6

Negotiating and Implementing an Investment Accord

Finding the Right Forum

Once negotiated, any accord on international direct investment and multinational enterprise must be implemented and administered. This entails empowering an organization to take on the task, including the dispute settlement mechanism.

In this chapter, two alternative venues for the negotiation, implementation, and administration of an accord on FDI are explored: through the World Trade Organization, or WTO (Jackson 1990; Julius 1994) or through a more limited group of nations such as the Organization for Economic Cooperation and Development (OECD). Other alternatives can be envisaged—for example, an entirely new international organization to deal only with investment issues—but these two are probably the most likely candidates. During the fall of 1995, the OECD nations in fact began negotiations on a Multilateral Agreement on Investment (MAI), and so this chapter focuses largely on specific issues that are likely to arise in the context of these negotiations. However, other accords with limited participation can be envisaged: for example, via regional economic groups such as the North American Free Trade Agreement (NAFTA), which already contains extensive provisions relating to foreign direct investment (FDI), the Mercado Común del Sur (Mercosur), the Asia Pacific Economic Cooperation (APEC) forum, the European Union, and/or other regional arrangements.

Because of their immediacy, the OECD negotiations warrant close examination. However, whether the OECD either will be or even should

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be the ultimate venue for an accord on FDI is not a settled issue. Direct investment has also been suggested as a "new issue" for the WTO and will almost surely be included on the agenda for the WTO ministerial meeting to be held in Singapore in late 1996. Therefore, both the WTO and the OECD (as well as regional arrangements other than the OECD) must be considered as viable alternatives, and thus arguments for and against each are laid out here.

The World Trade Organization (WTO)

A strong case for implementing a future accord on FDI through the WTO can be advanced on both substantive and institutional grounds. The main substantive argument for electing the WTO is that trade and investment policy issues are inextricably linked (Julius 1994). In services, trade and investment are especially linked, a fact that motivated the Uruguay Round negotiators to construct the General Agreement on Trade in Services (GATS), which is as much an investment agreement as it is a trade agreement.[1]

International trade and direct investment are also intimately related in many manufacturing industries, though the GATS agreement is not designed to apply to them. Global corporations handle a large percentage of world trade (more than one-third of merchandise trade), and its share in some nations is even higher (e.g., as high as one-half in the United States; see chapter 2). And, as has been covered in earlier chapters, the overall scope of WTO rules pertaining to direct investment in manufacturing is narrow and inadequate, despite the creation of the Trade-Related Investment Measures (TRIMs) and Trade-Related Aspects of Intellectual Property Rights (TRIPs) agreements, which do apply to this sector as well as to services.

On the institutional side, the principal case for including a direct investment accord in the WTO is that its membership includes most of the world's nations and will likely be enlarged to include the few that are not (such as China). OECD membership, by contrast, includes but a handful of developing nations. But developing nations are increasingly important both as host and home nations to direct investment. The barriers to FDI in these nations are typically higher than in the developed-country OECD nations, and thus the potential benefit of an investment accord is significantly greater if it were to cover many if not all developing nations.

The fact that most of the world's nations are presently members of WTO is both a plus and a minus. If a satisfactory accord on investment

1. But, as noted in chapter 5, the "positive list" approach to implementation of GATS constrains the coverage of the key national-treatment provision.

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could be negotiated and implemented within the WTO, it would involve most of the nations of the world, a very desirable goal. But to be effective, any such accord would necessarily cover new ground beyond the competence that at present is granted to the WTO and hence would require extensive new negotiations. Even a minority of WTO members could hamstring such negotiations at the outset. Such obstacles could be serious even in an ongoing negotiation that on the surface appeared to be heading in the right direction.

For example, many of the shortcomings of the TRIMs agreement can be traced to the original negotiating mandate that all measures covered in this agreement be directly and explicitly trade-linked and that any new measure, to the greatest extent possible, be placed in the context of existing GATT articles. This narrow mandate virtually precluded creative thinking or indeed even a thorough consideration of the relevant issues involving investment. If an issue was determined to not be "trade linked," it could not be considered, no matter how relevant or urgent it might have been in a broader context. This has led certain prominent authors to wonder if the WTO is a suitable vehicle for dealing with global issues such as investment and technology policy. Ostry (1990, 89) notes, for example, that "the rules-based GATT is not appropriate to deal with the innovation policy set [of issues]." Indeed, the WTO's own procedures prevent it from doing so. An effective investment accord within the WTO would require major rethinking and redirection of this organization's role.

APEC's struggle to negotiate nonbinding investment principles attests to the difficulties the WTO could expect on this score. The APEC exercise, involving a number of important WTO member countries (and one important prospective member, China), demonstrated that a number of these countries are not at present prepared to take on binding new obligations regarding direct investment. Many of the dynamic, newly industrializing nations of East Asia are among the most reluctant, despite their efforts over the past 10 years to liberalize policies toward direct investment.

