domestic resources which were in the hands of US and other foreign companies.

In many cases this involved the nationalisation of natural resources and the expropriation of the assets of foreign companies. Mexico was at the forefront of this shift, nationalising oil production in 1935, but the wave of expropriations continued throughout the following decades as former colonies in other parts of the world struggled to gain political and economic independence culminating in the Iranian Revolution of 1979 when the state took over the assets of the foreign oil companies.

As military solutions ceased to be acceptable, the capital-exporting countries responded to these losses by developing legal means to protect their companies. Following the early nationalisations in Mexico, the US claimed that, under international law, expropriation required 'prompt, adequate and effective' compensation. This principle for compensation became known as the 'Hull Rule' and is now contained in almost all modern investment agreements, starting with the bilateral investment treaties (BITs) of European countries. Germany was the first to sign such a treaty in 1959 with Pakistan. The US, who for long relied on their old treaties of Friendship, Commerce and Navigation (FCNs), only began signing BITs in 1983.

One major motivation to agree to such treaties was that investment guarantee insurance from the home countries became available only if a BIT between the home and the host country existed. From the point of view of host countries, it is necessary to acknowledge the political pressures that acted on some governments in the early part of this period. However, more recent BITs have generally been signed between countries that already have a well established diplomatic and economic relationship. As perceptions of foreign investment changed radically during the late 1980's and 90's, developing countries became increasingly receptive to foreign investment to finance development and came to see BITs as a tool for attracting it.

Bilateral developments were accompanied by steps at the multilateral level, especially in the United Nations. In 1964, the voice of developing countries in the international system was amplified by the establishment of the UN Conference on Trade and Development (UNCTAD), which allowed these countries to negotiate collectively. The focus of UNCTAD was the trade regime and it was there that the poor countries effectively bargained for a system of trade preferences, known as general system of preferences (GSP) schemes. In 1974, the Charter of Economic Rights and Duties of States (CERD) was adopted at UNCTAD. CERD asserts the right of every state to regulate foreign investment and nationalise foreign property upon the payment of adequate compensation.

Apart from state-to-state investment agreements, procedural rules for the settlement of investment disputes have also been negotiated. In 1966, the World Bank set up the International Centre for Settlement of Investment Disputes (ICSID) to provide arbitration of disputes between host states and foreign investors. A key attribute of the ICSID rules is that they do not oblige investors to exhaust local remedies before using the international mechanism. International arbitration was resisted for a long time, particularly in Latin America, where the *Calvo Doctrine* still held sway, but most countries have now signed on to ICSID.

Investment provisions also form part of many bilateral and regional trade agreements. For example, in the Western hemisphere, North American Free Trade Agreement (NAFTA: Mexico, US and Canada signed in 1994), G-3 (Mexico, Venezuela and Colombia), Mercosur protocols, Decision 291 of the Andean Pact and Caricom all contain investment provisions. The far-reaching provisions of NAFTA's Chapter 11 for investor-state dispute settlement are well known, but all the treaties now contain references to institutional mechanisms for arbitration, mostly under ICSID. This means that investors have the option to resolve the

Box 1: Landmarks in the History of International Investment

- Pre-World War I: colonialism and gun-boat diplomacy used to protect foreign investment
- Late nineteenth century, enunciation of the Calvo doctrine by Argentinian jurist emphasised primacy of domestic laws and processes for redress
- Post-World War I, the Hull-rule called for an international minimum standard, when expropriating foreign investment
- 1960's: independence of ex-colonies; wave of nationalisations and expropriations and increasing strength of these countries in international bodies
- 1962: UN General Assembly Resolution on Permanent Sovereignty over natural resources established a "right" to expropriate with compensation
- 1966: the International Centre for Settlement of Investment Disputes (ICSID) was established
- In 1974, the Declaration on the Establishment of a New International Economic Order (NIEO) was adopted by the UN General Assembly, which included the Charter of Economic Rights and Duties of States (CERD).
- 1990's: rapid rise in the the number of Bilateral Investment Treaties
- In 1994, NAFTA's Chapter 11 creates one of the most liberal investment regimes in force
- 1995: entry into force of investment-related multilateral agreements (GATS, TRIMS etc.)
- 1998: OECD's negotiations for a Multilateral Agreement on Investment (MAI) were terminated.

issue outside domestic courts without the involvement of the home state.

