

# **THE WORLD DEVELOPMENT REPORT 2005: AN UNBALANCED MESSAGE ON INVESTMENT LIBERALIZATION**

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## EXECUTIVE SUMMARY

1. The principal message of the World Development Report 2005 of the World Bank to the developing countries is that they should adopt liberal policies related to foreign investment to spur economic growth and development, and that the development of binding multilateral rules relating to foreign investment would create a favorable climate for foreign investment in developing countries. This is the same argument made by the developed countries for developing new rules on investment liberalization in the WTO and in bilateral agreements with developing countries.
2. However, such a message, when articulated in the context of the World Bank or in the context of the WTO, simply promotes the economic interests of the North. It disregards or downplays the fact that the promised developmental benefits of investment liberalization by developing countries have not yet, by and large, come about. FDI inflows, despite investment regime liberalization in many developing countries, continue to go, in large part, to developed countries and to only a few developing countries. In fact, relative to the share of FDI inflows of developed countries, the share of developing countries in general and of the poorest among them in particular, has been on the decline.
3. In addition to declining quantities of FDI inflows to most developing countries, the quality of FDI inflows vis-à-vis their developmental impacts on host countries continues to be a cause of concern for many developing countries. Investment liberalization along the lines proposed by developed countries would have developing countries do away with, for example, performance requirements and other regulatory instruments that could ensure that FDI provides direct domestic developmental benefits in terms of capital retention, technology transfer, and human resource capacity-building.
4. Such proposals for investment liberalization from developed countries run counter to their own historical experiences vis-à-vis FDI regulation. By and large, developed countries had, during their own development process, taken a strategic approach to foreign investment, characterized by flexible policy regimes and regulatory restrictions and requirements on FDI taken according to needs of and changes in their economic structure and external conditions.
5. Developing countries have, however, recognized the need for policy space and regulatory flexibility when it comes to FDI. It is on this basis that they have mostly been opposed to the launch of negotiations on new rules and disciplines on trade and investment in the WTO. They rightly understand that such new rules and disciplines could adversely impact on their policy space and regulatory flexibility vis-à-vis FDI regulation.
6. The WDR 2005, therefore, needs to provide a more balanced view of the trade and investment debate, in order to take into account developing countries' perspectives vis-à-vis foreign investment.

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**I. INTRODUCTION**

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2. This paper examines the underlying assumptions of WDR 2005 on investment liberalization; it establishes the links to the agenda of the developed countries in the WTO; it assesses the impact of the proposals for investment liberalization and multilateral investment agreements on restricting the development options and policy space of the developing countries; and it summarizes the views of the developing countries on their development needs and priorities vis-à-vis foreign investments.
3. The discussion is based on the WDR 2005 first draft of 11 May 2004; the submissions and statements of developed and developing countries to the WTO bodies; and the work of academics and development practitioners.

**II. THE WDR 2005 AND THE PROPONENTS FOR A MULTILATERAL FRAMEWORK ON INVESTMENT IN THE WTO**

4. This Section identifies the main underlying assumption in the WDR 2005, the key arguments advanced in the report, and the similarity of these arguments with those that have been put forward by developed countries in the WTO regarding a possible WTO agreement on investment as well as other so-called “Singapore Issues”<sup>1</sup>. This review indicates that while the WDR 2005 presents the case somewhat differently, the recommendation is the same as the agenda presented by developed countries in the WTO, that is, advocacy of binding international agreements on investment, and possibly agreements on other Singapore Issues, that protects and promotes the rights of investors by limiting the role of the State and its ability to regulate investments.

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<sup>1</sup> These issues, which were first included in the WTO’s work programme as a result of the 1996 Singapore Ministerial Conference (hence the term “Singapore issues”), refer to the proposed negotiations for WTO agreements that would fall within the scope of the WTO’s existing dispute settlement mechanism and which would: (i) curb the ability of governments to regulate and direct foreign investments (*trade and investment*); (ii) prevent governments from supporting domestic enterprises to enable them to compete effectively against foreign competitors (*trade and competition policy*); (iii) require governments to undertake binding obligations for costly changes in government procurement procedures to eliminate any advantages that local firms might have in the bidding process, and open up bidding procedures to foreign scrutiny and possible disputes (*transparency in government procurement*); and (iv) require governments to undertake binding obligations to effect costly changes in domestic procedures for the release of traded goods (*trade facilitation*).

## **A. The Message of the WDR 2005**

5. The WDR 2005 argues that improvements in the investment climate in developing countries will lead to increased flows of foreign direct investment (FDI) and consequently, to higher levels of economic growth and development. The report states that improvements in the investment climate – e.g. those location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs, and expand – are the driving forces behind growth and poverty reduction.<sup>2</sup>
6. It is further argued in the report that the establishment of international rules or standards relating to investment is one of the major factors that help to create a favorable climate for investment in terms of enhancing the credibility of government investment policies, reducing international transaction costs, and addressing international spillovers or shared concerns. However, no evidence is provided in the report in support of this argument. On the contrary, the report cites a survey that seemed to indicate that, at least as far as rules on corporate social responsibility are concerned, non-governmental initiatives had more influence on firms' investment decisions rather than governmental norms.<sup>3</sup>
7. The main underlying assumption of WDR 2005 is that more investment is always better than less investment, and hence the emphasis is on the quantity and not on the quality of capital inflows. This emphasis on quantity presupposes that all types of investment will be equally good and will automatically lead to economic growth and development. But it also lends support to the troubling perception that the objective is not to view investment flows in terms of the needs of developing countries but in terms of the need to improve the opportunities for investors in developed countries.
8. Recognizing and understanding this focus on the needs of foreign investors explains the main thrust of the arguments in the WDR 2005 regarding the role of governments and regulations *versus* market forces; the need for binding international agreements that provide harmonized and higher standards for the protection of investment and investors; and specific competition policies and trade facilitation measures geared towards reducing the costs for investors. The following is the gist of these arguments.
9. One, the report is in favor of passive state policies towards investment control and regulation. The report advocates that the role of the state, and governmental regulations should be to facilitate the free functioning of the market forces. According to the WDR 2005, developing countries tend to regulate more than developed countries in many areas that may be subject to FDI.<sup>4</sup> It stresses that governmental regulation in economic affairs may be justified only in response to a market failure and, even then, only if the

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<sup>2</sup> WDR 2005, Summary, para. 2.

<sup>3</sup> WDR 2005, Main text, p. 9.12, Box 9.7.

