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Postwar Efforts at Rule Making

There is no comprehensive, international set of rules on foreign direct investment (FDI) or the operations of global corporations parallel to the international trade rules embodied in the World Trade Organization (WTO). However, there are rules that partially cover FDI—that is, they are either incomplete or apply only to a few nations. These include certain of the "new issues" agreements negotiated in the Uruguay Round and now administered by the WTO, as well as those struck in other bodies.

In this section, all of these rules are surveyed, organized by the international organization or agreement in which they are codified: the WTO (including the predecessor General Agreement on Tariffs and Trade, or GATT), the Organization for Economic Cooperation and Development (OECD), the United Nations, the Bretton Woods institutions—the World Bank and the International Monetary Fund (IMF)—and the Asia Pacific Economic Cooperation (APEC) forum. The investment-related provisions of the two important regional trading regimes, notably the European Union and the North American Free Trade Agreement (NAFTA), are subsequently surveyed.

In chapter 1 it was argued that new international rules on FDI are needed. Chapter 4 outlined what these rules should be. This chapter attempts two tasks. The first is to provide a history of existing rules, with an emphasis on why no comprehensive rules have yet been agreed upon. The second task is to outline relevant ongoing activities in international forums and the positions of key nations and groups of nations.

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Multilateral Efforts to Create FDI Rules

WTO and the GATT

The Havana Charter of 1948, which was to have launched the International Trade Organization (ITO) to supplant the temporary GATT arrangement, covered some investment issues. Unlike the GATT, the Havana Charter addressed both international direct investment activities under Articles 11 and 12 and competition policies (antitrust policies) under chapter V. Had it been ratified, the ITO thus would have had some competence over both government policies and actions affecting global corporations and the conduct of corporations themselves.

The language of Articles 11 and 12, however, was rather weak and would not have per se provided for strong governance of host-nation policies and practices. For example, ITO member nations would have been exhorted "to give due regard to the desirability of avoiding discrimination as between foreign investments." But member nations would not have been *required* to commit to nondiscrimination nor to right of establishment or national treatment. The Havana Charter was silent on many of today's salient issues: for example, it laid out no rules such as on host- or home-nation investment incentives or performance requirements (most of which had not emerged as issues by 1947). Likewise, the Havana Charter contained no binding procedure to arbitrate disputes between investors and governments. All of these elements, as argued in the previous chapter, are requirements of a satisfactory international accord on investment.

Under chapter V of the Havana Charter, the ITO would have had some powers to regulate the restrictive business practices of global corporations. Thus, it would have had much more authority to regulate the activities of international firms than to regulate government actions affecting these firms. This asymmetry represented a major flaw in the charter; effective international rules on direct investment should obligate governments as well as international firms to certain standards of behavior, with the rights and obligations of each set of parties explicitly spelled out.

Thus, the Havana Charter really does not provide a model for what is needed now. Nor could it be expected to do so. The globalization of business was not then as large a phenomenon as it is today, and many of the issues discussed in the previous chapter had not yet become prominent. In the late 1940s, the charter's drafters most wanted to ensure that restrictive business practices, such as international cartels to fix prices or to restrict territories in which member firms could sell, did not negate the gains from trade liberalization. Such cartels had figured significantly in world trade in the Great Depression years (Edwards 1942; Hexner 1945). Thus, the restrictive business practices provisions of the Havana

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Charter were meant primarily to deal with international trade issues rather than international investment issues per se.

The Havana Charter was never ratified largely because of resistance from the US Congress (Diebold 1952; Schott 1990). Thus, the GATT became the major international instrument to guide world commerce. But, where the investment provisions of the Havana Charter were rather inadequate from today's perspective, the GATT as originally drafted was totally useless: it did not deal with international investment or competition issues at all. Furthermore, until the Uruguay Round of multilateral trade negotiations that were begun in 1986, GATT rounds (and other negotiations under the GATT aegis) largely steered clear of these issues.

Drawing on a report of the Joint Development Committee of the International Monetary Fund and the World Bank,[1] the United States in 1981 began to raise the issues of host-government policies toward FDI and MNEs in GATT discussions. At the Punta del Este meeting launching the Uruguay Round, discussion of "trade-related investment measures," or TRIMs, were included (see Graham and Krugman 1990 for an extensive treatment), partly to clarify ambiguities left in the wake of the GATT decision on the Canadian Foreign Investment Review Agency. The following mandate was established for the TRIMs exercise at Punta del Este:

> Following an examination of the operation of the GATT articles related to the trade restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade. (GATT 1986)

The FIRA decision was the outcome of a dispute the United States brought to the GATT in 1982 over Canadian legislation that gave FIRA, a Canadian government agency that was later renamed Investment Canada and is now part of Industry Canada, authority to impose certain types of performance requirements on local subsidiaries of non-Canadian firms.[2] A GATT panel ruled that FIRA's imposition of local-content requirements was inconsistent with GATT Article III.4 (national treatment) on grounds that such requirements had the effect of discriminating against imported goods relative to locally produced substitutes. But the panel noted that countries could in principle invoke Article XVIII.C to justify these requirements. Canada accepted the panel's ruling, but developing

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1. This report was drafted by Dale Wiegel, now head of the Foreign Investment Advisory Service (FIAS) of the World Bank, and the author under the supervision of C. Fred Bergsten, then-acting undersecretary for international monetary affairs at the US Treasury Department and chair of the task force appointed to prepare this study.

2. Investment Canada as a separate agency of the Canadian government was dissolved in June 1993; part of the functions of Investment Canada were transferred to the Ministry of Foreign Affairs and part to the Department of Industry and Science.

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countries took the statement on Article XVIII.C to mean that their own local-content requirements were consistent with GATT law and that the FIRA ruling therefore did not apply to them.

The TRIMs negotiations quickly bogged down over two issues. The first was defining a TRIM, and the second was determining whether the negotiating mandate covered TRIMs only as a condition of entry for the firm or TRIMs as a condition for receipt of investment incentives as well. On the second issue, the Negotiating Committee on TRIMs early on decided that investment incentives per se should fall under the jurisdiction of the GATT Committee on Subsidies. The United States, however, interpreted this to mean that both committees were to discuss TRIMs tied to investment incentives, while other nations held that this issue was reserved for the Committee on Subsidies. Given that investment incentive and performance requirements are often linked, the US position is intellectually defensible. However, TRIMs tied to investment incentives were doubtlessly put into the subsidies negotiations to reduce the scope of agreement in this domain; indeed, only limited restrictions on investment incentives tied to certain TRIMs emerged from the Uruguay Round (see below).

With respect to what types of measures should be considered as "trade-related" conditions for entry, the United States proposed eight types of measures to be prohibited: local-content requirements, export performance requirements, local manufacturing requirements, trade-balancing requirements, production mandates, foreign exchange restrictions (other than those consistent with existing GATT articles), mandatory technology transfer, and limits on equity participation and on remittances. Japan supported the United States on the first seven of these measures (as conditions for entry) and the European Union on the first six. Other developed countries (e.g., the Nordic group) proposed shorter and more specific lists.

However, when the Uruguay Round was completed in early 1994, only local-content and trade-balancing requirements and foreign exchange restrictions appeared in the final TRIMs agreement. In seeking an agreement to which all nations could subscribe, the negotiating committee bowed to the wishes of "hard-line" national governments, which resisted any discipline on TRIMs whatsoever. Thus, all but what were perceived to be the most egregious violations of existing GATT articles were removed from the list. This outcome did little more than codify the results of the FIRA decision and require nations to phase out GATT-inconsistent policies.

In the end all nations agreed to notify the WTO, within 90 days of its entering into force, of all TRIMs that were inconsistent with the GATT. Developed nations have two years to phase these out; countries categorized as "developing" or "least developed" have five and seven years, respectively. The phase-out period does not apply to TRIMs that were introduced within 180 days of the WTO entering into force; such TRIMs

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must be ended immediately, subject to one exception—countries are allowed to introduce new TRIMs during the relevant phase-out period if they are necessary to avoid disadvantaging existing investments currently subject to TRIMs. The whole issue of TRIMs is to be revisited before 2000 to determine if complementary provisions on investment or competition policy are warranted.