During the late 1990s, OECD (Organisation for Economic Cooperation and Development) members began to negotiate a Multilateral Agreement on Investment (MAI) which was to be the most ambitious investment agreement to date. The negotiations involved only OECD members with some other countries participating as observers. Despite OECD countries being of similar level of economic development, these negotiations failed for a number of reasons and are now widely considered to have been too ambitious. There was strong opposition from civil society, which regarded the agreement as weakening the ability of the state to regulate firms. The negotiations also stalled as country exceptions for sensitive sectors in which they did not want to allow free entry of foreign capital quickly ran into hundreds of pages. Many of the concerns that are now expressed about investment negotiations at the WTO arise from the far-reaching nature of the proposed MAI.

Global investment negotiations began in the context of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). Two agreements came into force in 1995 with the creation of the World Trade Organisation with a bearing on investment: the Agreement on Trade Related Investment Measures (TRIMs), and the General Agreement on Trade in Services (GATS). Most developing countries have so far made very limited commitments under the GATS accord, but again it is important to recognise that investment cannot be considered an altogether 'new issue' for the WTO. However, there has been considerable resistance on the part of the developing countries to the extension of discussions at the WTO to cover investment.

Developing countries have changed their attitudes to foreign investment and modified their legal position accordingly. However, while some countries have agreed to very far-reaching provisions in these agreements, others have been more hesitant. Policies to monitor and limit the type of investment that enters a country are still widely considered to be a key part of an independent development strategy.

Present Rules for Foreign Investment

Today, there is no one international investment regime governing the relationship between a foreign investor and the host country. Instead, this relationship is governed by a broad international legal framework, including customary international law, national laws, various international agreements and soft law.

The Framework Governing International Investment:

- **National Laws and Regulations.** Over the last ten years a total of 1,185 regulatory changes were introduced at the national level, the great majority of them creating a more favourable environment for the entry and operation of FDI.
- **Bilateral Investment Treaties (BITs)**. The number of BITs, agreements between two states, has exploded over the last decade. In the year 2001, there were 2,099 BITs in force and nearly four-fifths of these were signed during the 1990's. Common to most BITs are treatment standards such as most favoured nation (MFN) treatment, national treatment (NT), "fair and equitable" treatment and protection against expropriation. The vast majority of BITs contain dispute settlement provisions that allow investor to take their disputes to international commercial arbitration.

  In general, the BITs signed by the US and Canada tend to have more far-reaching provisions than those of European countries. For example, they employ a wider definition of investment which includes shares, stocks and bonds. They also require that foreign investors should be allowed admission to invest in any sector where domestic companies are allowed to invest ("national treatment") and that investors from one country should not be favoured over those from another in the admission phase ("most favoured nation treatment"). European agreements tend to employ a more restrictive definition and to apply NT and MFN principles only after the investor has been permitted to establish in the country.
- **Regional Agreements**. Many regional trade treaties now also contain investment provisions, such as NAFTA, the Energy Charter Treaty, the Pacific Basin Charter and the Cotonou Agreement between the European Union and its partners in Africa, the Caribbean and the Pacific.

Box 2: Is the Best BIT the Best Bet? – The Example of Bolivian water[2]

Many fear that multilateral rules like those imposed by GATS will lock countries into privatisation and prevent them from reversing these policies if they turn out to be unsuccessful. One example is the privatisation of water and sanitation services in the town of Cochabamba, Bolivia, where the public company was sold to the US transnational, Bechtel. The privatisation led to significant price rises, on average of 35 percent and as high as 106 percent for high earners. Farmers were also concerned that irrigation charges would be imposed. Mass demonstrations followed and the Government restored public ownership. If the Bolivian government had committed to liberalisation of the sector under GATS, such a reversal could have been open to challenge at the WTO as well as under BITs.

However, for the case in question, the investor is already pursuing redress, not through the multilateral trading system, but through the international investment regime. The investor has "sued' the Bolivian Government for breach of its obligations under a 1992 Dutch-Bolivian BIT before ICSID. Bechtels' "home state", the US, does not have a BIT with Bolivia, but Bechtel is still able to use a 1992 Dutch-Bolivian BIT as it was operating through a Dutch-based subsidiary, raising the suspicion that the country set up the subsidiary in order to benefit from the extra protection of the BIT. The web of BITs may therefore make it possible for investors to shop around for the right BIT, by incorporating a subsidiary in the country with the "best" BIT with the country in which the investor wants to invest!