However, as is noted later, the APEC experience might not be the definitive word on what might happen if investment issues were included in a future round of comprehensive negotiations under WTO auspices. Because of the multiple issues a large multilateral round covers, progress can be made on all fronts through compromises and trade-offs across areas, where negotiations dealt with one by one would have stalled.

It is also possible that the reluctance to adopt investment rules will erode as policy liberalization continues. As discussed in chapter 5, reevaluation and liberalization of policies toward direct investment have taken place in many nations, including the East Asian nations, with a resulting overall trend toward greater openness. Even if this trend has not now reached the point where a strong investment accord can be achieved,

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it may yet. For example, 10 years ago, consensus on even the relatively weak, nonbinding principles that were agreed in the APEC would not have been possible. If liberalization continues apace, a meaningful WTO investment accord may become politically feasible in another 10 years.

Furthermore, a plurilateral agreement within the WTO is not out of the question—that is, an agreement could be constructed to which only a subset of member nations would sign on. There are precedents to such agreements (e.g., the Agreement on Government Procurement negotiated originally in the Tokyo Round). Of course, for such an agreement to have meaning, a majority of the largest host and home nations to FDI would have to be signatories. However, all of the nations that would sign an OECD agreement would presumably also sign such a plurilateral agreement, and some nations not party to the OECD agreement might sign on as well. In such a case, a plurilateral WTO agreement would definitely be preferable to an OECD-only agreement.

It is also possible that an effective investment accord might be more feasibly negotiated in the context of new, comprehensive negotiations to further modernize international trade law, rather than as a stand-alone exercise aimed exclusively at FDI. This, again, is because there would be more scope for "give and take" (as there was in the Uruguay Round) than is possible in more narrowly focused talks. Thus, for example, developing countries might be more willing to enter into an agreement granting strong rights of national treatment to direct investors if these countries were to receive greater access to developed nations' markets for goods and services in products for which they hold comparative advantage.

Finally, a case for the WTO can be made on grounds of the increased leverage that can be gained vis-à-vis the ongoing accession talks with nonmember nations, especially China and Russia. In both of these nations, issues of national treatment for foreign-controlled enterprises loom large. In recent discussions over future Chinese membership, it has been made clear that improvements in the treatment of foreign-controlled enterprise will be one condition for this membership. An investment code within the WTO thus could motivate policy reform within both nations.

Alas, although this means of promoting investment policy liberalization would be of utility now, negotiations at the WTO level could not begin until 1997 and would presumably not be concluded for at least a year or two. Until then, the OECD MAI is the "main show in town" with respect to investment policy.

Organization for Economic Cooperation and Development

There are two main arguments for creating an agreement on investment within the context of the OECD: first, such an accord could be

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freed from the current WTO constraint that all issues be explicitly trade-linked, and second, the OECD nations have relatively common goals respecting what the rules governing international trade and investment should be. Thus, these nations ought to be in a better position to create an effective agreement than is the WTO. Whether this is in fact the case is, of course, an untested proposition.

Whether or not the OECD can achieve an investment agreement embodying significantly higher substantive standards than the WTO might rest on how well the MAI does in terms of national treatment. No OECD nation has openly opposed granting national treatment to foreign-controlled enterprises, both as it applies to existing businesses and to right of establishment, as long as reservations and derogations are allowed. But a number of questions naturally arise. Should there be restrictions on the scope of these reservations and derogations? Would signatory countries to an MAI be allowed to retain all existing reservations and derogations? Would these countries be allowed to add new reservations and derogations once the MAI came into force? Should there existing reservations and derogations be rolled back?

Interviews with officials from a number of countries have led this author to conclude that the OECD countries probably could agree to treating most (but not all) reservations and derogations in much the same manner as they were treated in the drafting of the NAFTA:[2]

- national treatment obligations are binding on all NAFTA governments, including state, provincial, and local governments;
- all existing reservations and derogations are "grandfathered"—that is, allowed to remain in effect (but certain Mexican reservations are to be phased out over time);
- all existing reservations and derogations at national, state, and provincial levels are to be listed item by item;
- under a "standstill" provision, the lists may not be expanded.

But is the "grandfathering" and "standstill" outcome good enough? OECD member countries have many such reservations in place (including but not limited to sector-specific ones) that are more than irritants. One objective of the MAI must therefore be to identify these and to resolve the difficulties that they pose. In the following, these reservations are identified by major category and an effort is made to determine where major difficulties lie.[3]

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2. OECD terminology is maintained here; the NAFTA refers to "reservations and exceptions."

3. There is some overlap in the categories presented here, but this is necessary to illustrate the facets of various problem areas.

