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# UNWANTED, UNPRODUCTIVE AND UNBALANCED: SIX ARGUMENTS AGAINST AN INVESTMENT AGREEMENT AT THE WTO

May 2003

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This paper is a response from leading UK development organisations to some specific arguments put forward in support of a multilateral investment agreement (MIA) at the WTO. Rather than reiterate all the arguments against such an agreement, it challenges some particular claims put forward by proponents of an MIA. The paper demonstrates that – despite the EU’s attempt to repackage it as an ‘Investment for Development Framework’ (IDF) – such an agreement would be against the interests of developing country members of the WTO.

This paper does not engage with the wider debate on the merits and challenges of foreign investment. Foreign investment can bring genuine benefits to the economies of developing countries and to some of the poorest communities in those countries. Yet it is wrong to assume that it will necessarily afford these benefits, or that foreign investment does not bring its own risks. The international community has an obligation to ensure that foreign investment works to the maximum benefit of development, and to guard against any threats to that higher goal.

## THE SIX ARGUMENTS

1. **An MIA would not increase FDI flows to the poorest countries**
2. **Non-discrimination is not a successful development strategy**
3. **GATS-style flexibility is a myth**
4. **An MIA at the WTO would not be a balanced agreement**
5. **An MIA would not see the end of bilateral investment treaties**
6. **A new set of complex negotiations might break the Doha camel’s back**



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## 1. An MIA would not increase FDI flows to the poorest countries

A common claim made in favour of an MIA at the WTO is that the increased security and predictability this provides investors will translate into greater FDI flows to developing countries, and in particular those marginalised countries which currently receive only meagre FDI inflows. Hence the statement from the UK Government, one of the foremost proponents of an investment framework at the WTO, that:

*This framework should help to create investor confidence through certainty, credibility and transparency, a confidence from which the poorest countries stand to benefit the most.* (UK Government 2003)

There is no evidence that an MIA at the WTO will lead to greater foreign investment for the poorest and most marginalised countries, let alone that they will be the ones “to benefit the most”. The UK Government has confirmed that it can point to no evidence for the claim it makes in the above statement, in that the two studies it cites in support of the claim relate to competition for investment between and within the larger developing countries, which already receive a significant majority of FDI flows to the South.

By contrast, there is an extensive literature stretching back over several years which indicates that an MIA will not lead to increased FDI flows to the poorest countries. The strength of this body of evidence has led the World Bank to conclude that:

*[A]n international agreement that seeks to substantially increase investment flows by increasing investor protections seems destined, on the basis of available evidence, to fall short of expectations. Some key issues are already covered by relatively strong investor protections in BITs. Moreover, it is not clear that any investor protections emerging from multilateral negotiations would add markedly to existing protections found in bilateral agreements. Finally, merely creating new protections does not seem to be strongly associated with increased investment flows. For these reasons, the overall additional stimulus of multilateral rules that apply to new investment over and above unilateral reforms would probably be small – **and virtually nonexistent for low-income developing countries.*** (World Bank 2003: 133; emphasis added)

This conclusion supports evidence already gathered in relation to investment flows arising from GATS. Foreign investment in services accounts for half of the world total of FDI flows, and developing countries have been assured in the past that making GATS commitments would increase the level of FDI they would receive in future. Yet this ‘signalling’ has not brought additional FDI flows to host countries as they had been led to believe. As UNCTAD concluded, on the basis of its assessment of the impact of GATS commitments on foreign investment:

*There is no empirical evidence to link any significant increase in FDI flows to developing countries with the conclusion of GATS.* (UNCTAD 2000a: 172)

The World Bank reports similar findings for bilateral investment treaties (BITs), which – despite being typically more ambitious than multilateral agreements – have also had minimal effect in increasing FDI flows. Noting the findings of a recent survey of FDI flows from OECD members

to 31 developing countries over 20 years, as well as previous UNCTAD research, the World Bank acknowledges:

*Countries that had concluded a BIT were no more likely to receive additional FDI than were countries without such a pact. (World Bank 2003: 129)*

It is well established that the key determinants of FDI flows to the poorest countries are economic and infrastructural determinants. UNCTAD's comprehensive analysis of the constraints on capital flows to LDCs highlighted in particular the costs of asset development, vulnerability to shocks, lack of business support services, weak physical, social and administrative infrastructure and the typically small scale of projects in the poorest countries (UNCTAD 2000b: ch.3).