<sup>4</sup> Id, p. 5.2, para. 5.6.

benefits from government intervention are expected to exceed the costs of intervention.<sup>5</sup>

10. The report states that non-transparent or unpredictable governmental policies and behaviors may adversely affect investors' decisions and thereby chill incentives to invest in a particular country.<sup>6</sup> The report cites surveys among firms and investors indicating that issues relating to policy and regulatory uncertainty dominate investor concerns vis-à-vis developing countries, and that reducing government-related regulatory or policy risks can increase the probability of new investments by more than 30 percent.<sup>7</sup>
11. The WDR 2005 also questions the utility of selective governmental interventions to promote and direct investment. It argues that competition between countries is intensifying and that this makes the repetition of the East Asian success story in selective intervention unlikely. Hence strategies that may have worked in the earlier periods offer little insights as to what might work today.<sup>8</sup> Moreover, selective interventions will provide protection which, although meant to be temporary, will be difficult to dismantle later due to vested-interests. On the other hand, such special privileges and monopoly profits will undermine firms' drive for innovation and efficiency.<sup>9</sup>
12. It is also argued that that selective or targeted policy interventions with respect to promoting certain investment areas or industrial sectors often end up failing to meet their objectives,<sup>10</sup> and stresses that such measures are more likely to succeed "when they complement rather than attempt to substitute for broader investment climate improvements."<sup>11</sup> Therefore, instead of prioritizing selective interventions, governments should put their energy into improving the underlying causes of disadvantages for firms (such as the inadequacy of the infrastructure, ambiguity in property rights, red tape, corruption, etc.), in which case selective interventions may not be necessary.<sup>12</sup>
13. Two, on the basis of the above arguments, it becomes important to curb governmental and regulatory activism and the report states that binding international agreements can be an important and useful tool in this regard. The WDR 2005 states that "[a]nother strategy governments can adopt to complement the basics of a sound investment climate is to draw on the growing body of international rules and standards in this area."<sup>13</sup> It argues that entering international agreements ties the hands of governments and locks-in policies. By increasing the price of renegeing on commitments, governments increase their credibility and therefore, reduce the perceived risks of investing in the country.<sup>14</sup>

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<sup>5</sup> Id., pp. 5.3 and 5.4.

<sup>6</sup> WDR 2005., Summary, paras. 3 and 6.

<sup>7</sup> Id., paras. 6, 11, and fig. 8.

<sup>8</sup> WDR 2005, Main text, p. 8.3, para. 8.12

<sup>9</sup> Id., pp. 8.4 and 8.5

<sup>10</sup> Id., pp. 8.1-8.25.

<sup>11</sup> Id., p. 8.24, para. 8.75.

<sup>12</sup> Id., p. 8.6

<sup>13</sup> Id., p. 8.25, para. 8.76.

<sup>14</sup> Id., p. 9.2, para. 9.4.

14. Three, the WDR 2005 suggests that the developing countries must have international agreements that have the following features:

- The agreements must focus on the liberalization of trade and investment and on the reduction in barriers that can improve the investment climate by reducing costs, expanding market sizes, and enhancing competition among firms;<sup>15</sup>
- The agreements must contain higher standards of protection for investment and investors. The report states that developing countries will benefit from a multilateral agreement on investment that provides high standards of protection to investors including provisions on dispute settlement, indirect expropriation and transfer of funds;<sup>16</sup>
- The agreement must encompass harmonization as opposed to customization of standards as harmonization reduces costs and also provides signals of high standards to traders and investors;<sup>17</sup> and
- The agreements must be binding commitments so that there is little chance of rolling back.

15. Four, the WDR 2005 argues that such international agreements will lead to greater flows of investment. This outcome is not guaranteed but the report asserts that there is evidence that investors rely on the assurances provided by binding international agreements to invest. However, the WDR 2005 does not provide any evidence in support of this assertion. To the contrary, the report acknowledges that empirical studies have not identified a link between the conclusion of bilateral investment treaties (BITs) and increased investment flows. In an attempt to reconcile this contradiction, the WDR 2005 makes the amazing claim that lack of awareness and understanding by investors of the existence of BITs may be preventing a stronger response in terms of increased investment flows.<sup>18</sup>

16. Five, the WDR 2005 also touches upon other areas such as competition policy and customs administration in developing countries in regard to their roles to facilitate or impede trade and investment flows. For example, the report argues that the effectiveness of competition policy in developing countries is diminished by other government regulations and practices, e.g., barriers to entry and exit. The argument seems to be that developing countries should allow totally free competition among local and foreign firms and investors irrespective of their sizes, market powers, roles in local job creation etc. Similarly, the poor administration of customs is highlighted in the context of higher costs to firms engaging in importing and exporting.

17. Finally, the WDR 2005 raises some issues of concern to developing countries. The report acknowledges that there is a trade-off between entering into binding international commitments and maintaining policy flexibility<sup>19</sup>, and

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<sup>15</sup> Id., p. 9.1, para. 9.2.

<sup>16</sup> Id., 9.13, Box 9.8

<sup>17</sup> Id., pp. 9.8 and 9.9

<sup>18</sup> Id., p. 9.3, Box 9.2.

<sup>19</sup> Id., p. 9.2, para. 9.4.



the report notes the complexity of multilateral negotiations. However, these issues are raised more as an afterthought and there is no discussion of how developing countries could deal with these problems. Instead the WDR 2005 argues that participating in such international agreements – and thereby agreeing to obligations and commitments that would be both difficult and costly to repudiate – may raise the credibility of governments with respect to their investment policies. Similarly, the report argues that despite the complexity of multilateral negotiations, agreements could be feasible given the possibilities for trade offs across a wide range of issues. The report suggests that the alternative to multilateral agreements could be bilateral agreements or regional agreements using NAFTA as a model.

## **B. The WDR 2005 Promotes the Agenda of the North**

18. The theme of this year's World Development Report is the promotion of the liberalization of investment in particular through, *inter alia*, the development of international agreements and disciplines. This is identical to the agenda that the developed countries have been advocating in bilateral trade negotiations (such as the US-Chile FTA<sup>20</sup>), in regional trade arrangements (such as NAFTA<sup>21</sup> or the FTAA<sup>22</sup>), and in multilateral negotiations in the WTO.
19. The developed countries have been at the forefront in pushing for the establishment of multilateral disciplines relating to investment liberalization within the WTO. At the initiative of developed countries, and over the opposition of developing countries, the Working Group on the Relationship between Trade and Investment (WGTI) was established by the First Session of the WTO Ministerial Conference in Singapore in December 1996 with the mandate to “examine the relationship between trade and investment.”<sup>23</sup>
20. This mandate was renewed by the WTO Ministerial Conference at the Fourth Session in Doha, Qatar, in November 2001.<sup>24</sup> However, negotiations on a multilateral framework on investment in the WTO were subject to the condition that any decision would have to be taken by explicit consensus,<sup>25</sup> and that such negotiations would take place after the Fifth Session of the Ministerial Conference in 2003 “on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations.”<sup>26</sup>

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<sup>20</sup> See US-Chile Free Trade Agreement, Chapter 10 – Investment, available at <http://www.ustr.gov/new/fta/Chile/final/10.investment.PDF>.

<sup>21</sup> See North American Free Trade Agreement, Chapter Eleven: Investment, available at [http://www.nafta-sec-alena.org/DefaultSite/legal/index\\_e.aspx?articleid=160](http://www.nafta-sec-alena.org/DefaultSite/legal/index_e.aspx?articleid=160).

<sup>22</sup> See Free Trade Area of the Americas, *Trade Negotiations Committee: Second Draft Consolidated Text*, FTAA.TNC/w/133/Rev.2, 1 November 2002, Chapter on Investment, available at <http://www.ustr.gov/regions/whemisphere/ftaa2002/tnc-w-133-06of12-eng.pdf>.

