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Incorporating FDI into the Development Process: From Traditional Concerns to a New Agenda for Action

This book has addressed three broad sets of questions: First, what are the benefits and opportunities of trying to use FDI to encourage development, and what are the lingering risks and dangers? When are the benefits and opportunities likely to outweigh the risks and dangers?

Second, how well do international markets function in supplying FDI to the development process, and what have been the principal obstacles preventing those markets from functioning more effectively? What is the role of market failure and market distortion in allocating FDI among developed countries, developing countries, and economies in transition?

Finally, beyond getting micro and macroeconomic fundamentals right, do hosts and would-be hosts in the developing world and the economies in transition need a distinctive policy toward FDI? Or, after concentrating on the large array of microeconomic, macroeconomic, and institutional fundamentals, can they be confident that international markets will offer them appropriate amounts of FDI? If, instead, they need a distinctive policy, how should it be fashioned?

This book has provided novel and somewhat surprising answers to all three. Looking first at the dangers and opportunities offered by foreign investors, both are substantially greater than conventional calculations would indicate. On the negative side, foreign firms with subscale operations and protection from competition generate the usual list of inefficiencies and misallocation of resources in the host economy. In many cases, they leave the recipient country worse off than if it had never received the investment in the first place. More than this, however, small protected FDI creates a vicious dynamic of adverse signals and perverse incentives (both economic and political) for all parties. Instead of providing a path for growth, dynamic learning, and development, this FDI tends to produce stasis and conflict, generating constituents that are likely to use their influence to maintain their privileged position and undermine the impetus to economic reform.

Compared to foreign firms with no constraints on ownership, those with constraints exhibit older technology and business practices and lag in introducing upgrades in technology and business practices. Constrained firms are less likely to export, and their backward linkages into the local economy are less sophisticated and dynamic.

On the positive side, foreign investors with full-scale operations under reasonably competitive conditions with no restrictions on ownership offer the usual list of capital, technology, and management benefits to the host economy. In addition, their local subsidiaries exhibit an integration effect when they become part of the parents' strategy to maintain a competitive position in world markets that provides more rapid upgrading of management, technology, and quality control than any other form of transfer. Thus, they create a dynamic link to the global frontier of best practices, most advanced technologies, and most sophisticated operational techniques in an industry. Simultaneously, they generate direct and indirect spillovers and externalities for domestic suppliers. FDI that creates a proprietary network of suppliers introduces a powerful interaction between parents and subsidiaries and between subsidiaries and host economies.

The payoff from success in attracting internationally competitive FDI in manufacturing, and in natural resources and private infrastructure, is often not limited to one plant or one project. In manufacturing and natural resources, the data exhibit a frequent follow-the-leader response of rival firms moving to the same country or region after the first movers in a given industry decide to undertake major rearrangements in their patterns of international production. Supplier firms, too, follow the prime companies. The clusters of resulting economic activity show further evidence of rents and externalities. In the industries examined most closely here—automotive, petrochemical, and electronics/computer—they exhibit agglomeration properties as well, including economies of scope, scale, and specialization. Even after the Asian economic crisis, FDI in infrastructure projects, in part linked to such clusters, still may accumulate to more than one trillion dollars in little more than a decade.

The rewards for success in attracting investors in well-structured projects, therefore, are large. So are the penalties and opportunity costs of failure. But how much, and what kind of, host-country intervention is needed to ensure success? Do international markets function well enough for hosts and would-be hosts in the developing countries and economies in transition simply to sit back passively and wait for FDI to appear?

Market Failures, Market Interventions, and the Struggle for International Corporate Operations

Turning next, therefore, to the second focus of inquiry in this study—how well the markets in which foreign investors are located allocate investment—there is evidence of major obstacles to the spread of international investment along lines that comparative advantage would otherwise dictate.

