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COMPARING FDI AND TRADE

FDI has become more important than trade as means to delivering goods and services. On the other hand, MNEs became the most important means of organizing international production and trade of goods and services. In 1995, whereas international trade totalled US$6 trillion, sales by 280,000 subsidiaries of MNEs totalled US$ 7 trillion. In 1996, FDI totalled US$ 350 billion, and the total investment generated by it in foreign affiliates of MNEs totalled US$ 1.4 trillion.

However, whereas developed economies reinforced their position as net exporters of capital [as they undertake more than 4/5 of FDI (out) and receive less than 2/3 of FDI (in)], and use FDI as the main means of controlling production, finance and trade worldwide, for developing economies exports continued to be the main means of delivering goods and services internationally.

Inward FDI to developing countries has increased significantly in the last five years to 1/3 of world FDI (in). However, the distribution of FDI amongst developing countries is highly skewed: the People's Republic of China alone received 36% of FDI (in) to developing countries; the next 5 developing countries (Brazil, Indonesia, Malaysia, Mexico and Singapore) received 28%; and the next 14 countries received 24%. Thus, the 20 richest or largest (market size) developing countries received 88% of FDI, whereas the 40 poorer, mostly from SSA, received only 1.3%.

In brief, developed economies are dominantly exporters of capital, and also absorb the lion's share of FDI (in). FDI became the dominant form of delivering goods and services, and MNEs became the dominant form for organising production and trade internationally. The developing countries' share of world FDI (in) grew to 1/3, but is highly skewed, as the top 20 countries (of more than 150) receive 88% of FDI accruing to developing countries and the poorer 40 only receive 1.3%.

THE MULTILATERAL AGREEMENT ON INVESTMENT (MAI)

What is MAI (as proposed by the OECD)?

- the MAI is a proposal (discussion concerning MAI have recently been interrupted) to combine and make consistent the rules governing trade, investment and technological development;
- its aim is to liberalise the flows of foreign investment by establishing a legally binding international agreement that takes precedence over regional and bilateral agreements;
- MAI introduces (over and above current practice) four new concepts, namely:
    - barriers and regulations on investment flows affect trade as if they were trade barriers, because of the link between trade, finance and investment. Hence, they should be abolished or minimised in line with trade agreements under WTO, and recently approved TRIMs (trade related investment measures) and TRIPs (trade related intellectual property rights);
    - foreign capital flows are to be given national treatment from the pre-establishment phase;

  - the definition of investment is so broad as to cover all forms of legal foreign capital flows, irrespectively of the nature of these flows (FDI, M&A or short term "hot" capital flows).;
  - incentives to attract foreign capital cannot be performance related. In particular, the following are to be prohibited:
    - regulations concerning the employment of nationals at any level;
    - regulations favouring the formation of joint ventures with national firms;
    - regulations concerning a minimum level of domestic equity participation and/or foreign ownership restrictions;
    - regulations concerning a minimum level of local components;
    - incentives related to technology transfer, exports and any other form of performance related incentives;
    - the entire system of incentives in under revision.

Why has a MAI been proposed in these terms?

- first, this idea comes from developed economies through their organisation, the OECD, because they are very large exporters of capital, and thus sensitive to the environment that affect capital flows;
- second, the Uruguay round of the WTO expanded the coverage of the trade agreements to introduce TRIMs and TRIPs (this means the combination of trade in goods, services and technology) and reinforced the implementation mechanisms;
- third, developing countries have liberalised their investment regimes because of WTO, market-friendly stabilisation and adjustment programs and bilateral and regional agreements they have entered;
- fourth, production, not only trade, has become more globalised and MNEs are the dominant means through which production and trade are organised around the world;

Thus, developed economies need to expand and facilitate market access for their MNEs, and they believe that the current process of liberalisation has shorten very significantly the distance to a completely liberalised investment regime.

If investment regimes have been liberalised, why is MAI necessary?

From the point of view of developed economies, MAI is necessary because of three reasons:

- it brings consistent into the triangle of trade, investment and technology transfers;
- under current arrangements, even liberalised investment regimes prevent national treatment from the pre-establishment phase (most only consider national treatment in some areas or after operation has begun);
- MNEs want to expand their market access worldwide and this agreement, that harmonises international policies, facilitates such an expansion.

DEVELOPING ECONOMIES AND MAI

Do developing economies accept MAI as proposed by the OECD?