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Potential Thorns in Negotiations over National Treatment

A number of issues including national treatment will arise in MAI negotiations. The most salient of these are discussed in this section. The same issues would arise if the accord were negotiated elsewhere; hence, the following discussion is relevant regardless of whether they are negotiated within OECD, the WTO, or, indeed, some other group.

Screening of Inward Investment

A number of member countries (e.g., Japan, Canada, Mexico, France, and Belgium) have on the books laws that permit government screening of inward foreign investments on economic or public-interest criteria (in the case of France, only acquisitions and not new "greenfield" investments can be screened). US government officials have indicated informally that, in their view, screening authority on any but national security criteria constitutes an unacceptable denial of full right of establishment and that the MAI should bar this screening on any except national security grounds.

One would hope that this largely anachronistic issue can be resolved. Those countries that legally can screen inward investment no longer exercise the authority particularly aggressively (if at all). Also, most countries that have screened investment can accomplish the same objectives through other, nondiscriminatory means (e.g., application of competition policy, especially merger control, which poses no national-treatment objections).

The easy solution would be for countries simply to allow such authority to lapse *de jure* in order to bring national law and policy into conformity with an MAI. But will this happen? One OECD member, Mexico, reportedly was willing to allow its authority to lapse as part of the NAFTA negotiations but decided to hang on to it in the face of Canadian determination to retain the Investment Canada Act, which establishes Canadian screening authority. Consequently, NAFTA permits screening of FDI. Where other relevant nations come out on this matter is yet to be revealed, but one would hope in the context of an MAI that Mexican sensibility would prevail in Canada and other nations that still have this authority.

National Security Exceptions

Almost all OECD nations agree that nations must be allowed to maintain national security exceptions to national treatment, but there is considerable variance as to how encompassing these should be. In the off-the-record interviews, officials of certain OECD nations said they thought the US Exon-Florio provision oversteps the bounds of what a legitimate national security exception ought to be. As is covered in some detail in

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chapter 5, this law gives the US president the authority to block a takeover of a US firm by foreign investors if the takeover threatens to impair the national security and if no other remedy to the threat is available in law. Such decisions are final and not subject to court challenge.

Most OECD member nations have some means to block takeovers of domestic economic activity by foreign interests for national security reasons. The US authority is exceptional in that it explicitly applies specifically (and only) to takeovers by foreigners. Also, because the Exon-Florio authority leaves very open the question of exactly what constitutes a threat "to impair the national security," a xenophobic US president could use the authority to block virtually any takeover of a US firm by any foreign investor for any reason whatsoever.

Although objections to the discriminatory nature of the Exon-Florio law (and the fact that it is not subject to judicial review) could be raised in the context of an MAI, most OECD members most likely see the objective of this law as legitimate. What MAI negotiations could usefully address is the appropriate bounds of national security exceptions to national treatment. As one senior US official explained, at the extremes it is easy to see where exceptions do and do not apply: a foreign takeover of a hotel chain does not threaten national security whereas a takeover of a major aerospace firm may pose such a risk. But many cases that come before the Committee for Foreign Investment in the United States (CFIUS), the interagency committee that administers Exon-Florio, fall into a gray area. For example, should the government, on national security grounds, mandate that a producer of specialized capital goods for manufacturing advanced integrated circuits maintain domestic ownership? In one celebrated case, the acquisition of the US-owned firm Semi-Gas by the Japanese firm Nippon Sanso, the US president ruled "no," but many in the US Congress (and, apparently, in the US Defense Department) criticized the decision. Clearly, the definition of boundaries for these exceptions need examination and clarification.

Exceptions for Cultural Activities or Industries

The problem largely arises in the context of the video broadcasting and motion picture industries, where France, Italy, and Canada reserve a certain percentage of capacity (i.e., broadcast time, film showings) for domestic produced or, in the case of the EU, regionally produced material. These nations argue that without such set-asides, foreign-made productions (especially US-made ones) would dominate available capacity, thus undermining the cultural identity of the local populace. The counterargument is that people should be allowed to view what they wish, irrespective of its origin.

Technology will likely make the whole issue moot. The expression

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“information superhighway” has become something of a cliché, but underlying it is a very real phenomenon, notably an explosion in the number of modes by which a high volume of information can be conveyed. Fiber-optic communications networks can now or soon will give households access to hundreds of video channels, including movies. Millions of books, documents, and data bases can be accessed via the Internet or written onto compact discs (and households commonly possess desktop computers that can access on-line services and read these discs). What point is there, then, in attempting to reserve some portion of information transmission capacity for local content? It is likely that households will eventually have ready access to virtually every “cultural” product ever made. If governments then attempt to restrict household access to foreign-produced products, circumvention of will be increasingly easy and costless.

