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Foreign Investment Issues in the WTO

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Summary

Negotiators remain deeply divided over efforts to develop a framework for discussing foreign investment issues for the World Trade Organization's (WTO) Fifth Ministerial meeting in Cancun in September, 2003. Members had agreed at the Fourth Ministerial at Doha that foreign investment would not be a part of the formal negotiations at Cancun, but that foreign investment issues and a framework for negotiating those issues would be agreed upon at Cancun so that negotiations could begin. The Doha Declaration also established January 1, 2005 as the deadline for completing those negotiations. One stated purpose of the negotiations is to develop a multilateral framework of rules on investment to secure "transparent, stable, and predictable" conditions for foreign investment. U.S. negotiators are pushing to achieve a number of broad objectives on foreign investment that are specified in the Trade Act of 2002 (P.L. 107-210). A number of countries and groups, including the European Union, Japan, South Korea, Switzerland, and Norway are pushing to complete the needed work so that foreign investment can be added to the next round of WTO trade talks. African nations and some Asian and Caribbean countries oppose including any discussion of investment at Cancun, which presents a significant hurdle in launching an agreement on this issue. Absent a broad multilateral agreement, nations likely will continue liberalizing foreign investment restrictions in competition with other countries or through bilateral investment treaties. This report will be updated as events warrant. Additional information about the WTO is available on the CRS Electronic Briefing Book on Trade at: [http://www.congress.gov/brbk/html/ebtra1.html].

Background

Increasingly, developed and developing countries have come to view foreign investment as an important stimulant to economic growth and as an important force for globalization. Nevertheless, foreign investment issues have long defied consensus in international forums. Foreign investment often produces sharp differences between the developed and developing countries, because it acts as a channel through which different countries' legal systems and social and economic values collide. In addition, public debates on foreign investment often focus on such perceived negative effects as environmental degradation, the transfer of technology, the erosion of culture, the potential loss of employment, and the inability of national governments to regulate or tax economic activity. In some cases, public opposition to broad multilateral investment agreements stems from concerns that such treaties encourage firms to shift more of their investment spending abroad, ultimately shifting jobs out of the United States and leading to fewer jobs and lower incomes in the United States relative to economies abroad.

Similar concerns sparked intense public opposition to foreign investment in 1997 and 1998 during debates within the OECD over a proposed agreement on investment, known as the Multilateral Agreement on Investment, or MAI. As a result, the Doha Declaration tasks the WTO Working Group on the Relationship Between Trade and Investment with clarifying a group of core issues: the scope and definition of foreign investment; transparency, or openness of laws and government regulations; non-discrimination; possibilities for developing a GATS-type list of pre-establishment investor commitments; development provisions; exceptions and safeguards; consultation and the settlement of disputes between Members; and the process of negotiations, including the way in which nations may choose to participate.[1]

According to the United Nations, foreign investment is carried out by more than 65,000 multinational corporations with over 850,000 affiliates abroad.[2] Spending on foreign investment by all countries increased more than seven times during the 1990-2000 period, rising from $200 billion in 1990 to $1.5 trillion in 2000. In 2001, however, such flows dropped by nearly half to $700 billion, reflecting the slow down in economic growth by the United States and other developed countries. The annual amounts of foreign investment flowing to developing countries during this period increased nearly five times, from about $50 billion in 1990 to $240 billion in 2000, but falling to $200 billion in 2001. By 2001, the total accumulated amount of foreign investment in all countries, or the total position, was estimated at $6.8 trillion.[3] According to the U.S. Department of Commerce, on a historical cost basis the total U.S. direct investment abroad position in 2001 was $1.38 trillion, slightly ahead of the total foreign direct investment position in the United States of $1.32 trillion.[4]

Given the huge amounts of funds and assets at stake, most countries not only favor foreign investment, but they often compete aggressively with each other for investment projects and funds. Often this competition takes the form of tax and other types of financial incentives, and it can include relaxing restrictions on investments in certain industrial sectors or areas of economic activity. Also, many countries now view foreign investment and international trade as complementary: as one rises, so does the other. Current estimates indicate that one-third of world trade is conducted by multinational

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[1] Paragraph 22 of the Doha Declaration. A copy of the Declaration is available at the WTO website: [http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm].

[2] *World Investment Report 2002: Transnational Corporations and Export Competitiveness*. United Nations, New York, 2002. p. 1.

[3] *Ibid*., p. 310.