Some of the obstacles spring from various kinds of market failure. The launching of export-oriented manufacturing operations from new locations in the developing countries and the economies in transition often involves acquiring information (about work ethic and culture, labor practices, ability of the surrounding economy to provide inputs, resilience of legal institutions, and credibility of public-sector commitments about taxes and other regulatory issues) that can only be generated through learning by doing, that is, by making the investment. This creates a conundrum, particularly severe for new world-scale-size indivisible projects: investors cannot obtain the information they need to invest without having already "tried out" the project. For firms caught in this bind and having to make irreversible investments under uncertainty, learning takes place at a socially suboptimal pace from the point of view of global welfare.

Then, once a first mover in an industry establishes a new site successfully, rivals move in a rapid follow-the-leader sequence that may undercompensate the initial investor for bearing the initial risk. Taken together, the catch-22 properties of learning and the appropriability problems for early movers are likely to lead to investment in new world-scale integrated manufacturing operations that is suboptimal for world growth. Thus, there is a rationale, at least in theory, for both multilateral and host-country efforts to subsidize the creation of externality-laden international production networks by multinational firms.

The analysis of natural-resource and private-infrastructure projects introduces a different kind of market failure, failure in long-term contracts. Natural-resource and private-infrastructure projects often require payment of a high risk premium long after the initial risk has dissipated, but (unlike most manufacturing investors) the parent corporations cannot use control over technology, advertising, and marketing (as the former can) to ensure that host countries honor the investment agreements that incorporate the high risk premium. They suffer greater structural vulnerability to the obsolescing bargain, as host authorities (often the successors to those who signed the original investment agreement) are tempted to tighten the favorable initial terms.

Without external efforts to strengthen the credibility of the initial-investment agreements, this can also lead to underinvestment in comparison to what would be socially optimal for would-be hosts and for the world at large.

Beyond the problems associated with market failures, hosts and would-be hosts in the developing countries and the economies in transition face the need to correct for market interventions by others on second-best grounds. In particular, national and subnational authorities in the developed countries have launched a counteroffensive of interventions to hinder or prevent the realignment of production along lines that global efficiency would suggest. This counteroffensive has grown in magnitude as the process of globalization has proceeded.

One might interpret this counteroffensive as simply old-fashioned protectionism attempting to slow down the ever-greater liberalization of trade and investment. But the characteristics of the industries in which FDI is found—imperfect competition, high wages, high benefits, high product differentiation, high research and development, large economies of scale—suggest a more serious, genuinely zero-sum struggle that is embedded with strategic-trade properties.

The same rent-generating, spillover-producing, externality-rich operations of international companies—often with agglomeration features of scope, scale, and specialization (at least in the automotive, petrochemical, and electronics/computer sectors examined here)—have become prominent targets for capture, or recapture, by developed countries as well. The international corporate activities that helped to create the industrial complexes of Minas Gerais, Sao Paulo, Monterrey, Matamoros, Surabaya, Jubail, and Penang, and could generate thick economic clusters of similar dimensions within new hosts like China, Russia, Romania, and Vietnam or within old hosts like India, Argentina, and the Philippines, have become prime objects for diversion back to locations in Europe, North America, and North Asia.

The central components of the counteroffensive—locational incentives, rules of origin, and antidumping regulations—are not just being used to protect inefficient industries but rather to recast the shape of economic geography, often along paths contrary to what comparative advantage would otherwise dictate.

The use of the strategic-trade framework to analyze this struggle is not just a theoretical embellishment. In contrast to conventional trade analysis, the strategic-trade framework suggests that the competition for international corporate investment will not necessarily be moderated by more thoughtful leaders and more careful analyses showing that protection and promotion hurt the country that engages in them. Instead, those thoughtful leaders are likely to be able to find justification in the data for energetic protection and promotion, just as their less thoughtful counterparts will. Only common agreement to limit the competition for FDI can control the escalatory dynamics of strategic-trade warfare.