<sup>23</sup> WTO, *Ministerial Conference – Singapore Ministerial Declaration*, WT/MIN(96)/DEC, 18 December 1996, para. 20.

<sup>24</sup> WTO, *Ministerial Conference – Doha Ministerial Declaration*, WT/MIN(01)/DEC/1, 20 November 2001, paras. 20-22.

<sup>25</sup> Singapore Ministerial Declaration, *supra* note 23, para. 20.

<sup>26</sup> Doha Ministerial Declaration, *supra* note 24, para. 20.

21. During the Fifth Session of the Ministerial Conference at Cancun, Mexico, in September 2003, the opposition of developing countries to the launch of negotiations on Singapore issues, including on investment, clearly indicated that neither of these two explicit consensus requirements had been met, and that, therefore, the mandate for the WGTI, as well as of the other working groups on the other Singapore issues, had expired.<sup>27</sup>
22. The agenda of the developed countries for the establishment of a multilateral framework agreement on investment in the WTO is evident in numerous papers submitted to the WGTI for discussion. The European Union stated that the current “patchwork of rules [relating to investment] is unsatisfactory and being increasingly seen as an inefficient and non-transparent framework for making investments and protecting investments abroad” and that, therefore, there is a “need, from the perspective of both states and investors, to start a discussion on the deficiencies of the rules governing FDI internationally at present and to consider questions related to the development of a level playing field worldwide for FDI. The WTO is in a position to be an instrument in answering these needs.”<sup>28</sup>
23. Canada has argued that “policies conducive to attracting foreign investment, such as transparent and non-discriminatory administrative norms and legal standards, are an essential condition for economic growth.”<sup>29</sup> On the subject of a multilateral framework on investment in the WTO, Canada argued that “[t]he inclusion in international investment agreements of principles and provisions aimed at promoting benefits from international investment flows to all Members is essential. The successful elaboration of such principles and provisions in the context of such a framework, in addition to technical assistance and capacity-building, would help encourage foreign investment and promote economic growth and prosperity in developing and least-developed countries.”<sup>30</sup>
24. In its submission, Switzerland concluded that:

“[a] transparent and predictable FDI regime is one of the key conditions to attract international investment. A multilateral Agreement on such investment will provide a common basic framework in this important policy area. Both host and home countries should benefit with the establishment of a clear framework including all the main elements mentioned in paragraph 22 of the Doha Declaration. However, as the liberalisation of FDI regimes during the past 20 years shows, other policies providing for an

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<sup>27</sup> See e.g. South Centre, *The Post-Cancun Legal Status of Singapore Issues in the WTO*, SC/TADP/AN/SI/2, November 2003.

<sup>28</sup> WTO, *European Community and its Member States – Submission*, WT/WGTI/W/1, 30 May 1997, p. 2.

<sup>29</sup> WTO, *Canada – Development Provisions*, WT/WGTI/W/131, 3 July 2002, para. 1.

<sup>30</sup> *Id.*, para. 2. Canada has also elaborated further on its thoughts with respect to the elements that should be in a prospective WTO multilateral framework for investment. See WTO, *Canada – The Interrelationship and Emerging Infrastructure of a Prospective WTO Multilateral Framework for Investment Based on Elements Identified in Paragraph 22 of the Doha Declaration*, WT/WGTI/W/157, 10 April 2003.

enabling environment continue to play a key role in investors' decisions.<sup>31</sup>

25. The United States pushed for the inclusion of portfolio investments within the scope of coverage of any multilateral investment agreement stating that “[a]n agreement limited to FDI denies the benefit of the agreement to portfolio investor partners and to the portfolio operations within a direct investment and thus will act to discourage FDI.”<sup>32</sup>
26. In supporting the call for a multilateral legal framework on investment in the WTO, Japan argued that the negotiation for, the substance of, and the use of, the rules on investment in such a multilateral framework would promote fairness and equity, predictability and transparency, efficiency and effectiveness, and the harmonization and consistency of rules.<sup>33</sup>
27. The issues that proponents of a multilateral framework for investment in the WTO would like to see in such a framework and subject to obligatory rules or commitments include the following:<sup>34</sup>
  - non-discrimination between local and foreign investors and investments;
  - pre-establishment rights and obligations;
  - transparency in investment regulation and in scheduling of commitments;
  - dispute settlement within the WTO;
  - exceptions and balance-of-payments safeguards.
28. Some proponents also recognized the need for a multilateral framework to take into account development policy and policy space for developing countries.<sup>35</sup> Other proponents noted that a multilateral agreement in the WTO would not automatically result in increased FDI flows to developing countries.<sup>36</sup>

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<sup>31</sup> WTO, *Switzerland – Multilateral Framework for Investment: An Approach to Development Provisions*, WT/WGTI/W/133, 18 July 2002, para. 24.

<sup>32</sup> WTO, *United States – Covering FDI and Portfolio Investment in a WTO Investment Agreement*, WT/WGTI/W/142, 16 September 2002, para. 13.

<sup>33</sup> WTO, *Japan – The Differences between Multilateral and Bilateral Agreements on Investment Rule-making*, WT/WGTI/W/67, 30 November 1998. See also *WTO, Japan – Consideration of the Necessity of Multilateral Investment Rules from Diversified Viewpoints*, WT/WGTI/W/158, 11 April 2003.

<sup>34</sup> See e.g. Canada, *supra* note 30; WTO, *Canada – Transparency*, WT/WGTI/W/155, 8 April 2003; WTO, *Canada – Exceptions and Balance-of-Payments Safeguards*, WT/WGTI/W/146, 17 September 2002; WTO, *European Community and its Member States – Concept Paper on Balance-of-Payments Safeguards*, WT/WGTI/W/153, 28 November 2002; WTO, *Canada – Consultation and Dispute Settlement*, WT/WGTI/W/147, 17 September 2002; WTO, *Chinese Taipei – Exceptions and Balance-of-Payments Safeguards*, WT/WGTI/W/144, 16 September 2002; WTO, *Chinese Taipei – Dispute Settlement Mechanism*, WT/WGTI/W/145, 16 September 2002; WTO, *Canada – Non-Discrimination and Modalities for Pre-Establishment Commitments*, WT/WGTI/W/130, 2 July 2002.

<sup>35</sup> See e.g. WTO, *Canada – Development Provisions*, WT/WGTI/W/131, 3 July 2002; WTO, *Switzerland – Multilateral Framework for Investment: An Approach to Development Provisions*, WT/WGTI/W/133, 18 July 2002; WTO, *European Community and its Member States – Concept Paper on Policy Space for Development*, WT/WGTI/W/154, 7 April 2003; WTO, *Canada, Costa Rica, and Korea – Negotiating a Multilateral Framework on Investment in the WTO*, WT/WGTI/W/162, 5 June 2003.