As noted, the Committee on Subsidies was charged with looking at investment incentives. In the end, a small step was taken: subsidies contingent upon export performance or domestic sourcing were banned. Because export performance or domestic sourcing requirements themselves are banned under the TRIMs agreement, these categories of banned subsidies reinforce this agreement.

The Uruguay Round also dealt with other issues that bear upon international investment. One of these was trade-related intellectual property (TRIPs) policies, of relevance to FDI because multinational firms are often the conduit of technology transfer to developing nations. The ultimate objective of the industrial nations was to encourage developing nations to strengthen their patent and copyright laws and enforcement. Many developing nations, especially in Latin America, had already been unilaterally doing so in order to lure inward technology transfer by multinational firms.

Certain developing nations raised objections to overzealous enforcement of the TRIPs policies. They referred in particular to industrial nations' use of border measures to block the imports of "clone" products from developing nations on grounds that these violate patent or copyright laws, when in fact no violation could be established in a legal proceeding.

Unlike in the TRIMs exercise, the developed-nation position largely prevailed in the TRIPs negotiation, doubtless because most of the larger and more rapidly growing developing nations were also shifting to greater legal protection for intellectual property. These nations have recognized that foreign suppliers of advanced technology are increasingly unwilling to transfer the technology (or even in some cases to sell products embodying it) in the absence of strong intellectual property protection.

The TRIPs agreement has several key provisions:

- **National treatment.** A nation must grant to the nationals of all GATT member nations treatment with respect to intellectual property no less favorable than the nationals of that nation.
- **Most-favored nation.** Any advantage a nation might grant to the nationals of another nation must be extended immediately to the nationals of all members.
- **Detailed rules on patents, copyrights, trademarks, service marks, etc.** There are also provisions protecting trade secrets and industrial de-

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signs; integrated circuits are granted special protection. Additionally, there is a provision that prohibits any "indication" on a product that would mislead a consumer with respect to its true origin.

- **Ban on anticompetitive practices in licensing of intellectual property**. The main provision calls for intergovernmental consultation where licensing practices might hinder competition.

- **Enforcement and dispute settlement procedures.** Minimum obligations of governments with respect to procedures for enforcing intellectual property rights within their territories are established. Foreign holders of intellectual property rights must have access to these procedures.

Disputes under the TRIPs agreement are to be settled under WTO dispute settlement procedures. Developed nations had one year from entry into force to accept the obligations of the TRIPs agreement and to bring their laws and practices into compliance with it. Developing nations would have five years to do so and least-developed nations eleven years. Developing nations are allowed five additional years (to bring the total to ten) to implement laws and policies affecting pharmaceuticals and agricultural products that comply with the TRIPs agreement.

A third area taken up in the Uruguay Round and bearing upon international investment was the General Agreement on Trade in Services (GATS). In many service industries, it is difficult to disentangle international trade from international investment. For example, in insurance, international trade is generated when insurance policies for individuals in one nation are written by a firm based in another. But such a transaction cannot on practical grounds take place unless the firm has offices and staff in place in the host as well as the home nation, and for legal reasons these offices and staff typically must be organized as a local subsidiary of the firm (and hence direct investment must take place). Indeed, in this industry, it is often difficult to determine on tangible grounds exactly where, geographically speaking, the creation of the service takes place, and hence difficult (and possibly moot from any but a legal perspective) to disentangle "local" provision of services by affiliates of multinationals from international trade in these services. For example, if the US office of a German insurer writes a policy for a party in the United States, this would be a sale associated with direct investment. But if the company's home office in Germany writes an identical insurance policy, this would be considered an import of services into the United States from Germany. And, if the US subsidiary wrote the policy but the home office paid claims on it, the policy would have aspects both of a sale associated with direct investment and international trade in a service.

Similar statements can be made about financial services industries (e.g.,

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banking, investment banking, and securities brokerage). In some service industries, international trade is virtually synonymous with FDI; for example, international hotel chains cannot exist without FDI.

Correspondingly, GATS' provisions for services are as much investment-related as trade-related. Part I of the basic agreement on services defines its scope, differentiating among (1) services provided in one member's territory to consumers in another member's territory, (2) services provided by affiliates of one member's nationals inside another member's territory, and (3) services the nationals of one member provide within another member's territory. This last distinction comes into play, for instance, in banking: If a subsidiary of a bank domiciled in country 1 provides a banking service in country 2, GATS provisions in category 2 apply. But if a local branch of the country 1 bank provides the service in country 2, category 3 provisions come into play.

Parts II and III of the GATS thus contain a number of provisions that could be placed in the more general investment accord this book proposes. For example, the draft agreement contains a most-favored nation (MFN) obligation whereby each signatory nation "shall accord immediately and unconditionally to services and service providers of any other party, treatment no less favorable than that it accords to like services and services providers of any other country." (Countries, however, may specify exceptions for MFN.)

Part II requires transparency in relevant national laws and regulations and requires that they be objectively and impartially administered. Further, parties must ensure that state-sanctioned exclusive service providers do not abuse their positions and that restrictive business practices are subject to consultations between parties with a view to their elimination. Finally, part II contains both general and security exemptions from obligations.

Part III pertains to market access and national treatment. Under the GATS, however, these are not general but rather sector-specific obligations, specified in individual national schedules. Thus, for example, a foreign-controlled insurance company is not entitled under the GATS to national treatment in any given nation unless the schedule of that nation lists the insurance sector. This "positive list" approach is anything but positive because a service activity does not benefit from its government's obligations unless that activity is explicitly listed. Under the market-access provisions, barriers to market access by non-national services providers would be reduced over time, providing of course that the specific industry is listed.

Also, the national-treatment provision is of rather strange construction. Unlike under a general concept of national treatment as would pertain to foreign investors, domestic suppliers and those of nationals of other members are not necessarily accorded substantially the same treatment under national laws and regulations under the GATS. Rather,

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nations are merely obliged not to modify conditions of competition in order to favor domestic suppliers.

A number of annexes to the draft agreement spell out provisions for specific service sectors.

Overall, the Uruguay Round agreements introduce a number of new measures into international trade law that bear substantially upon FDI and the operations of multinational firms. Most of these constitute positive steps in that they are designed to liberalize the environment in which multinational firms operate. However, they fall far short of constituting a comprehensive set of rules for international direct investment.

OECD

During the 1960s, the member nations of the OECD created two codes—the Code of Liberalization of Capital Movements and the Code of Liberalization of Current Invisible Operations—under which each nation pledged to remove barriers to inward or outward investment (including but not limited to direct investment), to allow free transfer of capital following liquidation of assets or the obtaining of long-term loans, and to allow current transactions (payments of dividends, interest payments, royalties, etc.). Although in principle OECD member nations have accepted these codes as binding, there is no mechanism in place by which they can actually be enforced, and national law or policy can override them. Under the first of these codes, member nations are exhorted (but not required) to avoid introducing new exchange restrictions on capital movements or making existing regulations more restrictive.

In principle, OECD members agreed when they adopted the Code on Capital Movements to accept the obligations therein *in toto*, although they would be phased in. However, member governments were allowed "to lodge reservations" (Article 2b) relating to Article 2a obligations when an item on list A, annex A (capital movement items) became applicable to them or when an item was added or an obligation extended to list A. Members could also lodge reservations at any time regarding items on list B, annex A (transfer items). These reservations are in annex B of the code, a glance at which reveals that Australia, Austria, Finland, Greece, Ireland, Italy, Japan, New Zealand, Norway, Portugal, Spain, and the United States all have listed at least some reservations with respect to inward direct investment. Many of these were sector-specific. In addition, all OECD nations can, under Article 3, take actions affecting international capital flows to maintain public order or public health, protect essential national security interests, or fulfill international obligations relating to peace and security without filing reservations. An OECD member country can also lodge a "derogation," the distinction being that the former is a long-term exception and the latter is in principle a temporary measure. The two codes in principle bind each member country to

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a "standstill" on new reservations and derogations—that is, it has an obligation not to enlarge its list of exceptions.[3]

Under OECD procedures, the standing Committee on Capital Movements and Invisible Transactions (CMIT) regularly reviews the practices of each member country to determine if these obligations are being met. In principle, any member country can demand that the country under review *or any other country* explain and justify any new measure that might violate code obligations. Also, the code calls for these governments to permit liquidation of nonresident-owned assets and the transfer of the assets or the proceeds of the liquidation, including capital gains thereon (Articles 1b and 2c).