What specific policies toward FDI—beyond improvement in the micro and macroeconomic fundamentals and in institutional structures—should hosts and would-be hosts in the developing countries and the economies in transition adopt? And what policy approach, individually and collectively, will best serve them as they try to incorporate FDI into their development strategies?

A New Policy Agenda toward FDI

Turning to the final question—the fashioning of a distinctive policy to incorporate FDI most effectively into the development process—what is striking is not only what should be included in the new agenda for action but what should be excluded.

High at the top of the list of what should be included in the new agenda are policies aimed at integrating world-scale manufacturing subsidiaries into the global/regional sourcing network of the parent and policies aimed at reinforcing the longer-term stability of investment agreements in natural-resource and private-infrastructure projects.

Both are more difficult and more contentious than conventional wisdom suggests. To accomplish these priorities requires three efforts on the part of authorities in the developing countries and economies in transition:

- *First*, support for extending and toughening the exercise (begun in the OECD) to make transparent, and then to limit, locational subsidies and locational incentives of all sorts;
- *Second*, mobilization of a campaign to halt, and roll back, the use of rules of origin and antidumping regulations to protect producers and divert investment flows from one region to another; and
- *Third*, participation in initiatives within the multilateral financial institutions to enhance the reliability of natural-resource and private-infrastructure agreements, with some flexibility for adjustment to national-treatment levels over long-term project life cycles.

Of equal importance is what is missing from this action agenda after evaluating the balance of costs and benefits of various popular policies toward FDI in relation to the economic and political/national security goals that those policies are intended to advance. Most resolutely dismissed is the use of domestic-content requirements to promote backward linkages, industrial deepening, or mere job creation.

FDI projects with high domestic-content mandates exhibit all of the negative characteristics listed earlier in this chapter, and more. They have high costs, show a lag in both technology and management practices, and offer slim hope of maturing from infant status to internationally competitive operations. They incorporate a political-economic logic of self-protection that frequently extends, in the cases examined here, to retarding host efforts at liberalizing trade and investment more generally. The contemporary effort of some developing countries and economies in transition to prolong the use of domestic-content requirements, or to make them less visible, or to craft the language of the requirement to be ostensibly consistent with WTO obligations is ill-advised as a development strategy.

Next-most confidently discarded is the use of joint-venture requirements to enhance development objectives such as technology transfer, international market penetration, or development of a robust supplier base.

FDI projects launched with joint-venture requirements show a high degree of conflict among the partners, suffer from a high degree of instability, and exhibit older technology, slower rates of technology transfer to the venture, fewer prospects for exports, and less sophistication in backward linkages to suppliers than do FDI projects without the mandate for joint ownership.

Finally, rejected with a considerable degree of skepticism is the so-called Korea model of insisting upon technology licensing agreements in place of FDI, with the hope of building an indigenous business class that might be more vibrant, or more effective in avoiding threats to national security, than one generated as a byproduct of less-intrusive policies.

The use of technology-sharing agreements as a substitute for FDI exhibits the same kind of large economic costs as do joint-venture requirements: lags in technology acquisition, in management practices, in external-market penetration, and in generation of an advanced supplier network. A path of development via the creation of national-champion firms and industries is fraught, in the evidence collected here, with traps and dangers for the country that adopts such an approach.

As for possibly offsetting political benefits, the breadth of instances in which maintaining ownership in national hands for genuine national-security reasons may be justified—to avoid dependence on monopolistic external suppliers—is quite narrow. Furthermore, the penalties in cost and performance associated with self-sufficiency in such instances is quite large.

Thus, domestic-content requirements, joint-venture mandates, and technology-licensing requirements as a substitute for FDI—however popular they continue to be—are decidedly absent from the list of policy recommendations for hosts and would-be hosts in the developing world and the economies in transition.