- **Multilateral Rules.** Some rules in WTO agreements already in force have implications for international investments. The General Agreement on Trade in Services, **GATS**, has been called the first multilateral investment agreement as *inter alia* it aims to establish a right of commercial presence for the purpose of supplying services. Since foreign direct investment (FDI) in services sectors accounts for approximately half of world FDI stocks and flows[1], the GATS framework means that there is an international framework that can be applied to a large section of world FDI. The Agreement on Trade Related Investment Measures (TRIMs) limits members' ability to regulate foreign investment by applying common host country requirements such as local content requirements, import-balancing requirements, imports limitations, and foreign exchange limitations and export limitations.
- **Optional Procedural Rules.** These rules such as the rules of the International Centre for Settlement on Investment Disputes (ICSID) and the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL) facilitate the settlement of disputes between states or between investors and states. A majority of countries have now become ICSID Contracting Parties. Most investment agreements allow for dispute settlement under these procedural rules.
- **"Soft Law" (non-binding international law).** These laws such as the OECD Guidelines for Multinational Enterprises guide investors towards good business conduct. The OECD Guidelines provide for review panels for company behaviour at the national level, but until now they have not been very active in their investigations. There are similar guidelines adopted by the International Chamber of Commerce.

Do Agreements Make a Difference?

If the main motivation for signing of international investment agreements is that they will increase the flow of investment into the country, then it is important to ask the question whether there is strong evidence to support this relationship. In fact, the evidence is inconclusive: on the one hand, flows of investment to developing countries have increased substantially over the last decade, with the exception of 2001-2002 when global investment flows signalled a sharp drop. This suggests that the steps countries have taken to liberalise their investment regimes have made their countries more appealing to foreign investors.

However, the evidence for BITs leading to increased flows is not very compelling. UNCTAD studies show that there is very little correlation between a BIT being signed by a country and that country receiving more foreign investment. This is partly explained by the fact that BITs are often signed in recognition of an important investment relationship between the two countries, rather than to create a relationship, and by the fact that BITs are also often signed as gestures of political goodwill between two countries whose economic ties are being strengthened. Furthermore, large investment flows may continue without a BIT being agreed, as is the case now of India and Malaysia with the US.

Investment agreements in force are, however, being put to increased use in investor-to-state arbitration. For example, of the about 80 cases handled by the International Centre for Settlement of Investment Disputes (ICSID) in its 35-year history, about half have been initiated in the past five years alone! This shows that the instruments are now being used, and are not merely show case pieces for governments who want to show their commitment to a stable investment regime.

International agreements should, in theory, in comparison to unilateral rules, increase the stability of the international investment regime. A multilateral assurance to protect foreign investment carries more credibility than a bilateral commitment, as it cannot be withdrawn as easily. On the other hand, the fact that commitments would be harder to withdraw is seen by some as the major problem with a multilateral agreement as it could lock countries into ill-considered liberalisation commitments. A lot of criticism of the failed MAI, NAFTA and the GATS agreement boils down to the fact that once countries sign up to these agreements, they can never reverse their policies. This is particularly sensitive in cases where a country opens up a sector to private investment and, under national treatment rules would therefore be obliged to open up

Box 3: The Cost of Attracting Investment -The Example of Intel's Investment In Costa Rica[3]

An illuminating example of competition between developing countries for one and the same investment is that of Intel's investment into Costa Rica. When Intel decided, in the mid-1990s, to locate a $300mn assembly plant outside of the United States, Chile and Costa Rica were shortlisted as the host countries. The two countries were similar in many respects, with a corruption-free, stable political regime, an effective legal system and a relatively skilled workforce. However, the winner, Costa Rica, was able to offer an attractive incentive package.

Being registered in an Export Processing Zone, Intel could take advantage of an 18-year "tax holiday", which meant Intel is totally exempt from taxes on profits for twelve years and pays only 50 percent of the normal rate in the following six years. Taxes on exports, imports and repatriated profits are exempt, and the government subsidises employment. Another important factor for Intel was that Costa Rica's labour laws allow for non-unionised factories.