How well the reviews have actually functioned is open to some debate. On one hand, reviews are scheduled regularly basis, and objections to individual countries' policies and practices are raised (but because the record of the sessions is not made public, it is difficult to know how often this happens). On the other hand, knowledgeable individuals have claimed that certain OECD nations have made no effort to bring national policies into line with the obligations of the code despite regular findings that reviewed policies violated these obligations.

In addition to the two codes discussed above, which do not provide for full national treatment for foreign-controlled enterprises in member countries, the OECD in 1976 drafted a nonbinding "national treatment instrument" (NTI). OECD nations choosing to adhere to the NTI (all currently do) must in principle grant national treatment to enterprises that are controlled by investors from another member country, subject to reservations and derogations.

A number of efforts have been mounted over the years to make the NTI binding and to make OECD countries subject to reviews similar to those conducted under the codes, but these have to date foundered over specifics.[4] In particular, a US-led effort to significantly strengthen the NTI failed in 1990 over the issue of whether these provisions would be binding on local governmental entities. The European Union maintained they should apply to the individual states of the United States and the provinces of Canada, a proposition to which neither the US nor Canadian governments were willing to subscribe at the time.

When the Declaration on International Investment and Multinational Enterprise was issued in 1976, the OECD nations also agreed to publish voluntary Guidelines for Multinational Enterprises, which were seen as an alternative to the UN code then under negotiation (see below). These

3. The codes also commit each member nation over time to "roll back" its exceptions—that is, reduce these in number or scope. However, in recent years, there has de facto been very little such reduction.

4. The OECD Committee on International Investment and Multinational Enterprise (CIME) is the organ that debates how to strengthen the NTI.

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guidelines attempted to establish new norms for disclosure requirements and plant closure procedures. Otherwise, they were largely an attempt to codify policies and practices that most OECD nations (and firms based in these nations) were already following. The United States indicated that it would accept the guidelines as a hortatory declaration only, one that had no standing in any actual situation involving US-based international firms.

In 1979 the OECD nations agreed to take limited steps to make investment incentives that member governments offered to global firms more transparent. This was in response to a nascent US effort to bring some discipline to bear on investment incentives and performance requirements (see discussion on World Bank and IMF below). The OECD issued declarations and related measures, but again, these were not binding on either member governments or firms.

In the fall of 1994, the OECD Secretariat began to prepare for creation of a "multilateral agreement on investment" (MAI) that would consolidate and strengthen existing codes and instruments. In June 1995, the annual meeting of OECD ministers endorsed this effort, and actual discussions among governments began in September. At the time of this writing, these discussions were just beginning, and no information was available on the outcome. Discussion of the MAI is taken up in chapter 6.

United Nations

As already noted, the 1976 OECD guidelines were largely a response to negotiations within the United Nation that were driven by a bloc of developing nations. At the time, scholars of mostly leftist leanings, who believed the multinational firm a malevolent entity, heavily influenced the thinking in developing nations about these firms and their direct investment and bred a largely hostile response among national leaders.

From about the time of the first oil crisis in 1974 until the debt crisis of 1982, these nations as a bloc (the Group of 77) lobbied the United Nations to create a "new international economic order" to foster developing nations' interests (see essays in Bhagwati 1977). Two keystones of the "new international economic order" were to be a mandatory code of conduct for multinational firms and a code to regulate restrictive business practices of these firms. Although negotiating committees were formed, none of the major industrial nations saw these as serious exercises, and no international agreements resulted. The drafting of the code of conduct was begun in 1977 and originally was to cover only the conduct of firms. In 1980 it was agreed that the draft should be expanded to cover the conduct of governments as well.

A completed draft was presented to the UN Commission on Transnational Corporations in 1982, but there was no consensus on whether to implement it. In 1988-90 certain developing nations and the UN Secretariat

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tried to revive the then-moribund negotiations on this code, and a revised draft was submitted to the Economic and Social Council, which forwarded it to the General Assembly. In 1992 the General Assembly failed to reach a consensus on the code, and a special intragovernmental group was convened to suggest further action. This group recommended that an alternative be found, in effect terminating the whole exercise.

International Bank for Reconstruction and Development (World Bank) and the IMF

In 1979 the United States opened discussions with a group of developing and industrialized nations under the Joint Development Committee of the IMF and World Bank on possible discipline of host countries' use of measures with potentially antidevelopmental effects. A Task Force on International Investment was constituted to explore this issue in tandem with OECD discussions on investment incentives and performance requirements. (See previous discussion on TRIMs in this chapter.)

The task force also considered performance requirements on global corporations. The United States emphasized the distorting (and thus antidevelopmental) effects of these requirements when they became a condition either for entry by foreign firms or receipt of investment incentives. The result of these discussions was an interim internal report that said performance requirements could distort both development and world trade. A number of academic works subsequently bolstered this conclusion (e.g., Grossman 1981; Davidson, Matusz, and Kreinen 1985), one of which was a direct result of a study commissioned by the development committee (Guisinger 1985). More recent work has been done on the possible distorting effects of investment incentives (OECD 1989; Moran 1990; Loree and Guisinger 1995). Although neither the World Bank nor the IMF acted on these conclusions, as already noted, the report nonetheless was an important impetus toward launching of the TRIMs exercise.

Within the World Bank, the International Center for the Settlement of Investment Disputes (ICSID) is designed to facilitate settlements of disputes between investor firms and host nations. There are 130 nations that are signatories to the ICSID. However, it has not been frequently used for this intended purpose. During 1994, for example, it handled only five cases. The ICSID could become more active in the future if it is used, as envisaged, as the principal arbitral body for the settlement of investment disputes under the NAFTA dispute settlement mechanism (see discussion below).

Also within the World Bank is the Multilateral Investment Guarantee Agency (MIGA), an institution designed to supplement and perhaps eventually supplant national investment insurance programs such as the Over-

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seas Private Investment Corporation (OPIC) in the United States. Like its national counterparts, MIGA was designed to encourage FDI specifically in developing economies. But, like ICSID, MIGA has been underused so far. In 1994, although 147 countries were signatories to MIGA, only slightly more than 100 total such contracts were outstanding, with contingent liabilities of about $1 billion. However, the demand for MIGA guarantees has been rising; in 1992 there were 244 applications for these guarantees, and in 1994 the number of applications more than doubled, to 574. Much of the demand for guarantees is associated with investment in the formerly socialist nations.

MIGA also provides technical assistance to developing countries through its Foreign Investment Advisory Service (FIAS). In 1994, FIAS completed 29 projects in 26 countries.

Regional Approaches to FDI

In addition to multilateral institutions, certain regional international groups have instituted rules on international investment and multinational enterprises. The most significant of these are the European Union and NAFTA, but APEC is also of interest.

Interestingly, there is almost no overlap between EU and NAFTA rules. Whereas the European Union has built up a substantial body of law and policy in competition policy, which can affect international investment and multinational enterprises, there is little EU law and policy on international investment per se. By contrast, the NAFTA lacks competition law or policy but breaks new ground with rules explicitly directed toward FDI and multinational firms' conduct.

European Union

The Havana Charter, though never enacted, did raise concerns about international cartels. This concern was also reflected in several articles of the Treaty of Rome, which was drafted in the middle 1950s and established the European Common Market. Articles 85 and 86 deal with cartels and monopolistic business practices (or, "abuse of a dominant firm position"), and Articles 92 and 93 deal with state aids to industry or regions that might distort competition or intra-European trade. Significantly, the European Commission's powers to deal with these practices exceeded those granted it in almost any other domain. There are no other Europe-wide rules or policy explicitly dealing with FDI or multinational enterprises in the Treaty of Rome, and it is an unsettled issue as to whether the European Commission can implement such rules or must negotiate them in international forums.