<sup>36</sup> See e.g. Canada, Costa Rica, and Korea, *supra* note 35, paras. 10 and 12. In this submission, these countries recognize that “a multilateral framework for investment in the WTO would not guarantee greater investment flows” even as they continue to stress that “[i]n the absence of investment rules,

29. The WDR 2005 appears to leave room for agreements that are less than a multilateral agreement. The report states that “[t]o be effective, common international standards do not always require binding treaty obligations. Countries or even firms can voluntarily adopt common norms, with the incentives to comply driven by reputation.”<sup>37</sup> Countries can also adapt their domestic policies to “Model Laws” developed by international agencies “to encourage convergence on common approaches” or use other strategies for the same end.<sup>38</sup>

30. The report also contains these words of caution:

“ Care needs to be taken to ensure not to curtail the policy space of emerging nations without clear justification. At a minimum, the voices of developing countries need to be heard when framing these initiatives. ...

“... Uniform global rules may be appropriate for some matters, but differences in priorities and capabilities need to be reflected in others ... And while well-conceived international rules and standards can be an important complement to domestic laws and policies, they cannot substitute for the development of local institutions.”<sup>39</sup>

### **III. RESPONDING TO THE WDR 2005**

#### **A. Responding to the WDR 2005's Underlying Assumptions**

31. Despite the preceding words of caution, the key message of WDR 2005 is that **“for governments at all levels, a top priority should be to improve the investment climates of their societies. To do so, they need to understand how their policies and behaviours shape the opportunities and incentives facing firms ... The agenda is broad and challenging, but delivering on it holds great promise for reducing poverty and improving living standards.”**<sup>40</sup> (emphasis added).

32. However, the authors of the report make no effort to provide empirical evidence in support of the sweeping assertion that increased FDI flows would lead to reduced poverty and higher living standards in developing countries.

33. The report also contains no evaluation of the levels of gross and net flows, of the quantity versus the quality of foreign investment and of the country and

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investment will continue to take place. But well crafted rules at the multilateral level can contribute to a framework not only where investment can take place and flows enhanced, but which can facilitate transparency and predictability, and thereby enhance economic efficiencies – as well as defer to sustainable development objectives.”

<sup>37</sup> WDR 2005, Main text, p. 9.8, para. 9.20.

<sup>38</sup> Id., p. 9.8, paras. 9.20-9.21.

<sup>39</sup> Id., p. 9.13, paras. 9.35-9.36.

<sup>40</sup> WDR 2005, Main text, p. 1.2, para. 1.6.

sectoral composition of these flows. An analysis of all these aspects of foreign investment is needed to determine the net benefit.

34. Reliance on data on gross FDI flows to developing countries provides a misleading picture of the overall benefits of these flows. The growth of FDI flows to developing countries from under US\$42 billion in 1991 to US\$ 240 billion in 2000<sup>41</sup> appears significant but FDI flows account for only about 10% of [a] typical developing country's gross fixed capital formation."<sup>42</sup> The distribution of FDI flows tends to be skewed in favour of a few developing countries and the data on gross flows need to be adjusted for profit repatriation. In fact, when account is taken of profit repatriation, debt servicing and reserve accumulation, the net flows to developing countries are hugely negative.
35. Ten developing countries accounted for 77 per cent of the total of FDI flows in 1995, and China has been by far the largest single developing country recipient of FDI in recent years."<sup>43</sup> The poorest developing countries receive very little foreign investment. "The share of 45 least-developed countries as a group in global FDI inflows is negligible at half a per cent and it shows a declining trend over the 1991-2000 period."<sup>44</sup>
36. The tendency of FDI to flow to better-off and faster-growing developing economies (such as those in Asia and Latin America), rather than to the poorest developing countries (such as those in Africa or the Pacific) has been evident since at least the 1970s. (see Box 1)

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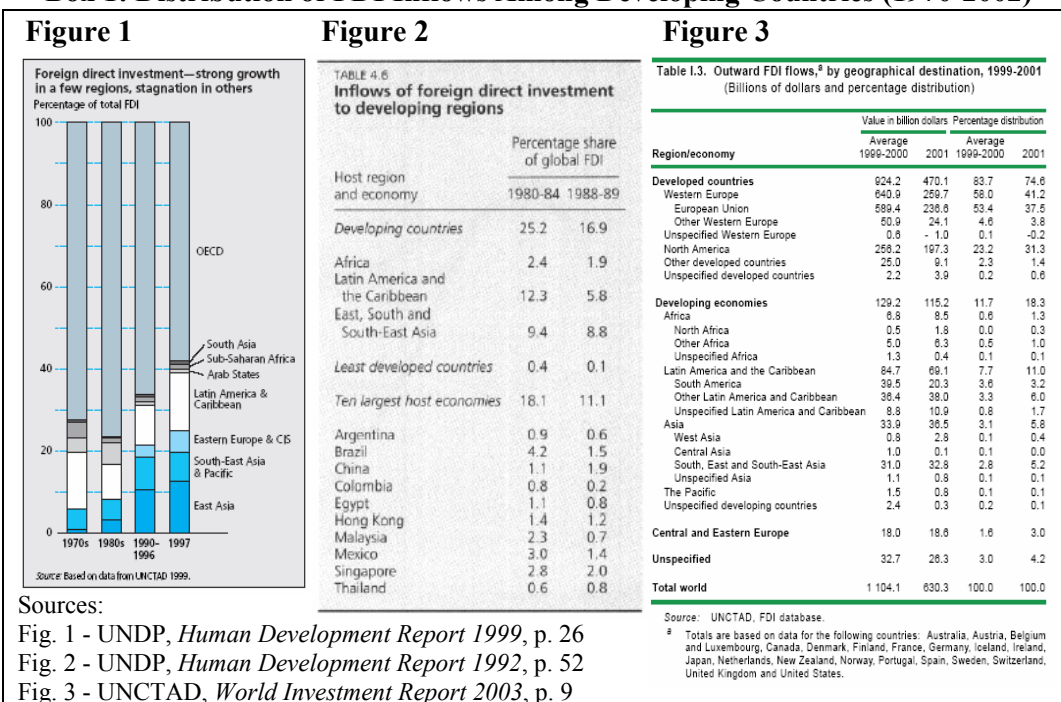
<sup>41</sup> See e.g. Carlos Correa and Nagesh Kumar, *PROTECTING FOREIGN INVESTMENT: IMPLICATIONS OF A WTO REGIME AND POLICY OPTIONS* (Zed Books, London, 2003), p. 12.

<sup>42</sup> Ajit Singh, *Foreign Direct Investment and International Agreements: A South Perspective* (South Centre TRADE Series Occasional Paper No. 6, 2001), p. 7.

<sup>43</sup> South Centre. *FOREIGN DIRECT INVESTMENT, DEVELOPMENT AND THE NEW GLOBAL ECONOMIC ORDER. A POLICY BRIEF FOR THE SOUTH* (South Centre, Geneva, 2000), p. 19.

<sup>44</sup> Correa and Kumar, *supra* note 41, at 12.