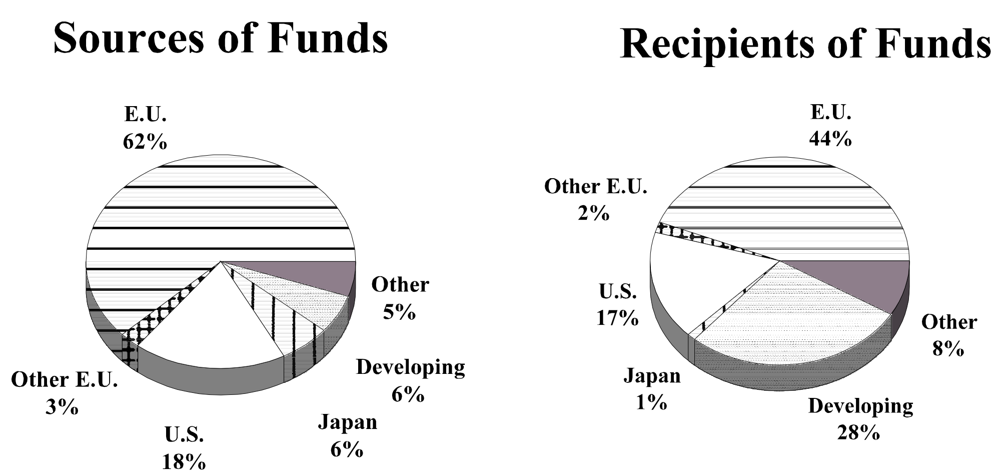
[4] Borga, Maria, and Daniel R. Yorgason. Direct Investment Positions for 2001, *Survey of Current Business*, July, 2002. p. 25.

corporations and their affiliates.[5] For the United States, the percentage is much higher: 56% of U.S. exports and 35% of U.S. imports are associated with multinational corporations.[6]

The desire for foreign investment flows, however, has tended to divide further the rich and poor countries on investment issues. Rifts among the richest countries have also become more apparent, despite the general trend toward eliminating, or reducing, most overt barriers to foreign investment. For most of the richest nations, represented by the Organization for Economic Cooperation and Development (OECD), a new round of investment talks is a priority, because they hope to begin formulating an international set of rules governing the treatment of foreign investment. Developing countries, which have come to recognize the benefits of foreign investment to their economies, have moved aggressively to attract foreign firms and oppose most efforts by developed countries to impose multilateral rules that might limit their ability to offer subsidies to attract foreign investment in a number of specified sectors.

Both the developed and the developing countries have a huge stake in any discussions concerning foreign investment rules. As figure 1 indicates, the latest study on foreign investment by the United Nations indicates that developed economies provided 94% of the total foreign investment funds in 2001, while developing countries received nearly 30% of those funds, up sharply from the 19% share recorded in 2000. The largest – and fastest growing – share of foreign investment funds is circulated among the richest countries, despite the gains made by developing countries in liberalizing foreign investment rules.

Figure 1. Sources and Recipients of Foreign Direct Investment Funds Flows of Funds in 2001 (percentage share of total flows)



Source: United Nations, New York, 2002. *World Investment Report, 2002: Transnational Corporations and Export Competitiveness*. TablesB1 and B2.

[5] *World Investment Report*, p. 1.

[6] Mataloni, Raymond J. Jr., U.S. Multinational Companies: Operations in 2000, *Survey of Current Business*, December 2001, p. 115.

The European Union is not only the largest source of foreign investment funds in the world, but also as the largest recipient of those funds. In 2001, the European Union provided $365 billion, or 62% of world foreign investment funds and received $323 billion, or 44% of the investment funds of other nations, primarily from within the European Union and from the United States. The United States, as the single largest investor and recipient of foreign investment, provided about $114 billion, or 18% of all investment funds and received $124 billion, or about 17%, primarily from countries in the European Union.

Investment in the WTO

The WTO and its predecessor organization, the General Agreement on Tariffs and Trade (GATT), have not directly tackled the broad issue of foreign investment rules. Instead, GATT and the WTO have dealt with a narrow set of very specific issues, which has left nations to formulate their own policies, either through bilateral investment treaties (BITs) – which numbered about 2,100 at the end of 2001 –, or through such entities as the OECD. Among the issues addressed, GATT and the WTO have dealt with specific aspects of the relationship between trade and investment through the General Agreement on Trade in Services (GATS), which concerns the supply of services by foreign companies, and through Trade-Related Investment Measures (TRIMs). Both of the agreements were negotiated during the Uruguay Round of multilateral trade talks.

The TRIMs Agreement, however, does not attempt to regulate the entry and treatment of foreign investment, but applies only to those measures that impose discriminatory treatment on imported and exported goods. This Agreement recognizes that certain national practices, such as local content requirements, can restrict and distort trade and, therefore, it supports the concept of "national treatment." As a result, the Agreement outlaws investment measures that restrict quantities, and it discourages measures which limit a company's imports or which set export targets. Among the measures not covered by the Agreement are export performance requirements, technology transfer requirements, and subsidies to attract investments in specific industries or projects.

The U.S. Position

Until the fall of 2001, the United States had opposed including foreign investment issues as a formal part of any new round of trade talks. U.S. negotiators argued that the WTO's working group on trade and investment was the best place to hammer out the multitude of differences that separate the developed and developing countries, as well as those issues that divide the developed countries. The Trade Act of 2002 (P.L. 107-210) contains a series of overall objectives that direct the work of U.S. trade negotiations in foreign investment. In particular, U.S. negotiators are directed to "reduce or eliminate artificial or trade-distorting barriers to foreign investment, while ensuring that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States, and to secure for investors important rights comparable to those that would be available under United States legal principles and practice." In order to accomplish these objectives, the Act specifies eight issues, including: reducing or eliminating exceptions to the principle of national treatment; freeing the transfer of funds relating to investments; reducing or eliminating performance requirements, forced technology transfers, and other unreasonable barriers to the establishment and operation of investments; establishing standards for expropriation and compensation for expropriation; establishing standards for fair and equitable treatment; providing meaningful procedures for resolving investment disputes; improving mechanisms used to resolve disputes between an investor and a government; and ensuring the fullest measure of transparency in the dispute settlement mechanism.