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Nonetheless, because of its rather broad powers to deal with cartels and abuse of dominant position, the Commission holds limited but significant power to regulate the European activities of global corporations. These powers, administered by Directorate General IV (DG IV) of the European Commission,[5] the Competition Directorate, indeed have been used on occasion to regulate global firms, especially mergers.

An early milestone in DG IV efforts to apply Articles 85 and 86 to mergers was the successful blockage in 1972 of an attempt by Continental Can Company of the United States to attain a dominant position in the European industry via acquisition (Brittan 1992). But the European Union did not have a merger regulation until 21 December 1989.[6] Under the regulation, DG IV can review a merger or acquisition involving two firms that meet minimum size criteria and criteria for minimum involvement in the European Union. If these criteria are met, the Commission can block a merger or acquisition involving one or more firms not domiciled in or controlled by EU nationals. In fact, the first blockage of a major merger involved a non-EU firm—the proposed merger in 1992 of de Havilland, a Canadian-based aircraft firm under the control of the US aerospace giant Boeing, and Aerospatiale, the French partner in the European Airbus consortium.

The European Commission has limited powers over governments as well as global corporations. The most important of these are powers to curb national governments' subsidies to enterprises (including state-owned enterprises) under Articles 92 and 93. In particular, Article 92 states that "any aid granted by a Member state in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the Common Market." Any measure that is deemed to be "incompatible with the Common Market" is, in principle, banned. This provision gives the Commission power to curb investment subsidies and other, subsidy-like investment incentives to multinational corporations.

In practice, however, investment subsidies in Europe are rife, and little has been done at the level of the European Union to stem them. Rather, Article 92 allows for a number of exceptions to the basic principle (as do a number of other articles of the Treaty of Rome), and many investment subsidies fall into these exceptions. These include aid to regions where the standard of living is considered to be abnormally low and aid "to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member state." In 1988-

5. Article 3 of the Treaty of Rome requires that "the activities of the Community shall include . . . the institution of a system ensuring that competition in the common market is not distorted."

6. This regulation actually entered into force in September 1990.

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90 the total state aid in Europe averaged $103 billion per year, of which about 40 percent went to manufacturing industries.

In recent years, the European Commission has tried to toughen up its oversight of state aid to industry. Article 93 calls for the Commission to "keep under constant review" all systems of aid in the European Union, and it empowers the Commission to order such aid abolished if it is deemed incompatible with the common market.[7] In particular, under the tenure of Sir Leon Brittan as competition commissioner, DG IV attempted to abolish subsidies to many manufacturing firms, going so far as to order repayment of the subsidies in some cases, including subsidies paid as investment incentives to some multinational enterprises. However, member nations frequently questioned whether or not DG IV was overstepping its authority in doing so, and some of the cases were referred to the European Court of Justice. As of this writing, the Commission postponed a decision on whether to take action against the government of Austria, which reportedly paid as subsidies one-third the cost of a new Chrysler factory in Austria to produce minivans (*The Economist*, 8-14 August 1992; for an overview of EU state-aid policy, see *European Economy*, September 1991). The current competition commissioner, Karel van Miert, has continued to espouse Brittan's policies on subsidies in principle, but many observers believe that DG IV under van Miert has in practice significantly softened its line.

NAFTA

In contrast to EU law and policy, NAFTA does explicitly address direct investment (for analysis, see Graham and Wilkie 1994; Gestrin and Rugman 1993). Most of these provisions are in chapter 11. They include the following:

- National treatment for investors from other NAFTA countries on the part of national, state, provincial, and local governments. Any such government must accord to investors (and their investments) from other NAFTA members treatment that is "no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments" (Article 1102.1).[8] Thus, national treatment in the context of NAFTA includes right of establishment.

7. The relevant authority is also administered by DG IV. Under a 1972 treaty, the Commission can take measures against Austria if its policies are found to be incompatible with a free trade agreement with Austria.

8. Under NAFTA parlance, the term "investment" generally would include a subsidiary or other legal affiliate of a multinational firm and "investor" the parent organization of that subsidiary.

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- Most-favored nation and minimum standard of treatment provisions (Articles 1103-1105). These are designed to ensure that any treatment a NAFTA government accords to investors and investments from NAFTA countries is no less favorable than treatment granted to investors and investments from non-NAFTA countries.
- Most new performance requirements on investments in NAFTA countries are banned, and old performance requirements must be phased out (Article 1106). Also, most linking of performance requirements to receipt of subsidies is prohibited. These prohibitions apply to all investments, and not just those of NAFTA investors.
- NAFTA investors can convert earnings, proceeds of sales, loan repayments, or other capital transactions into any foreign currency at prevailing market rates of exchange (Article 1109).
- No NAFTA country can expropriate investments of NAFTA investors, except for a public purpose, on a nondiscriminatory basis. Where countries do so, expropriations must follow due process and investors must be paid at the fair market value of the investment and without delay (Article 1110).

NAFTA chapter 11 sets new procedures for the resolution of investment disputes (Articles 1115-1138) that go beyond any other existing or proposed mechanism. Under these procedures, most investors (but not the entities created with the investments) may seek arbitration of a dispute against a member country. In most other international agreements (e.g., those of the GATT), only governments have standing to use the dispute settlement mechanism, and hence an investor must be represented by a government in dispute proceedings, even if the government is not a direct party to the dispute. Under NAFTA chapter 11, however, investors can pursue claims against a NAFTA government on their own behalf or on behalf of their investments (e.g., a subsidiary) if they can claim monetary loss or damages resulting from alleged breaches of chapter 11 obligations (or certain other obligations) by that government.

An effort must be first made to resolve the dispute through consultation and negotiation (Article 1118). If these fail, the dispute can be submitted to binding arbitration under the rules of the ICSID (see above) or the UN Commission on International Trade Law (UNCITRAL). Under either set of rules, an arbitration panel can order interim measures to protect the rights of the disputing investor and order that an award be made to the investor in the form of monetary (but not punitive) damages and/or restitution of property with applicable interest. This tribunal cannot, however, order a government to revoke or rescind a measure deemed to be in violation of NAFTA obligations. Any award the tribunal grants does not prejudice that investment's right to relief under domestic law.

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Although the NAFTA chapter 11 dispute settlement procedures break new ground, they still fall somewhat short of an ideal mechanism. These issues are taken up in chapter 7. One further note is that investors may avail themselves of other NAFTA dispute settlement procedures. Indeed, the chapter 11 procedures complement rather than substitute for more traditional ones.

NAFTA members may take numerous exceptions to the chapter 11 obligations, including general exceptions (e.g., national security) and country- and sector-specific ones, spelled out in the annexes to chapter 11 (discussed in detail in Gestrin and Rugman 1993; Graham and Wilkie 1994).

The environmental accord negotiated as a "sidebar" to NAFTA includes a provision that no country will lower its environmental standards in order to attract a new investment undertaking.

NAFTA also contains provisions on competition policy and the regulation of state enterprises and state-sanctioned monopolies, as well as measures to liberalize trade in financial services, which inter alia grant right of establishment to financial service providers of one NAFTA country in the territories of others.

Somewhat offsetting the liberalizing provisions of the NAFTA in the view of many are complex rules of origin. These prescribe complex and legalistic procedures for calculating local content, which, in the view of at least some analysts, favor incumbent firms over new entrants from outside North America.

It is too soon to assess the effectiveness of the NAFTA provisions on direct investment. In principle NAFTA investment provisions represent a significant net step forward. Indeed, many of these provisions parallel the description of an ideal international accord on direct investment, described in the previous chapter.

APEC

The APEC Ministerial Declaration of the meeting in Jakarta, Indonesia, in November 1994 endorsed a set of nonbinding investment principles. The APEC Eminent Persons Group had suggested just such a course at the 1993 ministerial meeting in Seattle. The APEC Committee on Trade and Investment (CTI) developed the APEC principles for consideration at Jakarta, following instructions of the APEC heads of state, who met at Blake Island, Washington, just after the Seattle ministerial meeting.[9]

The CTI experts group on investment principles met several times

9. Also, the Pacific Economic Cooperation Council (PECC), through its Trade Policy Forum, had developed a similar set of principles in the form of a model voluntary code for direct investment. This code was presented for APEC members' consideration at the Seattle meeting.