Governments worried about preservation of local culture would be far better advised simply to make sure that local cultural activities survive and that the products of these activities are accessible (even by subsidizing them, if there is a consensus that this is a wise use of taxpayer money). Also, governments should recognize that expansion of the channels and modes of information transmission will almost surely in the long run help make these activities viable.[4]

Also, efforts of nations to limit expansion of the “information superhighway,” or to put burdensome controls on the data that flow along it, are likely to be detrimental to the competitiveness of firms within those nations that depend upon information flow. Government review and permission is required for data transmitted in and out of Singapore, for example. Consequently, certain major financial institutions have located data processing operations elsewhere, to the detriment of the growth of Singapore as a major financial center.

Nonetheless, reservations to national treatment for cultural activities and sectors will remain an issue in the MAI negotiations. But the issue can be resolved via bargaining. The United States, which objects to such reservations, will likely accept some such reservations (or, at least, will mute its objections) if these are sufficiently small in scope and coverage. Certain European nations and Canada will seek reservations of greater scope. A compromise likely can be reached such that none of the concerned governments will be particularly happy with the outcome. And

4. The proliferation of modes of information transmission might indeed bring new prosperity to local culture because of a widening of the market for products embodying this culture. For example, this author has recently taken to viewing films made in China that are available on videocassette, an activity that would have been unlikely before the advent of this technology. By viewing them (and paying for the privilege), the author is doing his part to ensure that the Chinese film industry remains viable. And, when such films can be obtained via on-line access, as is almost sure to happen, this will expand the market for such films.

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in the end, the day will come when these governments realize that technology has made the issue truly moot.

Closely related to this issue is that of restrictions on participation by foreign-controlled firms in information transmission sectors; these restrictions are mostly created by government-sanctioned monopolies and associated practices. These are discussed separately below.

Technology Support Programs

As noted in the previous chapter, concerns over this issue have flared in recent years because of legislation proposed before the 103rd US Congress (the Democratic-controlled Congress of 1993-94) that would limit participation by firms under foreign control in certain US government-sponsored programs. The European Union was particularly vigorous in its opposition to the proposed legislation—none of which actually passed into law. Canada, Japan, and other OECD member nations also expressed concerns through a number of official channels.

At the top of the list of objections have been the Manton and Collins amendments to the National Competitiveness Act—the Manton amendment for its impossibly high reciprocity standards and the Collins amendment for prohibiting European participation in key programs, regardless of reciprocity standards (see chapter 5).

On the other hand, the Manton amendment was a response to perceptions of some members of the US Congress that US firms and their subsidiaries were excluded from technology programs sponsored by foreign governments and/or were barred from selling technologically sophisticated goods in certain foreign countries. Furthermore, these practices and barriers were perceived as not always transparent. Congressional ire centered mostly on Japan, but certain European programs (e.g., the ESPRIT information-technology R&D program and the JESSI semiconductor research program) also evoked concerns. Likewise, foreign firm participation has been restricted in certain US R&D consortia, such as Sematech.

This is another issue that is liable to fade with time. The Manton and Collins amendments did not become law, nor has the Republican Congress shown interest in reviving them. Both Europe and Japan have eased strictures against admitting foreign-controlled firms into technology consortia receiving public assistance.

Nonetheless, participation of foreign-controlled firms in government-sponsored R&D consortia and other technology programs is a valid issue for MAI discussions. Technology consortia are likely to grow in scope and importance, and more of these will involve participants of more than one nationality. They should be subject to unconditional national treatment except where a valid national security issue is involved. Technological development is, after all, very much a positive-sum game, and

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the long record of history reveals that it is pointless to try to contain commercially useful technology within a national boundary. Furthermore, in the relatively few cases where overriding national security considerations demand that certain technologies not be transferred (e.g, those associated with the production of nuclear weapons), it is best that all countries holding these technologies limit the transfer in concert.

Governments must, of course, set criteria for choosing participants in government-funded technology consortia. Not all applicants will be chosen, whether the applicants are domestically or foreign-owned. Thus, a useful exercise would be an examination of whether a truly "nationality-neutral," transparent national benefits test—or other criteria for selection—can be devised. If so, perhaps it could become the norm within the MAI: all countries would agree to use such tests and criteria in selecting program participants.

State-Sanctioned Monopolies and Other Sector-Specific Reservations

Certain sector-specific reservations, and especially those involving state-sanctioned monopolies as exceptions to national treatment, are likely to be among the most contentious of all issues raised in the context of an MAI.[5] Some of the sectors involved (e.g., telecommunications services) are among the most dynamic in terms of both growth potential and pace of technological development.