## Box 1: Distribution of FDI Inflows Among Developing Countries (1970-2002)



37. Projections of future FDI flows suggest no change in the country concentration. The major recipients are expected to be China, India, the United States, Thailand, Malaysia, Singapore, Korea, and Mexico. Other developing countries will be left to compete for a small share of these flows through further liberalization measures, additional incentives and increased targeting.<sup>45</sup> The result of this skewed distribution of FDI inflows is that, for developing countries in particular, “increasingly sophisticated and possibly resource-intensive policy measures are needed to retain existing FDI and attract new investment.”<sup>46</sup>
38. The skewed country concentration of FDI inflows and the declining nature of such flows to developing countries have taken place in a financially integrated world economy where developing countries, partly as a consequence of the debt crisis of the 1980’s, adopted increasingly liberal investment regimes.
39. In particular, the downturn of FDI inflows to most developing countries has prompted many of these countries, despite their misgivings and in many cases as a result of IMF structural adjustment programme or World Bank loan

<sup>45</sup> See e.g. UNCTAD, *Prospects for FDI Flows, Transnational Corporation Strategies and Promotion Policies: 2004-2007 – Global Investment Prospects Assessment (GIPA) Research Note 1*, TD(XI)/BP/5, 27 April 2004, pp. 5 and 14.

<sup>46</sup> *Id.*, at 14. It should be noted, however, that an increasing body of literature supports the conclusion that the provision of investment incentives by developing countries often do not result in increases in FDI inflows and, in fact, may even harm them. See, *inter alia*, Eric Neumayer, *GREENING TRADE AND INVESTMENT: ENVIRONMENTAL PROTECTION WITHOUT PROTECTIONISM* (Earthscan, London, 2001), pp. 7-8; WTO, *Secretariat: Note on the Impact of Investment Incentives and Performance Requirements on International Trade*, WT/WGTI/W/56, 30 September 1998, paras. 22, 52, and 62.

conditionalities, to further liberalize their FDI policies and regulations since the 1990s.

**Figure 4 – Changes in National Regulations of FDI, 1991-2002**

Table I.8. Changes in national regulations of FDI, 1991-2002

Item	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Number of countries that introduced changes in their investment regimes	35	43	57	49	64	65	76	60	63	69	71	70
Number of regulatory changes	82	79	102	110	112	114	151	145	140	150	208	248
of which:												
More favourable to FDI <sup>a</sup>	80	79	101	108	106	98	135	136	131	147	194	236
Less favourable to FDI <sup>b</sup>	2	-	1	2	6	16	16	9	9	3	14	12

Source: UNCTAD, based on national sources.

<sup>a</sup> Including liberalizing changes or changes aimed at strengthening market functioning, as well as increased incentives.

<sup>b</sup> Including changes aimed at increasing control as well as reducing incentives.

Source: UNCTAD, *World Investment Report 2003*, p. 39

40. Despite the liberalization of FDI policy regimes in many developing countries since the 1990s, however, approximately three-fourths of FDI flows continue to go to developed economies, while developing countries continue to receive only less than one-fourth (of which LDCs receive a little over one-third of one percent of total global FDI inflows). (see Box 2).

41. This suggests that policy liberalization alone has not been sufficient to attract FDI to the poorest countries. “The limited natural resource endowments and home markets of many low income countries tend to make these countries particularly unattractive to foreign investors. Thus, without strong ‘fundamentals’ for economic growth and development, investment liberalization may mean little to them.”<sup>47</sup>

<sup>47</sup> WTO, *India – Relationship between Trade, Investment and Development*, WT/WGTI/W/72, 12 April 1999, para. 8.

## Box 2 – FDI Inflows to Developing Countries (1991-2000)

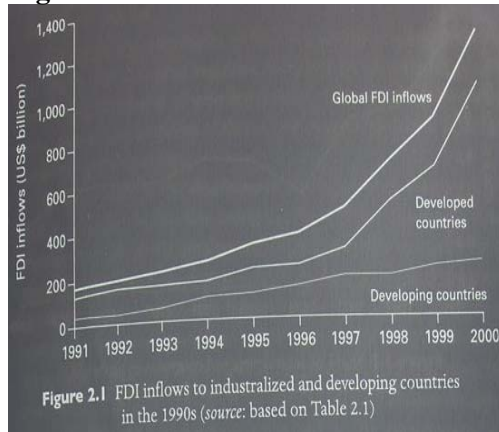
**Figure 5**

**Table 2.1** Global FDI inflows, by broad host groups, 1991–2000 (US\$ billion)

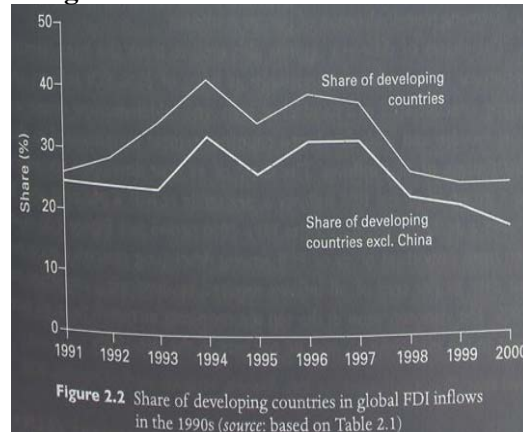
Host region	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
World	158.94	173.76	218.09	255.99	331.84	377.52	473.05	680.08	865.49	1,270.76
Industrialized countries	114.79	119.69	138.76	145.13	205.69	219.79	275.23	480.64	636.45	1,005.18
Developing countries	41.70	49.62	73.04	104.92	111.88	145.03	178.79	179.48	207.62	240.17
Share of developing countries (%)	26.23	28.56	33.49	40.99	33.72	38.42	37.79	26.39	23.99	23.89
Share of developing countries (excl. China) (%)	24.15	23.66	23.89	32.01	25.69	31.08	31.38	21.33	20.27	16.21
Least developed countries	1.83	1.46	1.74	1.17	2.00	2.39	2.52	3.71	4.53	4.41
Share of LDCs (%)	1.15	0.84	0.80	0.46	0.60	0.63	0.53	0.55	0.52	0.35

Source: UNCTAD data.

**Figure 6**



**Figure 7**



Source: Carlos M. Correa and Nagesh Kumar, *PROTECTING FOREIGN INVESTMENT: IMPLICATIONS OF A WTO REGIME AND POLICY OPTIONS* (Zed Books, London, 2003).

Fig. 5 - p. 8; Figs. 6 and 7 – p. 11

42. Furthermore, in addition to declining FDI inflows, even the level of gross flows of FDI may pose special hazards for developing countries given their weaker market structures and special development needs. More may not always be better in that “[t]here is an optimum level of flows and stock of FDI (which depends in part on its sectoral allocation) for any particular developing country, just as, by analogy, there is an optimum level of sustainable debt.”<sup>48</sup>

43. India raised many of the concerns of developing countries on the quality of FDI flows in its submission to the WTO:

“...‘more’ is not necessarily ‘better’ in the case of multinational corporate activities in developing countries. Studies have shown that between 25 and 45 per cent of FDI has a demonstrably negative impact on host societies. That is, the costs in terms of using scarce

<sup>48</sup> South Centre, *supra* note 43, at 2.



domestic resources inefficiently substantially outweigh the benefits of national income.

“Obviously, it (FDI) introduces the need for competition and, thereby, efficiency. To ensure the greatest contribution to their own development, host governments may in fact have to refuse to grant the kind of treatment that many international companies want most. In fact, screening mechanisms can help developing countries sort out beneficial from detrimental foreign investment projects.