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during 1994 to draft the principles. It was agreed that the objective of these principles would be to facilitate, rather than to inhibit, FDI and technology transfer. The principles would be strictly nonbinding and thus, inter alia, would not prejudice existing applicable international instruments, including bilateral investment treaties. The representatives of the various APEC nations expressed considerable diversity at the CTI meetings on what policy regimes toward FDI were desirable, and in the end many compromises were struck. As a result, they emphasized principles to which the APEC nations as host nations to direct investment might aspire rather than be bound:

- **Transparency**. Member countries are to make all laws, regulations, administrative guidelines, and other instruments of policy (including those instruments by which policy is actually implemented) publicly available in a readily accessible form.
- **Nondiscrimination between source economies**. Member countries are to extend to investors from any nation treatment in relation to the establishment, expansion, or operation of the investors' investments (e.g., subsidiaries) that is no less favorable than that accorded to investors from any other nation in like circumstances.
- **National treatment**. With exceptions as provided for in domestic laws, regulations, and policies, member nations are to accord to foreign investors, in relation to the establishment, expansion, operation, and protection of their investments, treatment no less favorable than that accorded in like situations to domestic investors.
- **Investment incentives**. Member nations should not relax health, safety, and/or environmental regulations as an incentive to foreign investments.
- **Performance requirements.** Member countries are to minimize placing of performance requirements on foreign investors as a means of achieving policy objectives in circumstances where these would distort or limit expansion of trade and investment.[10]
- **Expropriation and compensation**. Member nations should not expropriate foreign investments or take measures that have the effect of expropriation on a nondiscriminatory basis, except for a public purpose and in accordance with the laws of the country and principles of international law. If an investment were expropriated, the investor would be adequately and effectively compensated.

10. It should be noted that member nations of the WTO will be subject to the TRIMs agreement, which will disallow the use of certain types of performance requirements such as domestic-content or trade-balancing requirements. Because most APEC member nations are WTO members, some believe the APEC agreement represents retrogression.

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- **Repatriation and convertibility of funds**. Member nations are to allow the free and prompt transfer of funds related to FDI—such as repatriation of profits or dividends, royalties, loan payments, and liquidations—in freely convertible currencies, subject to the laws of each country.
- **Dispute settlement**. Disputes arising in connection with a foreign investment are to be settled promptly through consultations and negotiations between the parties to the dispute (the investor and the host-nation government) or, failing this, through procedures for arbitration in accordance with members' international commitments or through other arbitration procedures acceptable to both parties.
- **Entry and sojourn of personnel**. Member countries are to permit the temporary entry and sojourn of key foreign technical and managerial personnel connected with foreign investment, subject to relevant laws and regulations.
- **Avoidance of double taxation**. Member countries are to avoid double taxation of FDI-related income.
- **Investor behavior**. Foreign investors should facilitate acceptance of investment by abiding by the host nation's laws, regulations, administrative guidelines, and policies.
- **Removal of barriers to foreign capital**. Regulatory and institutional barriers to the outflow of investment are to be minimized.

One question that might be legitimately asked: if these principles are not binding, of what value are they? Do they, for example, protect investors in any meaningful way from arbitrary or capricious actions by host or home governments? Given that governments are not bound by the principles, a violation of any of them could not be challenged in national courts because these principles would have no standing in domestic law. Likewise, it is hard to conceive of a government being willing to enter into arbitration of a dispute involving alleged breach of one of the principles under the ICSID or UNCITRAL rules. Thus, in a legalistic sense, the principles provide no protection.

The principles could be of value, however, if APEC governments were inclined to bring national law and policy into conformity with the principles or even simply that in the de facto exercise of law and policy they elected to observe the spirit of the principles. Western lawyers might be somewhat discomfited by the rather imprecise language of the principles. But in the legal tradition of many of the East Asian nations—as far as civil law goes, at least—the letter of the law is somewhat loosely or even ambiguously stated and the law is interpreted according to rules of reason. Also, the East Asian approach to dispute

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settlement is to seek resolution through informal means as much as possible and in a fashion where neither party "wins" or "loses" but where both parties accept an outcome that is fair to both. Such an approach requires a common understanding of what is fair. The APEC investment principles might thus help establish such an understanding in the national policy domain.

Whether or not this comes to pass, the APEC experience in crafting investment principles demonstrated two things. The first is that a diverse group of nations, including some of the most dynamic of the newly industrializing economies, were willing to discuss an international convention on direct investment embodying the principles recommended in the previous chapter. The second, alas, is that while these nations are willing to talk about principles, they are not yet prepared to bind themselves to act on them. At the end of the day, the APEC investment principles were nothing but a hortatory declaration, and in language that is often ambiguous as well. The principles represent the beginning of a dialogue, but not a satisfactory end product.

Bilateral Treaties

In addition to the multilateral efforts just described, there have been bilateral treaties to advance international agreement on investment. Perhaps the most successful have been those governing the tax treatment of global corporations. A key object of many of these treaties is preventing double taxation by host and home country. In some cases, bilateral treaties have resulted in a small degree of tax law harmonization.

Of more limited success have been bilateral investment treaties (BITs) struck between European and developing nations, as well as similar treaties between the United States and a few developing nations. BITs typically provide for national treatment, freedom of capital movement, and some protection against expropriation.

In principle, full global liberalization of investment policy could be achieved via a large network of BITs. In practice, this would be difficult to achieve. If BITs were to be written between each pair of the nations, the total number of such treaties would exceed 7,000. Simply to negotiate these would require a virtual army of lawyers, and BITs now link relatively few pairs of nations.

It is sometimes argued that until the world is ready for a multilateral investment accord, BITs can fill some of the role such an accord would play. But most nations willing to enter into a BIT with, say, the United States probably would be willing to consider entering into a multilateral investment accord. Accordingly, BITs would seem to be something of a stopgap measure at best.

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Changing Positions of Major Home and Host Nations

As this survey indicates, existing international rules on direct investment are incomplete both in terms of geographic and substantive scope. But why has international agreement in this area proved so difficult to achieve? In answering this question, we shall also explore why some of these difficulties may be waning.

Industrial versus Developing Nation Perspectives

One reason for these difficulties has been disagreement between industrialized and developing nations on exactly what investment rules might be necessary. The United States, home to a majority of the world's FDI throughout much of the postwar era but now also the world's largest host nation, has historically viewed any accord that might be achieved on international investment as something that would apply principally to host-nation governments. US leaders believe, in essence, that outcomes of international trade and investment should be market-driven in order to be welfare-maximizing and that interventionist host-government policies are globally welfare-reducing, even if they increase local welfare. If one accepts this rationale, one accepts ipso facto the need for disciplines to limit interventionist policies. This explains why the TRIMs exercise was US-led and oriented almost exclusively to host-nation policies and practices.

Policymakers in most developing countries by contrast have perceived global corporations as powerful monopolists in the host-nation market that also tend to act as agents of home-nation policies. Thus, these nations have seen global firms as not necessarily serving developing nations' own interests. Leftist economists long argued that selective government intervention could reduce both the total rents these firms captured and the percentage of rents transferred back to the home nation. Governments of developing nations therefore have tended to view any international direct investment disciplines as something that should be brought to bear first on the global corporations themselves and second on their home nations. These perceptions explain why the UN code of conduct exercise, initiated by the Group of 77 developing nations, focused largely on the regulation of the global corporations themselves (in UN parlance, "transnational corporations," or TNCs) rather than host nations.

National interest groups, as well as economic reasoning, has shaped industrialized and developing nations' stances on investment policy. In the United States, for example, the two most prominent groups have been the US-based global corporations themselves and organized labor.

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Global firms have largely supported official US efforts to discipline host-nation policies but have often differed with official priorities at the level of specific policy measures. In particular, the global firms would accord greater priority than has the US government to right of establishment and equity limitation issues and less to investment incentives or performance requirements. Off the record, representatives of global corporations have indicated that when right of establishment was taken "off the table" in the GATT TRIMs negotiations, most US global corporations lost interest in the outcome of these negotiations, and that this is one reason for the comparatively weak outcome that characterizes the agreement.