The incentives that Costa Rica offers to foreign investors are not available to domestic investors. Chile, by contrast, applies a non-discrimination principle, under which foreign and domestic investors receive the same treatment. The example of Chile and Costa Rica's race for the same investment shows how incentives can play a role in investors' choice of location and how the competition for investment makes countries erode parts of the potential benefits of an investment.

For Costa Rica, the cost of attracting the investment was high, especially in the short-run in terms of forfeited tax revenue, linkages to local suppliers and the quality of employment offered by the firm. However, the investment also provides a long-term stimulus to the economy and may draw in other foreign investors.

the sector to foreign investors also. A number of troubled privatisations in the water sector have increased suspicion about foreign companies. Argentina, for example, is currently involved in two disputes with foreign companies in the sector, both for the early termination of water concessions while Bolivia is involved in a similar dispute [See Box 2].

Dangers of Incentives Bidding

One way that countries are trying to attract FDI is by offering a package of incentives to foreign investors. These incentives have become increasingly widespread since the mid-1980s and may include extended tax holidays, duty-free access to imports and exemptions from domestic legislation. However, the evidence suggests that other aspects of the investment environment tend to be much more important in the firm's decision to invest.

This "race" for investment might lead to incentive-bidding and decrease countries' benefits from FDI. If one country offers very generous incentives, others believe that they will have to follow so that they do not lose out on investments. Often, the incentives only apply to foreign investors, which gives the foreign investor an advantage over the local one. "Bidding wars" over tax reductions/holidays may be very costly to a country with limited tax revenues and so weaken public finances. The indiscriminate use of incentives can distort investment flows in favour of the countries that can afford to finance incentives. However, in the long run, the use of incentives implies losses for all countries.

The problem of incentive-bidding is one argument for countries to negotiate collectively, rather than competing against one another. However, none of the proposed multilateral agreements, such as the MAI, have dealt with this important issue. There has been no serious attempt to stop incentive-bidding in any multilateral framework, although the problem can only be tackled on a multilateral level! Of course, the issue is partly addressed in a minor way by the WTO Agreement on Subsidies and Countervailing Measures (ASCM), as certain investment incentives fit within the definition of a subsidy and, as such, are prohibited [See Box 3].

Costs and Benefits of a Multilateral Approach to Investment Agreement

The dominant trend in FDI policy in developing countries is towards liberalisation. If these changes are taking place bilaterally and regionally without a multilateral push, then the question remains about what more a multilateral regime would offer. Such a regime might even develop naturally over time as regional blocs grow. The Box highlights some of the key arguments made in favour of a multilateral approach.

Potential Benefits of a Multilateral Approach	Potential Costs of a Multilateral Approach
• Collective bargaining can give more strength to developing countries with similar agendas, as compared to individual bargaining for BITs. If there are multilateral negotiations on investment regulations, developing countries may gain from taking a common stand with other developing countries. • Incentive-bidding, where developing countries outdo each other by offering the most beneficial investment incentive packages, can only be addressed in a multilateral framework. • Multilateral negotiations may come under more scrutiny from civil society, as compared to bilateral negotiations, which are unlikely to attract much attention, and so important social concerns may be brought to the fore. • Transparency of domestic regulation may be improved. For example, South Korea had to clarify all its rules governing investment as part of the MAI negotiations, which was the first time these rules were presented in a coherent way to the Korean policy-makers themselves! • A multilateral agreement is more likely to come under regular review, especially if applying a uniform dispute settlement mechanism. • If a multilateral agreement is negotiated within the WTO setting, consistency with the WTO agreements such as GATS and TRIMs is likely to be ensured. • A comprehensive set of consistent rules among all the WTO members is believed to allow for a stable, transparent and consistent environment for firms operating in the global market, whatever their ownership structure or place of incorporation. • A multilateral agreement on investor's rights could stimulate the development of multilateral rules governing investor's obligations.	• A multilateral agreement could reduce the flexibility of countries to modify their development strategies in relation to foreign investments. For example, countries would not be able to reverse the decision to allow free entry of FDI into a particular sector. • A multilateral investment agreement would have such reach and involve so many countries that it might have the effect of codifying international customary law, which may not be to the advantage of developing countries. • An agreement on investment at the WTO might allow countries to impose trade sanctions as part of a dispute settlement procedure, whereas a bilateral agreement does not connect investment disputes with trade provisions. This could be very damaging to developing countries. • There is a deep suspicion of the WTO in many developing countries as the promised benefits of trade liberalisation have not accrued and agreements such as TRIPs is perceived as inherently biased toward rich countries. There is therefore resistance to broadening the scope of the WTO. • A "one size fits all" multilateral framework might give less scope to accommodate differences between countries at different levels of development. This concern could be addressed by providing for country-specific exceptions and special and differential treatment for developing countries.