Alas, there is a high potential for impasse on this set of issues. In the NAFTA negotiations, for example, neither Canada nor the United States rolled back any sectoral exceptions to national treatment. Mexico agreed to roll back some of its restrictions, but had a much longer list to start from, and these sectoral "concessions" involved sectors that officials had already decided should be at least partially liberalized (e.g., petrochemicals, where much modernization of the Mexican industry is needed).

Discussions in this area thus are likely to be characterized by aggressive efforts on the part of some nations to reduce others' reservations while retaining their own. For example, as already suggested, the US government will push hard for liberalization in information industries such as telecommunications services but will defend its own anachronistic Jones Act restricting foreign participation in intra-US maritime shipping. In such an environment, few if any sectoral reservations will likely be removed.

This would be a shame. To be sure, some of these reservations, the

5. The effect of state-sanctioned monopolies is to deny right of establishment to foreign-controlled firms. Although it could be argued that no national-treatment issue is involved because domestically controlled firms also lack right of establishment, this would seem disingenuous, given that some domestic firm (often state-controlled) does have access to the sector.

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Jones Act among them, are little more than irritants, but they are irritants with little contemporary justification. They should be reduced or eliminated.

Most contentious will be those associated with the transmission and processing of information; the relevant sectors center around (but are not limited to) the computer and telecommunications industries. The telecommunications industry in many OECD nations is characterized by state-sanctioned monopoly in the provision of services and preferential relations between the service provider and capital goods suppliers.[6] The industries are undergoing rapid technological change, and new technologies are creating market opportunities, some of which overlap other industries that increasingly must be viewed not as separate sectors but as different domains in one large industrial complex (as in fiber-optic network services to transmit products of the film, television, or publishing industries).

The issues involved in "mega-sectors" go well beyond investment reservations, and, indeed, these issues illustrate better than any other example the intertwining of trade and investment. Is cross-border data transmission a trade issue or an investment issue? It has to date been categorized as a trade issue, but if one starts to examine who has the right to construct and operate fiber-optic "loops," the investment component enters the picture quickly.

The transformations in this sector are so profound the whole issue of state-sanctioned monopoly probably ought to be reexamined more or less from the beginning. Do the preconditions originally used to justify monopoly (e.g., the existence of "natural monopoly") still exist, and if so, in what subsectors of the industry? In what subsectors can competition be of most benefit?

Will MAI discussions proceed to sort out these issues rationally? Probably not. Nonetheless, countries should recognize that there is much intellectual basis for reexamining sectoral restrictions in the name of national interest. Such a recognition could go a long ways toward liberalization of existing sectoral reservations.

Other Issues Related to National Treatment

There are additional issues related to national treatment, three of which are discussed here: most-favored nation (MFN), corporate governance, and privatization.

Most-Favored Nation (MFN) In the context of OECD, agreement on language for a most-favored nation clause should be easily attained.

6. However, deregulation and privatization are changing the structure of the industry in some of these countries.

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What will not be easy, however, is agreement on whether there should be any exceptions (or, as they are termed, "carve-outs") for "regional economic integration organizations" (the European Union and NAFTA are examples of REIOs). If an REIO is granted such a carve-out, a member state could offer better treatment for regional investors (and the entities in which they invest) than the MAI offers; that is, it would not have to extend this treatment to MAI signatories outside the REIO. In the NAFTA, non-MFN treatment to NAFTA members is largely confined to use of the dispute settlement procedures of chapter 11, part B (see chapter 5).

In the case of the European Union, the carve-out would likely extend to sectoral exceptions to national treatment. This would imply an end to sectoral reservations among REIO members but that they would remain in effect with respect to other MAI participants.

Fearful that intra-European sectoral liberalization (e.g., telecommunications and other common carrier activities) would not be extended to US-based or other multinationals based outside the European Union, the US business community opposes a REIO carve-out, and the US government position will likely reflect this opposition. The European Union maintains that the carve-out is necessary. In the case of banking, for example, EU members have agreed on minimum standards in the EU Second Banking Directive to allow home countries to supervise certain activities of multinational banks owned and domiciled in the European Union, and non-EU nations might not meet these standards.

Thus, in the OECD negotiations, EU member nations almost surely will demand a carve-out, and the NAFTA member states will almost surely seek to prevent it. Further, this demand extends beyond EU membership to include countries with which the European Union has association agreements. A possible compromise might be an MFN carve-out that would apply to banking alone. But whether either EU member states or the United States is prepared to commit to this idea specifically (a banking MFN carve out) or even the generic idea (sector-specific MFN carve outs) is a matter to be determined.

It is safe to say that the carve-out issue will be contentious and that the potential for deadlock is quite high. If such a carve-out is allowed, it might open the door for future carve-outs for other regional groups such as APEC.