The US labor movement in contrast has generally opposed outward investment by US-based firms, claiming that it leads to domestic US job loss. Organized labor has thus supported US efforts to discipline performance requirements. But the labor movement on the whole sees this discipline as at most a second-best solution. In their eyes, the best solution would be unilateral US policies limiting the ability of US firms to place direct investment abroad.

Thus, although both of these interest groups supported US efforts to create GATT disciplines on TRIMs (with lukewarm enthusiasm at best), the congruence between their interests and the official position has been by no means total. And on other issues (e.g., right of establishment), US global corporations and organized labor diverge.

Developing-country positions also to some extent mirror the interests of local constituencies. In particular, in many developing nations, local industries have grown up as protected monopolies.[11] One source of pressure in these countries for international regulation of global firms comes from local monopoly suppliers seeking both to maintain their protected status and to gain access to global firms' technologies and markets. Performance requirements, such as local-content and export requirements, can serve the interests of local producers who resist efforts to liberalize economic policies. In some cases, these requirements can also serve the interests of incumbent operations of multinational firms that have carved out dominant positions in certain markets.

Again, local interests have not been the only force behind developing countries' policy preferences, as enunciated by the Group of 77. Many policymakers still uphold the long tradition of intellectual support for interventionist policies to protect small nations from the putative market power of global corporations. Yet one of the ironies of modern economic life is that intervention to protect these nations from international monopoly may help perpetuate local monopoly.

Certain developing countries, however, have adopted a more accom-

11. The local monopolists in some cases include subsidiaries of international firms that entered the developing-nation markets under preferential arrangements.

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modating stance toward multinationals. These nations have recognized and sought the many benefits of FDI (e.g., technology transfer) but have simultaneously enacted policies, performance requirements in particular, to maximize the local economic benefit of this investment.

Europe

What about nations that neither follow the increasingly distant drumbeat of the Group of 77 nor fully subscribe to the total reliance on the free of the United States?

The European Union is both home and host to multinational firms, and most member governments have been both somewhat more sympathetic to the developing-nation perspective with respect to discipline on these firms than has the United States and somewhat less willing to impose strong discipline on host governments. Part of the reason for this doubtlessly derives from European nations' postwar status as host governments themselves. During the late 1960s and early 1970s, there was a groundswell of fear in Europe that the European economic landscape would be dominated by US-based global firms (see, e.g., Servan-Schreiber 1967).[12] Fear of US domination has largely subsided in Europe, to be replaced to some extent by fear of Japan.

Overall, many European nations have thus been somewhat ambivalent regarding international rules on FDI. At least some of the ambivalence has its roots in politics. Certain constituencies in Europe, for example, have opposed any effort to discipline host-country policy. These have included bureaucracies within national governments in Europe that have liberally used both investment incentives and performance requirements to lure new FDI projects to their territories. Ireland stands out in this regard.

But even in countries where national policy has not been especially oriented toward attracting FDI, antidiscipline constituencies can be found. For example, most regional development authorities in Europe have used investment incentives and performance requirements, including those that were ideologically committed to free trade (e.g., the Thatcher and Major governments in the United Kingdom and certain of the Länder in Germany). Indeed, even governments critical of global corporations (e.g., France under Gaullist governments) have used these measures quite liberally to attract FDI on terms favorable to the domestic economy. Thus, these authorities are themselves a constituency for subsidies. And of course it stands to reason that the recipients—both firms and regions—would also lobby for continued subsidies.

12. However, interestingly, within Western Europe (and not just the European Union) sympathy for the developing-nation perspective has been strongest in the Scandinavian countries, not themselves major hosts to US-based firms.

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There have been European constituencies on the other side. Finance ministries throughout Europe have criticized regional policies and the accompanying subsidies. Officials have often questioned the policy of using subsidies to lure activities to regions where they have not been viable and then, for political reasons, continuing to subsidize them (see, e.g., *Financial Times*, 10 July 1992; *The Economist*, 10 June 1995, 70, and 16 December 1995, 73). Further, the finance ministries have noted that investment incentives to non-European global firms have often simply prodded new business activities to relocate from one region of Europe to another with no net gain to Europe as a whole. Europe may in the aggregate have even experienced net losses because the subsidies may have resulted in a transfer of resources to foreign shareholders. Thus, when Europe stood in favor of the TRIMs during the Uruguay Round, it harkened to the collective voice of European finance ministries. But at other times other constituencies have drowned out this voice.

Because it comprises more than one sovereign state, Europe, of course, does not speak with a single voice on FDI. Of the large European nations, Germany has most consistently favored restrictions on government interventions affecting FDI; this has been true under both Christian Democratic and Social Democratic governments.

By contrast, France has at times pursued highly interventionist policies toward direct investment and multinational firms; interestingly, intervention was far more frequent under Gaullist governments than under the Socialists. The United Kingdom has conditioned receipt of investment incentives on adherence to performance requirements, a practice initiated under Labor governments but virtually unchecked under the Thatcher and Major governments.

The European Commission has sought restrictions on this type of practice and generally has stood for greater discipline on international investment, in part to increase its overall authority over the granting of state aids to industry. However, this has been done under the Article 92 authority of the Treaty of Rome, as discussed above, rather than as part of an overall policy on direct investment. Indeed, as discussed earlier, it is an unresolved issue whether the European Commission has competence over direct investment.

On the whole, Europe until quite recently has been unprepared to support international rules on international investment, due in part to the political clout of those who give and receive the subsidies. But the European Union has been shifting its stance to come more into line with the US position, as is discussed below.

Japan

Until recently, Japan has been neither major home nor host to much FDI. Thus, Japan has not historically been much involved in the debate

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over the global corporation or on international discipline on FDI. However, since the late 1980s, Japan has emerged as home nation to a huge amount of FDI. As a result, Japan's position is changing: worried about the asymmetry of its direct investment position, the government of Japan has been attempting to encourage inward investment. And in the meantime, Japan has been increasingly attempting to take a leadership role in multilateral initiatives, especially the OECD Multilateral Agreement on Investment.

United States

Indeed, almost all nations have made major changes in their positions in recent years. One striking reversal was sparked by the rapid buildup of FDI in the United States during the 1980s, which made it the largest host to FDI in the world as well as the largest home nation. Beginning in the second Reagan administration and continuing through 1996, some US congressmen and senators have routinely decried a loss of "economic sovereignty" resulting from non-US firms extending their control over domestic industry and demanded that something be done to regain it. Consequently, a number of legislative changes have been enacted or proposed that have altered the liberal policy position of the US government toward FDI. Neither the Bush nor the Clinton administrations backed the most radical proposals, and thus these have failed to be enacted. Nevertheless, some of the changes do represent a retreat from the principle of national treatment for foreign-owned firms (see discussion below).

The most important measure to be passed, the Exon-Florio provision of the Omnibus Trade and Competitiveness Act of 1988, gave the US president greater authority to block foreign takeovers of US domestic enterprises.[13] The measure applies only to cases where national security is "impaired or threatened to be impaired" by the establishment of an affiliate of a foreign-controlled firm on US soil through a merger, acquisition, or takeover of an existing US operation. Thus, national security is marked as a legitimate "carve-out" for national governments in exercising obligations under international law. However, implementation of Exon-Florio has been characterized by moderation.

In fact, the Bush administration chose to implement Exon-Florio in consonance with what it perceived to be the minimalist objectives of the original legislation (Graham and Ebert 1991). Of several hundred cases notified to the Committee on Foreign Investment in the United States

13. The original measure was linked to the Defense Appropriation Act and had to be renewed with this act. However, in late 1991, the measure was made part of permanent US law. (See Graham and Krugman 1995 for a fuller treatment of Exon-Florio.)

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(CFIUS) during 1988-92, only fourteen were subject to a full investigation, and only one actually was blocked.