What Next?

The "Doha Development Agenda"

When the members of the WTO met in Doha in 2001, they initiated a two-year work programme on investment leading up to the next Ministerial meeting. The Ministerial Declaration, now known as the "Doha Development Agenda" recognised "the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment". Countries agreed that a decision on the "modalities" of negotiations on investment would be taken at the Fifth Ministerial Conference in Cancun in 2003 before negotiations could begin. However, the ambiguity of the language means that the nature of the decision to be taken at Cancun is not clear.

As spelt out in the Doha Declaration, an investment agreement could take a "GATS-type, positive list approach". This means that countries make specific commitments in the negotiations to liberalise those sectors that they are ready to open up to FDI rather than stating the sectors that they want to exempt from liberalisation, as was the case in the MAI negotiations (the "negative list" approach).

Dangers and Opportunities of WTO Negotiations on Investment

There are a number of arguments that are frequently heard against investment negotiations at the WTO. Firstly, it is argued that it would extend the scope of the WTO beyond its areas of competence. However, investment has already been addressed at the WTO in GATS and TRIMs. Conceptually, as more and more trade takes place within transnational firms, there is also increasing interconnection between investment and trade.

A particular concern in relations to the WTO is that investment rules could be backed up by trade sanctions. Investment agreements to date grant investors rights without any corresponding responsibilities. If these investors rights are backed by trade sanctions, they will become stronger. Meanwhile, instruments that aim to regulate investors conduct, such as ILO code on labour standards and various Codes of Conduct for multinationals, are not backed by any sanctions.

The WTO is, however, the one forum that has the most developed and developing countries among its membership. Any agreement that would come out of the WTO negotiations is likely to be more acceptable to the majority of members than agreements negotiated in exclusive regional settings, such as the OECD. Another option would be to conduct the negotiations under the auspices of other international bodies, such as UNCTAD, which would be more acceptable to the developing countries.

Much of the criticism of the failed MAI from civil society was due to its failure to address issues such as corporate accountability and to guard against the erosion of regulation to protect environmental and labour standards. The same criticism is directed towards an investment agreement at the WTO. However, the bilateral and regional investment agreements already in force do not address these issues either. An agreement at the WTO, on the other hand, could include explicit provisions recognising the right of national governments to regulate investments in keeping with their development goals.

Furthermore, companies may be able to exploit the partial coverage of BITs by incorporating a subsidiary in a home country with a more generous agreement. The rising amount of litigation under BITs shows that they do have teeth, which is not necessarily to the advantage of developing county signatories.

Conclusions and Recommendations

When considering the case for a multilateral framework on investment, it is important to appreciate the fact that many developing countries have already made commitments in unilateral liberalisation, BITs, regional treaties and under GATS and TRIMs at the WTO. In some cases, countries have already tied their own hands. Campaigners and policy-makers who are concerned with investment rules need to maintain a broad perspective on investment rules, rather than focusing exclusively on the multilateral framework. They need to:

- Recognise the developments that are taking place at other levels – unilateral, bilateral and regional;
- Keep up-to-date on commitments for liberalisation of trade in services taking place in the GATS negotiations. Many of the most sensitive areas for FDI are service sectors;
- Keep close watch on the provisions of bilateral investment agreements. A rich country may be in a position to make greater demands in a one-on-one negotiation;
- Ensure that if multilateral negotiations take place, they address the issues that are currently lacking in the bilateral agreements and which can only be addressed at the multilateral level, such as incentives bidding;
- Pursue the campaign to formulate binding international rules on the behaviour of firms and to include these in future investment agreements.
- Push for genuine development provisions in all agreements that will allow host countries, and not just investors, to benefit from FDI.

Endnotes

1 UNCTAD World Investment Report 2001.

2 Source: Bridges March-April 2002 & Pacific News Service on December 19, 2001

3 Sources: Isabelle Dauner, INSEAD 2002. *Chile: In search of a second wind,* Wall Street Journal, September 25, 2000

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