How can reformers in the developing countries and economies in transition who wish to pursue this new agenda of policy initiatives and policy rejections weave together the components to enhance their prospects for success? Should they undertake reform unilaterally and piecemeal or as part of a grand bargain with reformers in the developed countries that is incorporated into a specially designed Multilateral Agreement on Investment (MAI)? What allies might be mobilized to help create such a structure?

Tactics for Pursuing the New FDI Agenda: Following a Path of Unilateral Restraint

Host countries must initiate many of the most important actions to attract and utilize FDI in their development programs on their own—in particular, improving the micro and macroeconomic functioning of their economies and strengthening commercial and judicial institutions that provide stability and dependability to all domestic as well as foreign investors.

At the same time, the most important FDI policy improvements recommended here—abandoning the use of domestic-content, joint-venture, and technology-licensing requirements and strengthening the credibility of long-term public-sector commitments—could also be adopted unilaterally, to the benefit of host authorities in the developing world and economies in transition.

The analysis undertaken earlier shows, for example, that

- the imposition of domestic-content requirements in protected local markets leads to less efficient production and provides less valuable backward linkages than does allowing foreign firms to set up operations oriented toward global or regional markets;
- the demand for joint ventures with local partners retards the introduction of latest technologies into the local economy; and
- the award of market exclusivity reduces the pressure for continual upgrading of inputs and best practices on the part of foreign investors.

Armed with these insights, Chinese development planners might want to reconsider the efficacy of bestowing sole right of establishment upon individual foreign investors or foreign investor groups for each segment of a given industrial sector, while insisting upon partnerships with indigenous firms. These joint operations utilize demonstrably older technology and have a poor record of adopting cutting-edge management methods. In the automotive sector—to give one example—this approach has already set in place an array of undersized plants more than ten years behind the competitive frontier of new products, processes, and management practices.

Similarly, the analysis introduced here shows that multilateral investment guarantees—sponsored by the Inter-American Development Bank, the World Bank Group, or other lending agencies—provide an umbrella of political-risk protection over large infrastructure projects. Projects such as multicountry regional power plants, whose underlying economics are quite favorable but whose prospects for contract stability are otherwise questionable, can rely on such guarantees to convince foreign investors to proceed. Armed with this insight, Central American development planners, or their counterparts in other regions, might want to reconsider the appeal of participating in such credit-guarantee programs, even though the latter deliberately constrain the flexibility of successor authorities to renegotiate the initial terms of such projects (Powers 1998).

There is no underestimating, however, how painful the decision will be for hosts and potential hosts in the developing world and economies in transition to give up the imposition of domestic-content requirements and to forego the use of joint-venture and technology-licensing mandates. Rules governing local content, ownership structure, and technology acquisition represent a vast pool of favors to bestow upon rent-seeking constituencies, and the abandonment of public-sector regulation in these areas is sure to generate powerful opposition. As evidence of such resistance, there is considerable uncertainty already about whether and how rapidly many countries will actually phase out domestic-content restrictions, despite the ostensible commitment to do so, as part of the Uruguay Round agreements, under WTO auspices.

Moreover, unilateral self-abstention from the use of domestic-content, joint-venture, and technology-licensing requirements—however beneficial the outcome will be to those countries that follow this route—leaves host authorities in the developing countries and the economies in transition tactically disarmed, so to speak, in the face of the counteroffensive against the globalization of industry launched by developed countries, and tactically disarmed against the escalation in the use of locational subsidies, rules of origin, and antidumping actions, which are hindering economic activity from moving along lines of comparative advantage in a North-South direction.

Host authorities in the developing countries and the economies in transition might want to think more broadly, therefore, about how they could work collectively to shape the treatment of international corporate activity around the world, seeking support in such an endeavor from among their own counterparts as well as among developed-country governments. The elements of the new agenda toward FDI outlined here are, in fact, well suited to the negotiation of a "grand bargain" that would incorporate trade-offs among the most objectionable investment-related policies of all parties, North and South.