This one case was the proposed takeover of a minor firm in the US aerospace industry by a state-owned enterprise of the People's Republic of China, and the block was seen as a largely politically motivated reaction to the events in Tiananmen Square in 1989. However, in the summer of 1992 state-owned French firm Thomson CSF withdrew a proposed takeover of the missiles and aerospace division of LTV almost surely because the deal would have been blocked under Exon-Florio. Some observers have seen this as a slight hardening of the administration's position on foreign takeovers of defense-sensitive US properties, and the deal led to changes in the administration of Exon-Florio that tilt in this direction.

Some analysts expected the Clinton administration to pursue a more activist enforcement of Exon-Florio than did the Bush administration. During the first three years of the Clinton administration, however, there were no controversial acquisitions of US high-technology firms, and thus it is difficult to distinguish any change in the level of activism. Indeed, what is most striking is that there is no evidence of a harder line.[14] To be sure, the Clinton administration has promulgated administrative changes to Exon-Florio, but these were in fact formulated during the last year of the Bush administration.

These are the new provisions:

- Investors controlled by a foreign government may not acquire US defense contractors with Department of Defense or Department of Energy contracts totaling more than $500 million in any one fiscal year.
- Entities under foreign government control cannot receive contracts involving access to information classified as "top secret" or higher, unless a waiver is granted by the secretary of defense.
- All cases where an investor under the control of a foreign government seeks to acquire or merge with a US firm producing defense-related technologies (including dual-use technologies) are subject to a mandatory Exon-Florio investigation.
- The president's science and national security advisers are added to CFIUS, the interagency group that conducts Exon-Florio reviews.
- Detailed reports must be presented to Congress of all cases CFIUS reviews.

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14. To many observers, the strongest indication of the Clinton administration's policies toward FDI lies not in its implementation of Exon-Florio but in its acceptance of NAFTA, with its strong investment chapter.

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- The secretary of defense can require that analysis of the potential for diversion of critical technology be part of a CFIUS investigation.
- In an investigation, CFIUS must consider a transaction's impact upon US "international technological leadership in areas affecting US national security" and also consider the potential effect of the transaction upon proliferation of nuclear, chemical, and biological weapons and upon the capabilities of countries that support terrorism.
- The Departments of Defense and Energy are required to create data bases to identify entities controlled by foreign governments that might pose risks to national security and to report to Congress on these.

The net effect is to produce an assumption against acquisition of US firms engaged in anything remotely high-tech by investors controlled by foreign governments (even friendly ones) and to move toward more specific criteria for determining what is in the interest of "national security."

Other laws besides Exon-Florio have been enacted since 1988 that place some restrictions on the participation of foreign firms in US high-tech activities (Warner and Rugman 1994). For example, the Energy Policy Act of 1992 allows a foreign-controlled firm to be eligible for Title XX through XXIII programs (which involve mostly programs for research, development, and commercialization of new energy-related technologies) only if certain reciprocity tests are met—basically, that US firms are afforded "comparable" participation in similar programs in the home country, have right of establishment in that country, and are afforded "adequate and effective protection" through home-country intellectual property rights laws.

Also, the Department of Energy, before allowing participation in one of these programs by a foreign-controlled firm, must determine that such participation is in the economic interests of the United States. Similar requirements must be met before a foreign-controlled firm can participate in the Department of Commerce's Advanced Technology Program (ATP), originally established under the 1988 Trade Act but amended in 1991 to include reciprocity requirements by the American Technology Preeminence Act. Likewise, similar requirements must be met if a foreign-controlled firm is to be allowed to participate in certain projects related to defense conversion, as specified in the 1993 defense appropriations bill. Responsibility for certification of eligibility for both the ATP and the defense conversion projects is given to the secretary of commerce.The National Cooperative Productions Act amendments of 1993, which exempt some manufacturing and R&D joint ventures from certain US antitrust provisions, also contain reciprocity requirements, most notably that the foreign-owned company's home country must grant national treatment to US firms. However, national treatment is to be

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assumed if the country participates in an international treaty requiring national treatment for US investors. Amendments to the Stevenson-Wydler Technology Innovation Act of 1980, passed in 1993, require that foreign-controlled firms participating in collaborative R&D arrangements with US national laboratories be from countries that allow US firms access to similar programs in those countries.

Additional reciprocity measures were contemplated in a number of bills before the 103rd Congress, including the Aeronautical Technology Consortium Act, the National Environmental Technology Act, the National Competitiveness Act, defense authorization legislation, the Hydrogen Future Act, the National Aeronautical and Space Administration Authorization Act, and the Omnibus Space Commercialization Act. None of these measures actually passed, but they did reflect the mood of the Congress before the November 1994 elections and are thus detailed here.

The most controversial of these were the Manton and Collins amendments to the National Competitiveness Act. This act itself would have amended and greatly expanded a number of existing acts, including the Stevenson-Wydler Act and the provisions of the 1988 Trade Act that established the ATP. The National Competitiveness Act would have authorized a wide range of government-funded or -organized consortia in R&D and commercialization of advanced technologies.

Under the Manton amendment (sponsored by Representative Thomas Manton, D-NY), participation in these would be limited to "US companies." A foreign-controlled company could qualify as a "US company" if reciprocity standards were met. Specifically, the amendment would have required a finding by the secretary of commerce that the country of the parent company provides US companies with "comparable" opportunities, offering them "access to resources and information equivalent to the opportunities offered under this legislation," and has an "open and transparent standards-setting process." Under the Collins amendment (sponsored by Representative Michael Collins, R-GA), the US government would be prohibited from providing any direct financial aid to anyone not a US citizen, national, or legal alien.

Critics feared that the Manton amendment would have violated precisely those national-treatment standards that the United States has long advocated as part of international law and, in doing so, set reciprocity standards that would have been difficult for most countries, even those that adhere to national-treatment standards, to meet. The Collins amendment, in turn, could have (under some interpretations) prevented any foreign-owned or -controlled company from participating in the relevant programs, no matter how well the reciprocity standards were met.

None of these measures actually passed into law in 1994. The Clinton administration opposed the Manton and Collins amendments, as did a number of large US business groupings, and as a result the National

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Competitiveness Act failed to pass.[15] But some analysts claim that some other aspects of current US policy implicitly violate national-treatment principles. The partnership between the US government and the US auto industry to develop a new generation of fuel-efficient automobiles is cited as one example because foreign-owned firms are apparently (though not explicitly) excluded from this partnership. Whether the actual working of the partnership de facto violates national-treatment principles is difficult to determine.[16]

None of the measures just discussed were resuscitated during the Republican-controlled 104th Congress, currently in session at the time of this writing, despite the fact that there is a wing of the party (represented by Patrick Buchanan among others) that might favor such measures. Thus, for the moment, the furor over foreign participation in government-sponsored or government-funded R&D consortia that fueled the Manton Amendment has calmed down. Whether this will continue to be the case should the Democratic Party regain control of one or both houses of Congress or should the current Republican majority move further to the right is uncertain, however.

In some contrast to the US Congress, individual US state governments tend to be wildly pro-FDI. Most of these governments in 1992 were actively courting inward direct investment, often offering potential investors large investment incentives to locate within their jurisdictions.

The Effect on Europe and Japan of US Shift

Overall, the United States has shifted its policy on FDI toward a little more conditionality in the application of national-treatment standards to some foreign-controlled firms operating in the United States. On balance, this has really not been a very great change. Nonetheless, Europe and Japan understandably view any change in US policy, however slight or subtle, toward less liberalization with alarm because they are major home countries to FDI in the United States. Consequently, the shift in US policy has led to subtle shifts in the positions of both the European Union and Japan.

For example, the European Union was a lukewarm US ally during the early 1980s on the issue of bringing GATT disciplines to bear on host-nation policy toward FDI. The EU position became apparent when

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15. Letter to Representative John Dingell, chairman of the US House of Representatives Committee on Energy and Commerce, from US Secretary of Commerce Ronald H. Brown, 15 June 1994; letter to Secretary Ronald H. Brown, 27 July 1994, signed by heads of several prominent US business organizations.

16. This is just the sort of issue an international investment dispute settlement mechanism could usefully address (see discussion in chapters 4).