Most developing economies have strong reservations towards MAI, and this is one of the chief reasons why MAI has not yet been agreed or formally introduced in the context of trade negotiations. The reasons for these reservations are the following:

- flows of capital are not determined by liberalisation or treaties alone. Actually, most MNEs do not consider liberalisation, beyond the reform of extremely anti-FDI regimes, as a determinant of their investment decisions. Thus, further liberalisation of current investment arrangements is not likely to increase flows of capital to the 40 LDCs if their market and profit opportunities, and their technological capabilities do not improve very substantially. The other side of the coin is that failure to liberalise further their investment regimes will not reduce FDI accruing to the 20 riches developing economies, because of the market and profit opportunities they provide, as well as their technological capabilities that MNEs would like to get spillovers from. The FDI already in is not going to exit if countries do not join MAI; and a non-attractive economy is not going to become more attractive by joining MAI:
- even if FDI increases with liberalisation, the benefits from FDI to the host economy depend on the implementation of selective policies that target technologies, skills, linkages and markets. The prohibition of performance related incentives and policies significantly reduces the value of FDI for developing economies, particularly for the richest ones;
- the pre-establishment national treatment clause is not likely to be accepted because of the very strong implications it may have upon: the development of domestic entrepreneurial capacities, the existence of domestic firms, the absorption capacity of the host economies, the face value of FDI and the issue of national sovereignty. It is argued that this clause is the at the centre of the conflict between developing and developed economies with respect to MAI;
- the broad definition of investment, that goes far beyond FDI, is also contested as it may actually increase financial speculation and economic instability.

There are three more reasons to contest the MAI as proposed by the OECD:

- there are several issues related to North/South economic relation that have never been implemented or whose negotiations are never ending because of explicit or implicit opposition by developed economies (e.g., agricultural protection);
- codes concerning the regulation of FDI (imposing investors duties) have been discussed but were not adopted yet, or if adopted are non-binding (whereas MAI is legally binding). These are:
    - the multilateral equitable principles and rules for the control of restrictive business (adopted in 1980 by the UN but non-binding);
    - draft UN code of conduct of Transnational corporations (not yet adopted);
    - draft international code of conduct on the transfer of technology (not yet adopted);
- codes adopted by the OECD concerning liberalisation of the investment regime within OECD are either non-binding or protect against the pre-establishment national treatment. These are:
    - code for liberalisation of capital movements adopted in 1961, is legally binding but the national treatment clause (for the post-establishment phase) was only introduced in 1984;
    - declaration of international investment and multilateral enterprises, adopted in 1976, is non-binding;

    - the above declaration includes a national treatment instrument (for the operational stage), and guidelines for multinational enterprises (voluntary standards of behaviour), which are non-binding;
    - the recommendations of the Council on bribery in international transactions (1994) also is non-binding.
- thus, it seems that when it comes to duties of foreign investors and developed economies, agreements are either not reached or, if reached, are voluntary and non-binding. When it comes to the rights of those investors and economies, they want to force agreements that favour their interests of expanding market access and profit opportunities.

Which are the available options for developing countries?

Option 1: developing countries can keep out of a MAI and wait for current arrangements (bilateral and regional) to evolve. This option has been working, gives more freedom for negotiation, and does not impose binding restrictions on pursuing development goals. Additionally, current arrangements often involve economies on similar stages of development. However, this option requires a collective will of all developing countries to resist pressure to join MAI, and this will does not exist. If some developing countries join MAI the others will have to enter because of fear or losing out, and current arrangements will become irrelevant. Developing countries are heterogeneous and this may strongly affect their interest, capacity and will to resist or support a MAI.

Option 2: prepare for negotiations towards a MAI. The argument for a MAI are that FDI and trade are complements and indistinguishable; a good framework for FDI is good for all investment; an international framework for investment regimes is consistent for everybody; and LDCs would get more FDI if they join MAI. The problems with this argument are threefold: liberalisation and treaties do not determine flows of FDI; given the differences in economic power and capabilities, a consistent (for everybody), legally binding framework is only going to favour those who have market power; the benefits of a MAI for developing countries depend on its content and forum.

The best forum for negotiating a MAI, form the point of view of developing countries is the WTO, because they have more influence over the WTO than the OECD, and the OECD is interested in pushing for maximum liberalisation because it represents the exporters of capital.

As far as content is concerned, the major problem to deal with is the national treatment from pre-establishment clause. This clause should be excluded, or development reasons should be included as a case for general exception to be legally bound to comply with this clause. The definition of investment covered by the agreement should follow the UNCTAD (FDI) definition (initial capital, re-invested profits and intra-firm debt transactions). Performance related incentives should continued to be allowed, as investors should have duties, not only rights, and developing countries should also have rights to pursue legitimate development goals, not only duties to provide MNE with more markets and profits.