Leaders from the developing countries and the economies in transition might well conclude that they should seize the initiative and propose their own structure for an MAI configured substantially differently from the undertaking that has been pursued under OECD auspices.

Rather than making the challenge of trade and investment liberalization doubly difficult, mixing together the concerns of both developed and developing countries might, paradoxically, enhance the prospects for success.

Tactics for Pursuing the New Agenda toward FDI: Negotiating a Grand Bargain within a Broadened and Revised MAI

How would an MAI structured to serve the interests of host authorities in the developing countries and economies in transition, as well as to advance global economic welfare, be similar to and differ from the MAI under negotiation within the OECD? What forces might be mobilized to move a reconfigured MAI forward? What forum would be most appropriate to sponsor such an exercise?

Several of the central issues in the MAI discussions within the OECD—in particular, national treatment, right of establishment, sector-specific reservations, and national security exceptions—might well reappear in an MAI that had been recast to suit the particular interests of developing countries and economies in transition. The analysis introduced here should help to loosen their resistance to compromise

National Treatment

The national-treatment principle allows foreign affiliates in a country to be subject to laws and policies no less favorable than those applied to domestically owned firms operating in the same sectors. An abandonment of domestic-content, joint-venture, and technology-licensing requirements would eliminate the three largest areas in which developing countries and economies in transition have been inclined to insist upon the right to impose special conditions on the operations of foreign firms. The foregoing of export-performance requirements in return for discipline on all locational incentives and reform in rules of origin and antidumping (the key element in the negotiation of the grand bargain, as indicated below) would end discriminatory practice in a fourth area. The incorporation of a multilateral standard in natural-resource and private-infrastructure agreements to limit renegotiations after 10 years to economywide tax levels disposes of the final area.

Right of Establishment

Right of establishment refers to the principle that FDI be allowed in all sectors of a domestic economy, with any exceptions being completely transparent (see sector-specific reservations and national-security exceptions, below). The dynamic that most effectively triggers investment flows of the kind and magnitude that contribute most to host development comes from attracting investors to engage in operations that may improve their competitive position worldwide. This upsets the equilibrium in the industry and all firms have to adjust. In the process, various externality-laden operations are relocated to the benefit of developing countries and economies in transition. This is antithetical to one of the principal ways in which hosts have tried to control right of establishment, namely, to divide a domestic industry into segments and award investment rights within each segment to a single foreign investor (often with a designated domestic partner). Opening domestic industries up to competition for entry among foreign investors, while letting the latter choose whether or not they prefer local partners, both enhances the benefits generated for the host economy and sweeps away a principal use for controls over right of establishment.

Sector-Specific Reservations and National-Security Exceptions

In light of the analysis offered here, sector-specific reservations to national treatment and right of establishment merit sharp reduction or elimination. The practice of limiting foreign ownership by insisting upon joint ventures or technology-sharing agreements carries severe disadvantages as a development strategy. So does the attempt to build industries of international competitive status via special cultivation of national-champion firms. Legitimate exceptions to safeguard national security, moreover, fall within a relatively narrow and objectively defined band that is likely to preclude extensive appeal on these grounds.

As indicated earlier, genuine national-security threats arise only when external suppliers of a vital good or service are sufficiently concentrated that those suppliers could collude to delay, deny, or place onerous conditions on the provision of the good or service. Foreign firms in industries that do not exhibit the twin characteristics of vitalness and extreme concentration should be free to enjoy national treatment and right of establishment, including right of establishment via acquisition. The national-security needs of developed countries, developing countries, and economies in transition can be met with a common attempt to agree on how to measure such worrisome degrees of concentration, with transparent debate about whether specific cases fall therein.

Thus, a careful reassessment of the costs and benefits of some of the most-objected-to practices on the part of developing countries and economies in transition, as developed here, should assist in convincing those who defend these practices to limit or constraint their use. But if host authorities in the developing countries and economies in transition are going to shift their policies to meet many of the conditions that developed countries have been demanding of them, why not exact some concessions on issues of extreme importance to themselves in the process?