Other Positions

Most of the developed countries hope any future talks will help eliminate numerous restrictive foreign investment practices in developing countries. Their list of negotiating objectives includes domestic content requirements, rules of origin, regional subsidies, and reform of antidumping regulations. Some members also advocate a wide-ranging review of the TRIMs agreement, to which the developing countries have already committed themselves, in order to phase out domestic content and trade or financial balancing requirements and export performance requirements.

As a whole, the developed countries, represented by the OECD, favor eliminating most of the national restrictions on inward and outward direct investment. Exceptions to this policy include a desire to retain exemptions for industries or sectors that individual countries deem to be important to their national security or of special national importance. Since its inception in 1961, the OECD has voiced its support for free and open trade in goods and services and in the free movement of capital between members. This support is demonstrated in two legally binding agreements between OECD member countries: the OECD Code of Liberalization of Capital Movements; and the Code of Liberalization of Current Invisible Operations. In 1976 the OECD also adopted the Declaration on International Investment and Multinational Enterprises, which constitutes a policy commitment to improve the investment climate in each member country. The Declaration consists of four parts: the Guidelines for Multinational Enterprises, which is a voluntary set of rules; a statement on National Treatment; a statement on Conflicting Requirements; and a statement on International Investment Incentives and Disincentives. Beyond these instruments, the OECD Ministers adopted in May 1999 the OECD Principles of Corporate Governance, which is a set of non-binding principles that are intended to serve as a reference point for countries' efforts to evaluate and improve their own legal, institutional and regulatory framework.

Developing countries, however, are at odds with the majority of the objectives set out by the developed countries. These countries are unlikely to negotiate over the issue of reducing investment subsidies without a willingness on the part of the developed countries to consider imposing additional regulations on their use of rules that govern the use of locational incentives, especially at the sub-national level, and tax holidays for investors. Furthermore, the developing countries want the developed countries to agree to negotiations governing the use of anti-dumping regulations and counter-vailing duties, which most of the developed countries oppose.

The lack of progress in formulating multilateral rules on foreign investment spurred most nations, including the developing countries, to formulate bilateral investment treaties. As a result of this experience, developing countries, as a broad group, now question whether multilateral rules on investment are preferable to bilateral investment treaties. According to the United Nations, the developing countries are in the midst of a "third generation" of investment promotion policies.[7] In the first generation of such policies, nations liberalized their rules on foreign investment to provide a favorable business environment. In the next step, governments began actively to attract foreign investment. In the current phase, governments are targeting foreign investors in distinct industrial sectors that meet the country's developmental priorities. Many of the developing countries doubt that a broad multilateral agreement will provide them with the level of flexibility they believe is required to pursue their own foreign investment and development policies and that they currently enjoy under bilateral agreements.

Conclusions

Most of the WTO participants agree that something needs to be done to make the rules governing foreign investment more consistent across national borders. Formal negotiations as part of the next round of trade talks, however, won't come easily given the wide range of views and the differences of objectives that presently exist between the developed and developing countries over foreign investment rules. Competition between the developed and developing countries and between regions of the world for much sought-after foreign investment funds also substantially raises the stakes for all countries involved and likely could further complicate the process of reaching any international agreement on a broad set of rules governing foreign investment.

Absent a multilateral agreement on foreign investment rules, nations likely will continue to rely on bilateral investment agreements or on incorporating investment rules in regional, or in multi-country economic agreements to reduce existing restrictions on foreign investment. The economic incentives for countries to reach a multilateral agreement, however, may not be substantial. Countries that reduce restrictions on foreign investment are unlikely to see a dramatic shift in foreign investment spending in their favor, because so many other nations are making similar adjustments. On the other hand, nations that either do not reduce their restrictions on foreign investment, or impose new ones, likely will experience a noticeable lack of such investment.

Commitments to liberalize policies governing foreign investment that nations made in such international agreements as Trade-Related Aspects of Intellectual Property (TRIPS) and the General Agreement on Trade in Services (GATS) sparked the trend toward greater use of bilateral and multinational foreign investment agreements. Experience with these agreements indicates that negotiating a new comprehensive agreement on foreign investment likely will be time-consuming and likely offer limited immediate economic rewards. The alternative process of formulating bilateral investment agreements, although more time-consuming and piece-meal, likely offers greater economic rewards on a country-by-country basis in the short term for U.S. firms. It is not clear whether the collective rewards that arise from bilateral investment treaties are greater than those that could be gained through a multilateral agreement that offers a smaller list of benefits from any one country, but extracts those benefits from a greater number of nations.

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[7] *World Investment Report 2001: Promoting Linkages*. United Nations, New York, 2001, p. 14.