By contrast, surveys conducted in order to identify key investment determinants in the poorest countries reveal that regulatory and legal frameworks do not constitute a major obstacle to investment decisions – particularly in light of the considerable liberalisation of FDI regimes in recent years. One survey of investment determinants across 30 African countries identified the regulatory and legal framework as having a negative impact on investment decisions in under 5% of cases (UNCTAD 1999: 51). Another confirmed that while foreign investors in Africa see the existence of a reform programme with the World Bank or IMF as a sign of stability, “they do not rank this as an important factor in investment decisions” (Bhinda et al. 1999: 55).

As a result of this accumulated evidence, there is a strong consensus that an MIA at the WTO is unlikely to lead to increased FDI flows to the poorest countries. The UK Government and others should therefore abandon their unsubstantiated claims to the contrary.

## **2. Non-discrimination is not a successful development strategy**

Most economic historians agree that during the earlier stages of development, countries from the UK right through to more recent examples such as Finland, China and Malaysia have systematically discriminated between domestic and foreign investors in their industrial policy. They have used a range of instruments to build up national industry, including limits on ownership, performance requirements on exports or local employment, insistence on joint ventures with local firms and barriers to brownfield investments.

Only when domestic industry has reached a certain level of sophistication, complexity and competitiveness do the benefits of non-discrimination and liberalisation come to outweigh the costs. As a result, countries generally move towards a greater degree of non-discrimination and liberalisation as they develop, as seen most clearly in the case of countries such as Taiwan and South Korea. In that sense, liberalisation is better seen as an *outcome* of development, not a cause. As noted by Professor Dani Rodrik:

*There is no convincing evidence that trade liberalization is predictably associated with subsequent economic growth. The only systematic relationship is that countries dismantle trade restrictions as they get richer. (Rodrik 2001)*

Non-discrimination, and in particular national treatment, has historically seldom been part of successful development strategies. When challenged, even the most well-versed World Bank trade specialists have struggled to identify a single country which has developed on this basis – US

investment negotiator William Tagliani, replying to this question at a March 2003 investment seminar in Geneva, suggested South Korea!

Cambridge economist Dr Ha-Joon Chang summarises the historical evidence in a forthcoming paper entitled *The WTO and Foreign Investment: Don't do as we did, do as we say* (Chang and Green 2003; see also Chang 2002). The title reflects the concern among many developing country delegates at the WTO that the remarkable historical amnesia being displayed by the rich countries stems more from double standards and self-interest than any genuine urge to enable others to learn from developed countries' past mistakes.

At the very least, this absence of any historical basis for the assertion that an MIA at the WTO would be 'pro-development' places an added burden of proof on its proponents. Those proponents argue that developing countries can be guaranteed 'policy space' to protect pro-development policies by making the agreement very flexible. As suggested by EU negotiator Fabien Lecroz to the Geneva seminar mentioned above: "You could be a WTO member, a signatory of an investment agreement, and keep your market completely closed to FDI, and with no national treatment. That is your policy choice."

Yet non-discrimination is a 'core principle' of the WTO, part of its institutional DNA. However much flexibility may be provided initially, there will be an inevitable tendency for negotiators to close down developing countries' national policy space in this and successive rounds of negotiations, forcing them into a developmentally premature application of national treatment to FDI. This has already been the experience of developing countries in relation to the supposed flexibility of GATS (see next section), and underlines for them why an MIA at the WTO will fail to work in the interest of their economic development.

### **3. GATS-style flexibility is a myth**

Following the language of the Doha Ministerial Declaration, EU submissions to the WTO make reference to using a 'GATS-style approach' to a new WTO investment agreement, claiming that this will provide flexibility for developing countries to protect national development policies in the face of non-discrimination disciplines. However, GATS is not a model of flexibility. It is in fact undermining the ability of developing countries to use appropriate policies to achieve development (Hardstaff 2003).

In particular, the arguments over the 'flexibility' of GATS are flawed because:

- Its rules (e.g. on *de facto* discrimination, domestic regulation and subsidies) are riddled with uncertainty, encouraging a more cautious approach by regulators for fear of infringing WTO rules and making it difficult to list exemptions.
- It requires governments to know, in advance, all the possible GATS incompatible regulations they, or successive governments, might want to use in future in order to list exemptions at the time of making commitments.
- It effectively 'locks in' policy, making it virtually impossible to alter commitments in the future. This denies future governments the option to change economic course, roll back liberalisation, increase regulation or list extra exemptions.