As part of a grand bargain, therefore, host authorities from the developing countries and economies in transition will want to halt the counteroffensive against the spread of FDI along lines of comparative advantage by ensuring that the reconstituted MAI incorporates limits on the award of investment incentives, including investment incentives by subnational entities, and includes substantial reform of rules of origin and antidumping regulations.

Within the context of the grand bargain, host authorities in the developing countries and economies in transition should probably be willing to give up their right to use export-performance requirements as well, however useful and justified such requirements might have been in the past. World welfare would probably be enhanced by creating a playing field for international investment that sloped slightly in favor of developing countries and economies in transition because, as demonstrated earlier, such a slope would facilitate experimentation and learning on the part of international investors. However, the best outcome that representatives from these areas can aim for is a relatively level playing field in place of the adverse tilt that antidumping regulations, rules of origin, and locational subsidies on the part of developed countries now generate.

This suggests that the WTO, and not the OECD, is the appropriate forum in which to seek such a grand bargain, because in the WTO the concerns of most vital interest to the developing countries and economies in transition can adequately be addressed.

To be successful in extracting concessions from the developed countries under the auspices of the WTO, however, the developing countries and economies in transition will have to ensure that blocking coalitions do not emerge from within their own ranks. Latin American countries such as Argentina, Chile, and Mexico, for example, may have to lure India, China, and several of the Southeast Asian nations away from the lingering desire to avoid national treatment or to maintain domestic-content requirements. Similarly, the members of regional groupings such as ASEAN or Mercosur will have to sublimate their urge to deploy investment incentives against each other into global limitations on locational subsidies.

In short, a potent negotiating strategy within the WTO will depend upon the ability of leaders from the developing countries and economies in transition to weave together agreement on sensitive investment-policy issues among their own members.

Within both richer and poorer countries around the globe, the pursuit of a grand bargain is certain, to be sure, to generate considerable opposition among the more entrenched and less-competitive economic groups. But if reformers in the developing countries and economies in transition do manage to muster support internally for changes in the use of domestic-content, export, joint-venture, and technology-licensing requirements, they would then be able to reach out to reformers in the developed countries to mobilize support for changes in the use of locational incentives, rules of origin, and antidumping regulations. The task ahead for liberalizers in the South and North remains, nonetheless, daunting.

Especially difficult will be the challenge of imposing discipline over developed-country authorities in awarding large packages of locational incentives to investors. For the very reasons that developing countries value world-scale operations by international companies—high wages and benefits, associated research and development, possible externalities and agglomeration effects—national and subnational governments in the developed world are continuously being tempted to "race to the top" in offering grants and subsidies.[1] Within the developing world, regional rivalries—such as those among Singapore, Malaysia, and Indonesia—generate the same competitive dynamic.

At the same time, however, the OECD has achieved slow and steady progress in bringing transparency and public concern to the incentive race. In the European Union, Thomas (1998) argues that the European Commission's Directorate General IV, which is responsible for competition policy, has been relatively successful in implementing notification requirements for investment subsidies and limiting (sometimes lowering) their dimensions. In Canada, the creation of a Code of Conduct on Incentives, with complaints referred to the Internal Trade Secretariat for consultations, has had some impact on moderating incentive competition, despite the considerable autonomy of the provinces from the federal government. Even in the United States, there have been "no raiding" agreements in the Midwest and the Northeast, accompanied by a rise of nongovernment organizations dedicated to educating public officials and the public at large about the pernicious impact of subsidy races—although the United States remains the outlier in terms of lack of self-discipline. While locational grants are advertised as creating jobs, they constitute subsidies to capital and make income distribution less equal. Taxpayer coalitions have objected to large investment incentives as corporate welfare.[2]

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1. For the futility of such a race, and the disadvantages for poorer contestants, see Graham (1998).