Corporate Governance It is widely acknowledged that differences in corporate governance among countries affect the ease with which takeovers can be achieved. For example, cross-holdings of equity within and across large financial *keiretsu* in Japan make it very difficult or impossible for a firm to achieve an unfriendly takeover of a *keiretsu* member (regardless of whether a foreign or domestic investor mounts the take-

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over bid; see Lawrence 1993).[7] Similarly, large-scale holdings of equities in German companies by the largest German banks make it difficult to mount unfriendly takeovers in that country. In other countries, such as the United Kingdom and the United States, the equity shares of many major firms are widely held, such that it is relatively easy to achieve unfriendly takeovers.[8]

There is a long-standing and largely unresolved debate over whether a relatively easy unfriendly takeover is socially preferable to a relatively difficult or impossible takeover. To distill the debate (and thereby risk oversimplifying), many financial economists argue that prohibitively high barriers to unfriendly takeovers prevent corporate "raiders" from taking control and removing the old management of an underperforming firm.

But it is also argued that a constant threat of unfriendly takeovers can lead to "short-term" outlook—that is, management is inclined to increase reported current earnings at the expense of longer term performance. In Germany and Japan, it is argued, the major institutional shareholders, who have a major stake in the firm's performance, will act against managerial malfeasance and thus fill some of the positive role of the corporate raider. An emerging empirical literature does, however, lend credence to the hypothesis that unfriendly takeovers improve managerial performance and that major institutional shareholders are often slow to respond to managerial problems even where they have a major stake.

Whatever the outcome of this debate, there is little question that the ease or difficulty of achieving unfriendly takeovers varies from nation to nation. The issue for the MAI is whether to address these asymmetries.

On this issue, two additional points must be made. First, existing asymmetries do not constitute *de jure* exceptions to national treatment—that is, in countries where unfriendly takeovers cannot be successfully mounted, the barrier applies to domestic as well as to international investors. Second, there are private practices in some countries, regarding mergers and acquisitions, that lead to de facto discrimination against foreign investors. This would be the case, for example, if all foreign bids to acquire control of a firm under financial duress were to be treated as "unfriendly" whereas the domestic bids were viewed somehow as "friendly."

Concerns about such private practices are valid. But whether these concerns should be addressed in the MAI is open to question. They could also be addressed as part of competition policy and, indeed, such concerns might be better handled substantively by experts in this field than by direct investment experts. And, on grounds of *Realpolitik*, there

7. The "financial" *keiretsu* are sometimes termed "horizontal" *keiretsu*; examples include the Mitsui and Mitsubishi groups.

8. It should be underscored that the claim is that in these countries an unfriendly takeover is *relatively* easy. High absolute barriers to such takeovers may still be present.

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is little hope at present that any of the relevant nations would make changes in corporate governance in response to an MAI.

Privatization There seems to be some consensus among OECD member nations, or at least a large subset of them, that when publicly owned firms are privatized, the share offerings should be structured and conducted so as not to discriminate against potential foreign investors. Whether this consensus is wide enough to permit incorporation of an explicit provision in the MAI is not yet clear.

Issues Other than National Treatment

National treatment and issues related to it will not be the only difficult issues in MAI negotiations. The OECD will have to also address performance requirements and investment incentives.

Performance Requirements

The challenge for the MAI, it would seem, is to do at least as well in restricting performance requirements as NAFTA did (see chapter 5). It should be relatively easy to ban performance requirements, at least as conditions of entry, in six of the categories on the original list of those the Uruguay Round negotiators considered in the Trade Related Investment Measures (TRIMs) negotiations.[9] After all, the United States, the European Union, and Japan all favored such a ban during the TRIMs negotiations.

But can a longer list be agreed upon? On this, a list prepared by the OECD Business and Industry Advisory Committee (BIAC)—which includes all eight items on the original TRIMs list plus one additional item, manufacturing limitations—is the right place to start (BIAC 1995). All nine items should be treated in an MAI just as they were in TRIMs—that is, nonconforming measures should be first listed and then rolled back according to an agreed-upon schedule.

Investment Incentives

While the prospects of a satisfactory agreement on performance requirements are quite promising, the same cannot be said for investment incentives. Investment incentives—which are, at root, a form of subsidy—are in many OECD countries granted mostly by nonfederal governments, such as individual states in the United States and Australia, the prov-

9. These six were local-content requirements, export performance requirements, local manufacturing requirements, trade-balancing requirements, production mandates, and foreign exchange restrictions (other than those consistent with existing GATT articles).

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inces in Canada, and the Länder in Germany. The federal governments are reluctant to restrict investment incentives or other subsidies granted at the subnational level. In some OECD countries where federalism is less pronounced, the central government actively uses subsidies (including investment incentives) as instruments of industrial policy. These governments also are unwilling to give them up.