- It has no end point. GATS requires successive rounds of negotiations aimed at progressively higher levels of liberalisation. The regulatory exemptions governments list in one round of talks are targeted for removal in the next.
- It is an extremely complex agreement involving bilateral negotiations and multilateral commitments, providing opportunities for political and economic pressure to be exerted on developing countries.

Experience with GATS clearly shows that a ‘GATS-style positive list approach’ does not guarantee the flexibility developing countries need to pursue appropriate policies. In fact, over time, GATS guarantees a steady *reduction* in flexibility. As the Indian Ambassador to the WTO highlights in raising concerns over a proposed investment agreement, “As our experience with services has shown, great pressure would be brought to bear on developing countries to give greater – and still greater – market access to developed countries in these areas in subsequent stages.” (Permanent Mission of India, Geneva, 2003)

Given the explicit proposal that a WTO investment agreement should be based on the same approach as that used in GATS, it is clear that the proposed MIA will also fail to provide the flexibility developing countries need to protect their national development policies and to ensure that FDI works to the benefit of their economies and their peoples.

#### **4. An MIA at the WTO would not be a balanced agreement**

Proposals in favour of an MIA at the WTO envisage a new set of disciplines and obligations on host countries, bound and enforced through the mechanisms of the WTO. By contrast, there is no mention of the parallel responsibilities of investors and their home governments. This imbalance threatens to undermine national and international attempts to hold foreign investors to account for their activities – and in particular TNCs.

In part, this imbalance is because the WTO is a negotiating forum for nation states, and has no jurisdiction over investors. This highlights further why the WTO is not an appropriate forum for dealing with investment issues, which require a different set of instruments and expertise from those established under the trade mandate of the WTO. Once again, the unsuitability of the WTO in this regard has been clearly demonstrated in the GATS context, where the intrusion of free trade principles behind national borders threatens key standards and regulations which are vital to the successful delivery of services.

The binding nature of host countries’ WTO liberalisation commitments can be contrasted with the voluntary nature of TNC codes of practice, be they adopted unilaterally by individual companies or applied on an international basis, such as the ILO and OECD guidelines. Attempts to turn UN codes of conduct on TNCs into enforceable international treaties have been actively resisted by developed country governments – yet the provisions of codes such as the UN Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices and the Draft Human Rights Principles and Responsibilities for Transnational Corporations and Other Business Enterprises are there to be incorporated into legally binding agreements, if developed countries are prepared to drop their opposition to such a move.

Developing country delegates to the WTO have raised this issue of imbalance on numerous occasions, most notably in the joint submission by six delegations, including China and India, in November 2002 (China et al. 2002). However, the call to restore balance between host countries' and investors' obligations has gained greater international momentum in the wake of the recent spate of corporate fraud and accounting scandals. The plan of implementation agreed at the World Summit on Sustainable Development held in Johannesburg in September 2002 called for urgent action to promote corporate accountability at all levels, including through "full development and effective implementation of intergovernmental agreements", as a means to making globalisation equitable and inclusive.

Relations between TNCs and host countries are in many cases already tilted in favour of the investor, not the potential development benefit of the investment. A new set of obligations on host countries bound and enforced through the WTO would tilt the balance still further, and make it increasingly difficult either to defend the domestic economy from the worst abuses of foreign investors, or to use FDI to its maximum development advantage. Instead of pursuing an MIA at the WTO, any energy which the international community can spend on a set of multilateral investment rules should be directed towards a binding framework of regulations governing the activities of TNCs.

## **5. An MIA would not see the end of bilateral investment treaties**

Proponents of an MIA at the WTO argue that it will free developing countries from having to negotiate a plethora of BITs, in which they will be at a greater disadvantage because of unequal bargaining power. This argument is flawed for a number of reasons.

Firstly, there is no evidence that WTO agreements act as a brake on bilateralism. The multilateral system became much more powerful in the 1990s, yet the EU and USA, among others, vigorously pursued new bilateral and regional economic agreements. Any MIA to be negotiated at the WTO would leave uncovered many aspects of investment currently included in BITs, and there would be a continuing demand for bilateral treaties to make up the shortfall. In agreement with other commentators that envisage a continued growth in the number of BITs even alongside an MIA (e.g. UNDP 2003: 251), the World Bank concedes:

*In the case of the WTO, the Doha Ministerial Declaration reflects a significantly more-limited approach that clearly does not view a multilateral framework on investment as a substitute for bilateral and regional arrangements. (World Bank 2003: 127)*

The argument that an MIA will act as a substitute for BITs is even weaker if the former is as 'light' as the EU and UK Government currently suggest.