“This gives rise to the related question of investor's obligations. Such obligations may be important for various economic, social and cultural necessities. Any study of trade and investment interface thus inevitably introduces concepts of TNC obligations, which are not new to the discussants here. We need to avoid tragedies of the type we had in Bhopal, India, a decade ago.

“We may also need to study obligations for the protection of the environment and sustainable development. Should TNCs, for example, not be asked to maintain the same environmental standards in host countries as they have in home countries, even though host country domestic investors have certain lower standards on account of lack of capital, technology or skills required, or on account of better assimilative capacities in their regions? These are issues that need further study.”<sup>49</sup>

44. The risks associated with foreign investment flows relate to the impact of these flows on the balance of payments, macroeconomic management, the exchange rate, restrictions in the transfer of technology, and crowding out of domestic enterprises. . In other words, “FDI may have both a short and a longer-term structural influence on the composition of a country’s external payment flows [...] unfettered FDI may create a time profile of foreign exchange outflows (in the form of dividend payments or profits repatriation) and inflows (e.g. fresh FDI) which may be time inconsistent. Experience shows that such incompatibility, even in the short run, may easily produce a liquidity crisis [which could in turn] degenerate into a solvency crisis with serious adverse consequences for economic development.”<sup>50</sup>
45. The Asian financial crisis in 1997-98 showed that FDI flows may contribute to volatility and financial fragility when not adequately managed and regulated. “While a direct investor usually has some immovable assets, there is no reason in principle why these cannot be fully offset by domestic liabilities. Clearly a direct investor can borrow in order to export capital, and thereby generate rapid capital outflows.”<sup>51</sup> Furthermore, FDI flows may come in surges, affecting the exchange rate and the competitiveness of the tradable sectors with further consequences for the balance of payments.

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<sup>49</sup> India, *supra* note 47, para. 4.

<sup>50</sup> Singh, *supra* note 42, at 8.

<sup>51</sup> *Id.*, at 7.

46. One of the most sought for benefits of FDI is its potential spillover effects on domestic firms in regard to managerial and technical efficiency and technology transfers. But there is also the possibility that local firms may be crowded out by the entry of TNCs “given their superior technology, appeal of brand names and aggressive marketing techniques. The crowding out effect may be sharper when the technology gap between foreign and domestic firms is very wide”<sup>52</sup> which is mostly the case in many developing countries.

47. UNCTAD has pointed out that:

“... FDI may have uneven effects on development. Effects are determined to a large extent by the conditions prevailing in host countries, by the investment strategies of TNCs and by the policies of host governments. Host governments do indeed retain a role in influencing the benefits that their economies gain from inward FDI. TNCs can be powerful agents of dynamic comparative advantage if a proactive and efficient government takes their efficiency needs into account and offers the right set of incentives and support measures for upgrading and transferring technology skills.”<sup>53</sup>

48. The many economic, financial and social risks associated with FDI flows lend support to the cautious approach taken by developing countries towards investment liberalization. Foreign capital flows can lead to higher levels of investment and growth but developing countries must retain the responsibility to determine the timing, amount and type of investment (including specific investment projects) that may enter the country. Developing countries need to have in place the capacity to monitor the net benefits of FDI flows in a number of areas. This is contrary to the passive stance towards foreign investment recommended by the WDR 2005.

49. **The experience and evidence of the impact of FDI across countries – developed and developing alike – over time suggests that active and effective State intervention may be needed in order to ensure that developmental benefits are obtained from FDI.** When today’s developed countries and the newly industrialized countries in Asia were net recipients of FDI, they “imposed regulations on foreign investors in order to ensure that such investment contributed to their long-term national development.”<sup>54</sup> That is,

“[T]hese countries took a **strategic approach** to foreign investment. This meant that different sectors could be subject to different policies at the same time.... Their respective policy stance also evolved over time, according to changes in their economic structure and external conditions. [emphasis in the original]

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<sup>52</sup> Correa and Kumar, supra note 41, at 14.

<sup>53</sup> UNCTAD, *Foreign Direct Investment and Development*, UNCTAD/ITE/IIT/10 (Vol. 1) (United Nations, Geneva, 1999), p. 50.

<sup>54</sup> Ha Joon Chang and Duncan Green, *THE NORTHERN WTO AGENDA ON INVESTMENT: DO AS WE SAY, NOT AS WE DID* (South Centre & CAFOD, Geneva, 2003), p. 33.

“The historical experience of today’s developed countries shows that a well-devised set of restrictions and performance requirements on foreign investment has been a key ingredient in their recipes for success. While only some of these countries were hostile towards foreign investment, none of them pursued policies that were uncritically welcoming to foreign investment, in marked contrast to what many of those same countries recommend to today’s developing countries.

“History also shows that a strategic and flexible approach is essential if countries are to use foreign investment to pursue long-term national interests. Rather than sticking to one rigid recipe, most successful economies have changed their policies towards foreign investment according to changes in their stages of development, national priorities, and the world economic environment.”<sup>55</sup>

50. UNCTAD has also argued for an active role for the state towards investment indicating that “the best way of attracting and drawing benefits from FDI is not always passive liberalization (an “open door” policy)... [P]olicies can induce investors to act in ways that enhance the development impact [of FDI] – by building local capabilities, using local suppliers and upgrading local skills, technological capabilities and infrastructure.”<sup>56</sup> For all of these reasons, the harmonization of investment policy through binding commitments in the WTO, as called for by the developed countries, is an issue of special concern for developing countries.

## **B. Investment Liberalization and Development Goals**

51. In the WTO discussions on the relationship between trade and investment, developing countries have insisted on the need to preserve policy space and flexibility for adopting development policies. This means retaining the right to make selective interventions and adopting a strategic approach as described above. The developing countries argue that “the flexibility for pursuing various developmental options is key to the future of any developing country; anything that reduces the flexibility currently available to countries should not be an advisable course to pursue.”<sup>57</sup> They have stressed that “in assessing the issues involved in a possible multilateral framework on investment, developing countries had to reconcile the need for foreign investment with the guarantee that in future they would be able to react to the changing needs of their economies.”<sup>58</sup>

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<sup>55</sup> *Id.*, at 35-36.

<sup>56</sup> UNCTAD, *WORLD INVESTMENT REPORT 2003: FDI POLICIES FOR DEVELOPMENT – NATIONAL AND INTERNATIONAL PERSPECTIVES* (United Nations, New York, 2003), pp. 85 and 87.

<sup>57</sup> WTO, *India – Communication*, WT/WGTI/W/86, 22 June 2000, para. 3. For a brief discussion of the concept of “policy space” as advocated by developing countries in the context of UNCTAD XI, and which concept is relevant to this paper, please see South Centre, *The UNCTAD XI Sao Paulo Consensus: Defining UNCTAD’s Mandate*, SC/TADP/AN/GEG/5, July 2004, paras. 14-19, available at [http://www.southcentre.org/tadp\\_webpage/research\\_papers/instigovernance\\_project/unctadxi\\_saopaulo\\_consensus\\_comments\\_jul04.doc](http://www.southcentre.org/tadp_webpage/research_papers/instigovernance_project/unctadxi_saopaulo_consensus_comments_jul04.doc).