Many analysts believe the upshot is that the issue of curbing investment incentives in MAI is "dead on arrival"—it won't be taken up, let alone resolved.

This would be unfortunate for two reasons.

The first is that if participation in the MAI is to be broadened to include developing countries, and if these countries are to be asked to give up performance requirements, their governments are almost sure to ask as a quid pro quo that the industrialized countries accept disciplines on investment incentives. Developing-country governments widely perceive investment incentives as the industrialized countries' instrument of choice to offset developing-country performance requirements (and, in some cases, to offset investment incentives in the developing world). That is, they fear that these investment incentives divert investment away from developing nations.

Thus, a widening of the MAI (including ultimate implementation at the WTO level) demands that it cover investment incentives. Indeed, many developing countries would see the MAI as a less-than-serious exercise if it does not provide such coverage.

Regional Arrangements Other than the OECD

As noted in the previous chapter, there are regional agreements on FDI such as APEC and NAFTA. Regional accords on investment can contribute to investment liberalization, but they are not the ideal approach. Each regional arrangement by definition involves only a subset of the nations in which the multilateral corporations operate. By their very nature, regional arrangements will deal with parochial issues that a more global arrangement might avoid (e.g., rules to determine which entities qualify for benefits under the accord and which do not, including the "rules of origin" that are ubiquitous to free trade areas).

Nonetheless, regional accords might have a strong role to play as stepping stones toward more global arrangements. Regional accords might provide experience regarding which measures are beneficial and which are not. Positive experience in one region might lead to liberalization in other regions, or even a policy competition among regions that "ratchets up" substantive standards. For example, if APEC were to revisit direct investment issues and develop a code with substantively stronger provisions than those of its current, nonbinding principles, this might in turn

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put pressure on WTO negotiators to create a strong investment instrument.

In the end, if such "ratcheting up" were set in motion, one would expect substantial similarity among regional agreements. When and if this state of affairs comes to pass, it would be a relatively easy task to pull the common elements of these agreements together into a global code (Bergsten 1996). Thus, regional investment agreements are probably best viewed as a means to a global accord on investment rather than an end in themselves.

NAFTA has already demonstrated that an investment instrument can be embodied within a regional agreement that involves a developing country—that is, one that has historically been outside the ranks of the OECD.[10] Can the NAFTA precedent be extended to cover other nations or other regions?

One obvious possibility, already being pursued in talks with Chile, is NAFTA enlargement. But another possibility would be enlargement of the substantive scope of existing regional agreements to include investment issues. A candidate would be Mercosur, the common market arrangement between Argentina, Brazil, Paraguay, and Uruguay. Mercosur has no investment chapter now, but given the scope and pace of investment liberalization in many of the member nations, this could change. Mercosur itself might in the future be enlarged into a free trade and investment area that encompassed all of Latin America and even eventually joined with the NAFTA, a goal embodied in the vision of a future Free Trade Area of the Americas (FTAA) as put forth at the 1995 Summit of the Americas in Miami.

As noted in the previous chapter, APEC agreed on a set of nonbinding investment principles at the 1994 APEC ministerial meeting at Jakarta, Indonesia. These principles could be the basis for an investment accord within APEC. However, as also noted previously, the existing principles would first have to be strengthened as well as made binding.

Another candidate for an investment agreement is the European Union. The original Treaty of Rome establishing a European Common Market did not contain a comprehensive set of principles regarding direct investment, although the founders envisaged free movement of labor and capital among the member nations. The various EU acts and directives since enactment of the Treaty of Rome (including the almost 300 directives that constituted the "Europe 1992" effort, as well as capital-movement liberalization measures associated with the Maastricht Treaty) have subsequently created something of a de facto direct investment accord within Europe. However, the European Commission and the governments of the member states share authority over many FDI-related

10. Mexico did, however, join the OECD in 1994.

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issues, while individual member states retain competencies over certain aspects of direct investment policy (e.g., the right to screen inward investment, including on national security grounds, and the right to impose performance requirements and/or link these to investment incentives).[11]

While FDI flows within the European Union are relatively unfettered, Europe might still benefit from a common (and liberalized) policy on FDI, especially with regard to FDI from nations that are not EU members. However, the shared competence of the EU and national on FDI-related issues constitutes a serious obstacle. Consequently, the European Union will likely continue to move toward a de facto common policy while its member governments retain specific competencies.

Where Do We Go from Here?

The main policy question posed by the globalization of business is whether remaining barriers to direct investment (and other forms of commercial activity of multinational firms conducted outside their home countries) are to be lowered further. These barriers will never disappear altogether. However strong the case that direct investment enhances economic welfare, there are interests of national governments that are not wholly congruent with those of multinational firms—those involving issues of national defense being the most obvious example. An international accord on direct investment could encourage national governments to regulate multinational activity in a uniform manner, as well as prohibit or at least discourage certain government actions that collectively reduce welfare.