2. On campaigns against corporate welfare that include the call to limit locational incentives for international companies, see Thomas (1997); A Circle of Spiraling Payments, *Financial Times*, 8 October 1996; O Governor, Won't You Buy Me a Mercedes Plant? A Bidding War's Bite in Alabama, *The New York Times*, 1 September 1996.

The attempt to constrain subsidy races with multilateral disciplines may offer better prospects for success than the competition between leading and lagging areas within a nation or regional grouping would allow. Like the European Union, Canada, or the United States, developing countries that have trouble controlling competition for investment within their own regional organizations—such as ASEAN, where relatively rich Singapore is prone to veto the call for prohibitions on investment subsidies—may discover that the extra benefits that would accompany the establishment of global limitations offer a channel for self-restraint that is otherwise unavailable.

But, despite some progress in transparency and acknowledgment of the mutually destructive nature of subsidy races, much work remains to be done in controlling the use of investment incentives.

Perhaps less difficult may be the job of harmonizing and restraining the use of rules of origin to divert investment to particular regional trading associations. In part this is due to the fact that the next rounds of regional negotiations—NAFTA-enlargement, Free Trade Area of the Americas, EU-Eastern Europe accession agreements, EU-Mercosur expansion—will both highlight the contradictions among rules and necessitate some kind of harmonization under WTO auspices. In part, this is because international firms are realizing, from experience, that the special-interest-driven process that pervaded earlier EU and NAFTA policy formation is damaging their own prospects for global sourcing and is incompatible with their own longer-term self-interest.

More arduous will be the attempt to redefine the basis for antidumping actions in line with the original objectives of prohibiting international price discrimination and predatory business practices. The task is especially difficult because the new structure of protectionist and distortionary antidumping regulations is now incorporated in the WTO. In this ostensibly arcane but extremely important area, the international corporate community missed an important opportunity for reform in the Uruguay Round (Cumby and Moran 1997).

But the costliness of the error has been registered in remarkably rapid fashion: the United States has become one of the largest targets of antidumping actions in the world, launched not only by other developed countries but increasingly by authorities in the developing countries and economies in transition as well. Finger (1997) has detected the beginnings of possible pressures from the business communities of both the United States and the European Union for modification of antidumping procedures.

There is no doubt that achieving the changes and reforms in the most objectionable investment-related policies of all parties, North and South alike, will be a long, hard, uphill battle. But at least it is possible to see more clearly now what kinds of trade-offs are essential and what kind of outcome would be most beneficial to all parties.

Leadership, Vision, and a New North-South Dialogue

To have a chance at success, leadership and vision will play a crucial role. Because the process will be politically painful for authorities in the developing world and the economies in transition, and for authorities in the developed world as well, the former may be tempted to pursue the new agenda slowly, half-heartedly, and with reluctance and hesitation. The result would be a grudging, reactive participation of developing countries and economies in transition in the liberalization of trade and investment, with a prolonged and slow phaseout of domestic-content, joint-venture, and technology-licensing requirements. The complementary demand for developed countries to end the distortionary practices that prevent investment from moving more freely from the capital-rich countries would likely be met with an equally grudging response on the part of the latter.

How it would turn history on its head if the reverse were true, that is, if instead of reluctance and hesitation, reformers in the South were to provide the impetus to launch the next great round of liberalization. For that to occur, a group of visionary, assertive, and even indignant new leaders must emerge, eager to transform the WTO into an institution that meets their needs on trade and investment issues, preaching liberalization and equal treatment rather than protection and special treatment. They could define the issues and dominate the terms of debate for the next decade, leading both North and South toward the common goal of bringing investment-forcing interventions around the world under multilateral discipline.

To have this truly global initiative for reform originate in the developing countries would mark a watershed in international governance.

This could ignite a new convergence of effort between liberalizers in the North and liberalizers in the South to improve the competitive workings of markets in the international arena, as well as in their own domestic economies.