<sup>58</sup> WTO, *WGTI – Report on the Meeting Held on 14 and 15 April 2003*, WT/WGTI/M/21, para. 70.

52. The need for flexibility encompasses a number of issues. An important concern is the definition of investment. Developing countries have almost unanimously supported limiting discussions on investment to Foreign Direct Investment. The developed countries, in particular the US and Canada, wish to expand the definition of investment so as to include portfolio investments.
53. China, in its submission has responded that “Foreign Portfolio Investment (FPI) ... particularly the short-term capital flows of a speculative nature, imposes substantial potential threats and risks to the national economies for those Members with less mature capital markets and less effective supervision and regulation capacities ... FPI, including capital flows of a speculative nature, and debt as well as loans should be excluded”<sup>59</sup> from the discussions on investment within the WTO context.
54. Developing countries also feel that the deliberations on investment in the WTO should focus on investments with the highest potential for growth and trade expansion. They have suggested that here may be merits in distinguishing different forms of FDI flows, arguing that “[g]reenfield investment, for example, would be of more significance than mergers and acquisitions as they could have more beneficial spread effects on the economy.”<sup>60</sup>
55. Mergers and Acquisitions have acquired growing importance as a form of investment in developing countries in recent years and this has raised many concerns about the net benefits of this type of investment. A particularly troublesome issue is that “FDI entry via an acquisition may not represent any addition at all to the capital stock, output or employment”<sup>61</sup> of the host country. Also “if FDI takes the form of acquisition of host country corporations on the stock market, the net result could be that of the best developing country corporations being acquired by the much larger multinationals even though the latter would not be as efficient as the acquired corporations.”<sup>62</sup>
56. The issue of competition between local and foreign firms is another important concern of developing countries. Crowding out effects are likely to occur when TNCs outperform domestic enterprises, which is bound to be the case even with respect to the larger domestic firms in developing countries. For this reason, developing countries have stressed the importance of retaining the flexibility to support local firms to improve their performance and enhance the linkages of TNCs to the local economy. “[T]he building up of domestic entrepreneurial industrial and technological capabilities is essential not only to cope with, but also to realize the full benefits from FDI and foreign technology. Without sufficient domestic capabilities, FDI and foreign technology seldom permeate the productive system of the national economy.”<sup>63</sup>

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<sup>59</sup> WTO, *China – Scope and Definition*, WT/WGTI/W/159, 15 April 2003, para. 5.

<sup>60</sup> WTO, *India – Development Provisions*, WT/WGTI/W/148, 7 October 2002, para. 5.

<sup>61</sup> Singh, *supra* note 42, at 11.

<sup>62</sup> *Id.*, at 12.

<sup>63</sup> WTO, *India – Communication*, WT/WGTI/W/74, 13 April 1999, para. 9.

57. Developing countries are opposed to the automatic application of the principle of non-discrimination to investment regulation, as proposed by the developed countries and the WDR 2005. They insist upon the need for flexibility to direct FDI to specific sectors and/or regions, according to their development priorities. The developing countries believe that there should be “[s]elective and judicious intervention of the government...to support domestic industry and technology creation, sometimes even to ensure a level playing field for domestic enterprises, particularly the small and medium size enterprises,”<sup>64</sup> and add that “the pursuit of full employment required policies to safeguard the viability of [local SMEs], including by ensuring that they maintained significant market shares, which would not be compatible with the principle of national treatment and market access commitments.”<sup>65</sup>
58. The response of the developed countries is that an investment framework designed on the basis of the “positive list”<sup>66</sup> approach of the WTO’s General Agreement on Trade in Services (GATS) would provide developing countries with the flexibility required. The developed countries argue that this approach will enable developing countries to determine the extent and speed of investment liberalization, as well as to establish conditions for granting access to foreign investment, in order to achieve specific development goals.
59. Unfortunately, the experience of the developing countries in the negotiations of GATS does not provide sufficient reassurance of flexibility. First, there is a presumption of progressive liberalization under GATS which could be applied to investments in general and this could put pressure on developing countries to gradually eliminate restrictions and conditions on foreign investments across all sectors. Second, once made, commitments are extremely difficult and costly to reverse, which is in fact the main advantage that the WDR attaches to binding rules on investment. Third, “the requirement that all exceptions be scheduled at the time of commitments implicitly presume an inconceivable degree of *ex ante* knowledge about an infinite range of policies”<sup>67</sup> that may be appropriate under current circumstances and those that may be desirable in the future. This would require a capacity for forecasting the needs of the economy over time which is limited in all countries, but particularly so in the developing world which lacks the resources, network of research institutes and business groups to advise the government on these issues.

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<sup>64</sup> Id., para. 6.

<sup>65</sup> Statement by the delegation of Indonesia. See WGTI, *supra* note 58, para. 46.

<sup>66</sup> The GATS positive-list approach requires WTO Member States to create a “positive list” – i.e. identify and list down specific services sectors in their GATS Schedule of Specific Commitments – to which their GATS commitments on market access and national treatment will apply. All other services sectors that are not listed down by WTO Members in their positive list will not be subject to market access liberalization and national treatment commitments, meaning that maximum policy flexibility with respect to controlling market access and providing preferential treatment in favor of domestic services and service providers will be retained and not be subject to GATS rules.

<sup>67</sup> Albert H. Cho and Navroz K. Dubash, *Will Investment Rules Shrink Policy Space for Sustainable Development? Evidence from the Electricity Sector* (South Centre TRADE Working Paper No. 16, 2003), p. 5.

60. In a working paper co-published by the South Centre and the World Resources Institute that looked at case studies from the electricity sector to assess the extent to which GATS disciplines and future investment disciplines modelled on the GATS-positive list approach could limit policy flexibility, the conclusions reached from these case studies were that:

“... in order to create a socially progressive and environmentally sustainable electricity sector, countries may reasonably wish to pursue heterodox policies that run counter to investment disciplines. Specifically, these cases demonstrate how both industrialized and developing countries have used available policy space to build a domestic political consensus around environmental policies, to direct foreign capital to needed social and environmental ends, to address long-standing social inequalities, and to deal with external shocks.

This paper further argues that proposed extensions to international investment rules are likely to shrink policy space for sustainable development, and that measures designed to provide flexibility, such as the “positive list” approach whereby countries gradually schedule commitments over time, may nonetheless prove to be unduly limiting in practice.”<sup>68</sup>

61. Based on the above considerations, developing countries insist that “host countries should have the right to regulate FDI – and to screen and channel it – in accordance with their domestic laws, policies and regulations”<sup>69</sup> and concluding that “the GATS-type positive list approach [is] not compatible with [their] development concerns and consequently not appropriate in any future multilateral investment framework.”<sup>70</sup>

62. In the GATS negotiations, developing countries requested the liberalization of the mode of supply of services through the temporary movement of natural persons and so far there has been no response from the developed countries on this issue. In the WTO discussions, the developing countries have called the attention to the imbalance and inefficiencies derived from an approach that requires the free movement of capital while preserving barriers to the movement of labour. “Not ensuring the mobility of labour as a complementary and critical factor to the mobility of capital can have far-reaching consequences on production frontiers, scales and scope of production and associated costs.”<sup>71</sup> The developing countries have suggested that “a liberal integrated approach is necessary to the mobility of labour as part of the global flows of capital, goods and services.”<sup>72</sup>

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<sup>68</sup> Id., at 2.