Secondly, the TRIPS experience demonstrates clearly how, in terms of the obligations placed on developing countries, a WTO agreement acts as a new 'floor' and not as a ceiling. Morocco, Singapore, Chile and the whole of Latin America are now under pressure from the USA to agree to 'TRIPS plus' rules. Jordan has already succumbed.

Indeed, it is very hard to imagine the WTO agreeing to rules which genuinely discourage bilateral agreements by placing a *limit* on the demands that industrialised countries can make of developing countries, e.g. regarding deregulation.

Thirdly, market access negotiations within any MIA based on a GATS-style approach would be conducted bilaterally, so the scope for direct economic and political pressures remains. GATS already provides direct experience of how these pressures are brought to bear on developing countries in secret bilateral negotiations, and UNCTAD's survey of developing country delegates reveals that lack of transparency in that process is hindering their ability to defend their own interests in the negotiations (UNCTAD 2002).

As noted by H.E. Dr. Toufiq Ali, Bangladesh's Ambassador to the WTO and current coordinator of the LDC group:

*When you go into a bilateral format of the negotiations, you are vulnerable. Why? Because against a major developed country, you simply cannot withstand the level of scrutiny. And you do not have the strength in numbers that you get in the multilateral process. This is exactly what happens bilaterally in the WTO. Within a multilateral context, in the WTO, sometimes developed countries are unable to get their way with us. But when you come to the bilateral mode, we find that where they are unable to persuade us to agree to something multilaterally, they apply pressure bilaterally and get it done. (Ali 2003)*

The depressing conclusion from the last 18 months suggests that it may not be any easier to obtain development-friendly agreements inside the WTO than it is outside it, despite the fact that developing countries can club together. They joined forces over TRIPS and look what has happened: even the EU has tried to renege on the Doha agreement.

## **6. A new set of complex negotiations might break the Doha camel's back**

The launch of the Doha negotiating agenda was hailed as a breakthrough for multilateralism, and a breakthrough for developing countries, which stood to gain great benefits from new agreements on a range of issues. Now, a year and a half later, the WTO is facing a major crisis as it attempts to negotiate that agenda. Deadlines on agriculture, special and differential treatment, TRIPS and implementation have all been missed. Lack of political will among developed countries, lack of capacity in developing countries, and the sheer size and complexity of the agenda have led to extremely slow progress and now threaten complete breakdown. This would jeopardise any gains that developing countries might make from a favourable conclusion to the round.

It is quite clear that most developing countries are opposed to expanding the WTO agenda to include negotiations on the new issues. At Doha, 29 developing countries explicitly mentioned the new issues in their statements. Of these, 22 opposed their inclusion in the Doha agenda, while only three spoke in favour of their inclusion (Mexico, South Korea and Venezuela). At the most recent meeting of the WTO's Trade Negotiations Committee in Geneva (2-3 April 2003), both the Africa group and the LDCs group at the WTO reaffirmed their opposition to the launch of negotiations on these issues.

To insist upon adding new issues to a clearly unmanageable agenda at this point is misguided. Rather than forcing through a set of new negotiations which most developing countries do not want, developed countries must show more flexibility if they want developing countries to remain committed to the WTO process. Dropping the insistence on new issues would be of huge political significance, provide a clear signal that the EU is listening and is willing to address developing countries' concerns seriously. It would also go some way to improving the atmosphere of mistrust and bitterness that has characterised WTO meetings in recent months.

The problems with the Doha agenda are practical as well as political. Many small delegations are struggling with the current agenda, and simply could not engage with the new issues. They would therefore run an extra risk of an outcome that does not reflect their interests. Rather than expecting already overloaded delegations to cope with a raft of new negotiations, the UK government could propose that capacity problems at the WTO are addressed directly by looking at issues of scheduling, deadlines and organisation of meetings. There also needs to be official recognition that capacity issues will take many years to resolve – and can certainly not be addressed adequately during the lifetime of this round.

In this situation, adding more issues to an overcrowded agenda will only make the situation worse, compounding the problems being faced as negotiators attempt to work their way through the Doha negotiating agenda. New issues may prove to be the last straw for the Doha camel. The EU should drop its insistence on forcing through its aggressive agenda in face of longstanding developing country opposition at the WTO.

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