Can a consensus among nations be developed with respect to what, if any, standards should be embodied in such an accord? Although no such consensus has yet been achieved, it is more likely today than at any time in the postwar period. For example, within APEC, officials have been able to agree on principles to which nations might eventually aspire; one suspects that even this degree of consensus could not have been reached five years ago, and certainly not ten years ago.

If the ultimate objective is an effective accord on investment that would be global (or nearly global) in coverage, then the two alternatives discussed in this chapter are really but two different means to this end. Agreements among limited sets of nations, including regional agreements and the OECD MAI, might in this light simply be seen as stepping

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11. One important implication, relevant to negotiation of a multilateral accord on direct investment, is that neither the Commission alone (as it does on matters of international trade) nor the governments of the EU member nations alone can negotiate on behalf of the other.

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stones toward an accord that eventually could be embodied in the WTO.

Thus, the question becomes, which of the two alternatives is the more promising? In a world of global corporations, an accord on direct investment should itself be global in scope. Inevitably, this suggests that the WTO is the ultimate venue for such an accord. But how soon could it be achieved? Should limited agreements such as that in NAFTA or those that are soon to be negotiated such as the MAI be allowed to run their course in the interest of "experimentation" before the WTO takes up the issue, or should the WTO move into this domain quickly following the 1996 ministerial?

Obviously, the world community must decide the answer before the 1996 WTO ministerial meeting in Singapore. And they should decide to act. The WTO should begin negotiation of an investment accord immediately following this meeting, and the MAI negotiations should be terminated in deference to the WTO negotiation. Although useful in the absence of WTO talks, the MAI negotiations involve too few nations to accomplish very much. Indeed, much of the value of an international accord on direct investment lies in getting non-OECD nations to sign on. For this to happen, these developing nations must actually participate in the creation of the accord, something that is not possible as long as the main negotiation takes place within the OECD. Even if the WTO outcome were to be an agreement of somewhat less substance than can be achieved in the OECD, the value of greater global coverage outweighs the risk of lesser substance.

Conclusions

The ultimate goal of an international accord on direct investment is to foster the free flow of capital, technology, and managerial expertise across national boundaries. Such rules should be subject to minimal limitations necessary to maintain national defense capabilities, to assure that investment flows do not endanger human health or vitality, and to assure that global firms do not attain monopoly status or otherwise engage in practices that reduce competition. The free flow of capital, technology, and know-how will enhance the efficiency of economic activity everywhere, due to both direct effects, such as technology transfer, and indirect effects, such as increased competition and spillovers.

This goal would be best met if nations were to extend the law and policy of the WTO further into the investment domain by adopting an accord embodying the provisions laid out in chapter 4. This would be preferable to other alternatives, such as the OECD's Multilateral Agreement on Investment (MAI), for two reasons: First, the WTO accord would cover the most territory—most of the world's nations are already mem-

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bers and most of those that are not now seek membership. Second, the substantive provisions of such an accord could be linked to and made consistent with other WTO agreements, a desirable end because of the inextricable links between direct investment and international trade.

Is the world ready for an investment accord of the sort proposed here? The economic case for such an accord is compelling. As detailed in chapter 2, the scope of globalized business is large and growing. Direct-investment-related activity figures at least as much in the globalization of the world economy. Equally important are the pervasive links between this activity and international trade.

The main obstacles to a global investment accord are political. At root is the clash between the objectives of sovereign nations and those of global corporations. Such clashes makes the need for an effective enterprise-to-state dispute settlement mechanism paramount: creating such a mechanism (or upgrading existing ones) would be a chief end of an international investment accord.

At the time of this writing, negotiations for the OECD MAI are ongoing and the Singapore summit meeting of the WTO was set for December 1996. The Singapore meeting will likely reveal how much weight the WTO intends to give to investment issues. Two things can be said about the current situation: First, the existence of the OECD negotiations should not deter the WTO from launching its own effort to create an effective investment instrument. Second, if continued, the OECD effort should be conducted with an eye to the possibility that it will be melded into a future WTO negotiation.

Should the WTO negotiate an investment accord in isolation from other trade issues (as the OECD now seems to be doing)? The answer is clearly no. The Uruguay Round left numerous trade and trade-related issues as "unfinished business"(Bergsten 1996; Feketekuty 1996). The reasonable thing for the WTO to do would be to launch a series of exercises to address all of these issues. In this context, an investment accord would be one of several parallel undertakings.

This might sound like a call for a new round of multilateral trade and investment negotiations. It is. The agenda of the WTO was left unfinished with the end of the Uruguay Round, and the global economy is developing too fast for this unfinished business to remain unfinished.

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