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the United States proposed, at a 1981 meeting of the GATT Consultative Group of 18 (CG-18), that the GATT Secretariat compile an inventory of trade-related investment measures. The European Union indicated support for the modest proposal in principle but then effectively killed it by indicating that resource constraints prevented it from being given priority. Since then, Europe has moved much closer to the US position. For example, by 1990, as previously indicated, the EU and US positions in the TRIMs negotiations were virtually identical.

Why did Europe modify its position in favor of such discipline? Almost surely leading the list would be pressures from European-based global corporations. These firms have seen their stakes in their overseas affiliates rise enormously in the last decade, and thus their awareness of the detrimental effects of host-nation policies on their affiliates' interests has risen as well.

Indeed, the host nation these European firms are most wary of in this regard is the United States. Consequently, European officials have expressed great concern over the shift toward conditional national treatment exhibited in the proposed US laws outlined above. Their shift toward support of international discipline on host nations thus partly reflects their desire to secure a more liberal US policy.

But the shift probably also reflects the growing scope of the European Commission's jurisdiction in determining EU trade policies. As noted earlier, the Commission has long favored greater discipline on international investment and is claiming that international investment issues fall under EU competence rather than that of member-nation governments. Where this competence actually will reside, as it happens, will depend upon the venue in which new arrangements are negotiated (see chapter 6).

Firms based in Japan have even more cause to be wary of the United States. Much of the US furor over foreign-controlled enterprises is an offshoot of a larger hostility toward Japan, which was reflected in congressional attitudes in the late 1980s and early 1990s. Most probably in response to pressures from Japanese industry, the Japanese government has hardened its position in favor of increased discipline on host countries.

Latin America

But nowhere have attitudes toward FDI and multinational enterprises shifted more than among many of the developing nations. In many of these countries, the debt crisis of the early 1980s led to a reevaluation of their opposition to FDI as a means of drawing foreign capital into their economies.

Under the de la Madrid administration, Mexico opened its economy to attract foreign direct investors. Mexico's participation in the drafting

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of NAFTA, with its pioneering provisions on direct investment, followed substantial unilateral liberalizing measures (Graham and Wilkie 1994). In June 1993, Mexico announced that it would incorporate its obligations under chapter 11 of the NAFTA into domestic law and extend most-favored nation (MFN) status to all foreign direct investors and investments in Mexico, thus effectively extending the NAFTA obligations to all nations and all investors.[17] Other Latin American nations have also unilaterally liberalized their policies toward FDI, most notably Chile, Argentina, Venezuela, and Colombia (Hufbauer, Schott, and Clark 1994).

Chile began to reform its FDI regime in the late 1970s, well before the other countries, but a number of restrictions remain, such as those on profit repatriation, where other Latin American nations have dropped them. In addition, Chile continues to screen new inward FDI. Chile will likely be required to liberalize its policies further as a condition of joining NAFTA, as it seeks to do.

Argentina began in 1989 to liberalize its policies, abolishing most performance requirements, freeing capital movement, and providing national treatment for foreign-owned firms. The reforms were fully codified in a 1993 decree.

In 1989 Colombia issued a decree to implement reforms along lines similar to those of Argentina (i.e., to provide for national treatment, free movement of capital, and abolition of performance requirements). Colombian officials have claimed that its policies toward inward FDI were by 1993 even more liberal than those of Mexico. However, many significant sector-specific restrictions remain.

Venezuela's reforms are less extensive, with some performance requirements and many sector-specific exceptions to right of establishment and/or national treatment remaining.

Not all Latin American nations have put FDI reforms in place. The major exception is Brazil, which still maintains a quite restrictive regime, including numerous sectoral restrictions on foreign ownership, restrictions on capital movement, and a plethora of performance requirements.

The movement toward investment liberalization in Latin America must be evaluated in light of historic perceptions of these nations: FDI has long implied to them loss of control over their own destiny. But the debt crisis brought home to a number of these nations the fact that sovereign debt to international banks can imply even greater loss of control. In addition, the experiences of a number of Asian nations, especially Taiwan, Singapore, Hong Kong, and several other of the fast-growing Southeast Asian countries have also demonstrated that a degree of openness to FDI can bring many developmental benefits.

17. ''Obligations'' in this instance is to be interpreted as those in NAFTA chapter 11, part A. Non-NAFTA investors do not have recourse to the dispute settlement procedures (and the host-nation obligations under these procedures) of NAFTA chapter 11, part B.

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East Asia

Will this lead to greater support among other developing nations for multilateral discipline on FDI? The answer may lie in those Asian countries that have used FDI to advantage. Singapore, Hong Kong, Malaysia, Thailand, and, to a lesser degree, Taiwan generally welcome FDI, but with strings attached. The strings are in the form of performance requirements, especially those designed to increase local value added and exports (and thus are prohibited under the terms of the final TRIMs agreement). These countries showed considerable reluctance to give up these policies during the TRIMs negotiations. This reluctance was further borne out in discussions held during 1994 leading to APEC's adoption of its nonbinding investment principles, which, as noted earlier, were substantively weak as well as nonbinding.

But officials of these countries are worried about trade restrictions in the industrialized world that can be invoked as sanctions for performance requirements (e.g., the United States has taken action against Taiwanese performance requirements under section 301 of the trade act on grounds that their effect is to nullify the benefits of liberalized trade to the US economy). With the implementation of the Uruguay Round, these countries almost surely will have to phase out performance requirements that are inconsistent with the TRIMs agreement or face the near certainty of sanctions. They might thus be willing to exchange new rules restricting performance requirements on foreign investors for a stronger multilateral discipline on bilateral sanctions.

But perhaps an even bigger impetus to these nations' acceptance of international rules is the opening of China to FDI. Since 1990, China has become quite open to FDI, where before it was virtually closed. With a home market potentially larger than any other in the world, China has received a large and growing amount of FDI (see chapter 2).

China's policies are not wholly unrestrictive. Direct investors in China often must meet performance requirements, but they have often received investment incentives.[18] A number of basic issues remain unresolved in China: property rights, including intellectual property rights, are often ill-defined or poorly enforced, and affiliates of foreign firms operating in China are often denied national treatment. However, the attraction of the Chinese market, and the desire of many multinational firms to establish foothold operations there, has resulted in substantial numbers of foreign firms entering China, often in joint venture with Chinese partners, with no indication that the flow of FDI into China will abate significantly in the near future.

The interest of foreign investors in China has proved worrisome to a

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18. At the time of this writing, China was taking steps to reduce the number and magnitudes of investment incentives being offered.

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number of its Asian neighbors, who fear possible diversion of investment from their markets. These fears do not seem well founded. For example, Urata (1995) demonstrates that FDI into China by Japanese electronics firms has not displaced the activities of these firms in other Asian nations. Nonetheless, this fear of diversion has encouraged Asian officials to at least enter into dialogues about whether international rules might be useful. The APEC nonbinding investment principles represent one manifestation of this willingness. As little as five years ago, even this limited agreement would have not been feasible.

Other Developing Nations

Even some developing countries that continued to take a hard line on rules on FDI during the 1980s and to espouse the "new international economic order" have shown some inclination toward liberalization in the 1990s. Leading the list is India, whose policy stance in international forums did not change during the 1980s, despite some internal liberalizing reforms attempted under the Rajeev Ghandi administration. However, in the 1990s India has begun to recognize the benefits of FDI and accordingly has loosened its regulations regarding inward direct investment. It would be premature to announce that a major policy shift has been effected there—in international forums India still clings to its hardline position—but the beginnings of such a shift are clearly evident.

Conclusion

This chapter demonstrates that most of the elements of an international accord on direct investment outlined in the previous chapter exist in one international agreement or another. However, the myriad international agreements on direct investment amount to something of a crazy quilt. Coverage of existing agreements is partial both in terms of geography (different nations participate in different agreements, and some nations participate in several) and substance. Provisions of some agreements are nonbinding, as in the case of the APEC investment principles, or unenforceable as in the case of the OECD codes and instruments.

Wouldn't it make sense to convert this crazy quilt into one coherent agreement that operated worldwide? This question is addressed in the next chapter.

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