<sup>69</sup> Statement by the delegation of Malaysia. See WGTI, supra note 58, para. 79.

<sup>70</sup> Statement by the delegation of Kenya. See id., para. 82.

<sup>71</sup> WTO, *India – Global Relationship Between the Mobility of Capital and the Mobility of Labour: Selected Issues for Consideration*, WT/WGTI/W/39, 4 June 1998, para. 7.

<sup>72</sup> Id., para. 3.

63. The developing countries have also stressed the importance of performance requirements to guarantee that linkages with the local economy are established as well as to avoid some of the potentially negative effects associated with FDI. In the past, the developed countries made extensive use of investment restrictions and performance requirements to support local businesses and to achieve specific policy goals, including local content requirements and other measures which they are now proposing to prohibit by WTO rules.<sup>73</sup>
64. From the perspective of developing countries, “performance requirements constitute one of the basic mechanisms for harmonizing foreign direct investment and national objectives and priorities of developing countries,”<sup>74</sup> since TNCs act according to their strategic global objectives which may or may not coincide with those of the host economy. In their view, performance requirements are necessary for the achievement of the goals to improve the competitiveness of local firms, diversify production and exports and move up in the technological ladder, improving labour skills and raising incomes.
65. Indeed, as developing countries move up the technological and production ladder and as a country’s export structure shifts from a dependency on commodity exports towards exports of higher value-added and innovation-based products, incomes and standards of living also increase and become more sustainable in the long-run. (See Box 3).

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<sup>73</sup> The Agreement on Trade-Related Investment Measures (TRIMs) adopted during the Uruguay Round prohibits measures imposed on investors that provide advantages to local goods to the expense of imports and those that establish quantitative restrictions on imports and exports.

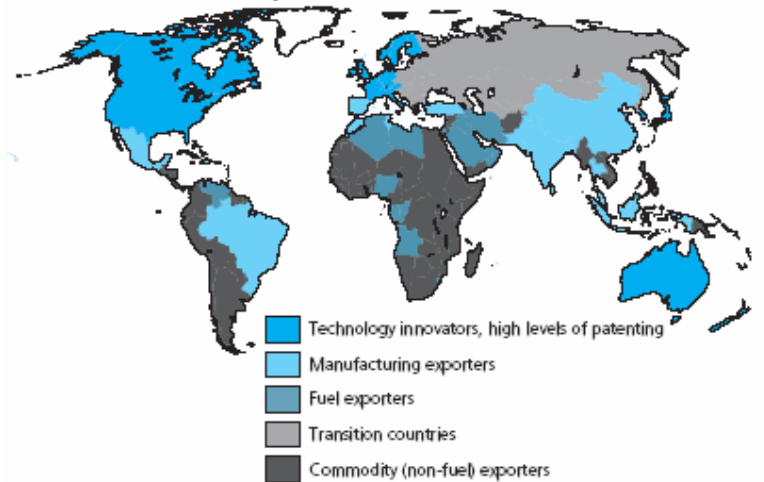
<sup>74</sup> Statement by the delegation of Brazil. See WTO, *Council for Trade in Goods – Minutes of the Meeting of 12 to 13 March 2003*, G/C/M/69, 7 May 2003, para. 4.2.

### Box 3: Economic Structures and Economic Growth Patterns

**Figure 8**

MAP 1

Classification of countries by economic structure, 1995



Map 1 divides the world into five categories. First are countries with high economic innovation, as measured by the number of patents per million people, shown in dark blue. These tend to be the high-income countries. Second are developing country exporters of manufactured goods, shown in lighter blue. In 1995, at least half of these countries' exports were in the manufacturing sector. Third are the fuel-exporting countries, shown in blue-grey. Fourth are transition countries, in grey. Fifth are the commodity (non-fuel)-exporting developing countries, in black.

**Figure 9**

TABLE 1

**Economic growth rates by country group, 1980–98**

Group	Countries that grew in GDP per capita	Average annual growth in GDP per capita (%)
Technology innovators	18 out of 18	1.7
Transition countries	4 out of 12	-1.7
Fuel exporters	2 out of 13	-1.5
Manufacturing exporters	23 out of 24	2.7
Commodity (non-fuel) exporters	29 out of 61	-0.1

Note: GDP per capita is measured in purchasing power parity.

Source: Maddison 2001; World Bank 2002j.

Table 1 breaks down patterns of economic growth by economic structure. Grouping countries in the same five categories as map 1, the table shows that the main problems in economic growth has come in three types of economies: transition countries, oil-exporting economies (which faced a huge loss of purchasing power from their single or dominant export commodity) and commodity (non-fuel)-exporting developing countries. Most of the commodity exporting countries are in Sub-Saharan Africa, Latin America and Central Asia. Innovating economies and manufacturing exporters among developing countries by and large experienced economic growth.

Source: UNDP, *Human Development Report 2003*, p. 85

66. Host governments, particularly those in the developing world, have limited capacity to regulate the conduct of Trans-national corporations whose global scope and economic power are bigger than that of many countries. Performance requirements are seen by developing countries as means to address some of the practices of TNCs that may prejudice the host economy including preventing “tax evasion, restrictive business practices, illicit payments and abusive transfer pricing.”<sup>75</sup> Developing countries have pushed

<sup>75</sup> Correa and Kumar, *supra* note 41, at 28.



for a review of current WTO disciplines that prevent them from using performance requirements and have insisted in the context of investment discussions to start a thorough discussion of the developmental aspects of these measures.

67. In addition, they have proposed a comprehensive approach towards the regulation of TNCs' activities, including the adoption of binding rules whose enforcement will be dependent upon host and home country governments.<sup>76</sup> According to developing countries, a basic requirement of TNCs' activities would be that they "strictly abide by all domestic laws and regulations in each and every aspect of the economic and social life of the host members in their investment and operational activities."<sup>77</sup>
68. Finally, most developing countries do not believe that a multilateral framework on investment would lead to higher investment flows to developing countries in general and the poorest ones in particular. They also argue that the existing network of bilateral and regional treaties provide adequate protection to investment since "discussions have not shown clearly the benefits emanating out of the multilateralization of bilateral treaties."<sup>78</sup>
69. The opposition by most developing countries<sup>79</sup> – including those from Africa, the Caribbean, the Pacific, Asia, and Latin America<sup>80</sup> – to the launch of negotiations in the WTO on the relationship between trade and investment policy ( as well as with respect to the other Singapore issues) is based on their past experience of the negative effects of FDI. Developing countries believe

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<sup>76</sup> See WTO, *China, Cuba, India, Kenya, Pakistan, and Zimbabwe – Investors' and Home Governments' Obligations*, WT/WGTI/W/152, 19 November 2002, for a discussion of the elements proposed by developing countries for inclusion in a future agreement on corporate responsibility and accountability and the role they foresee for home country governments in terms of enforcement.

<sup>77</sup> *Id.*, para. 10.

<sup>78</sup> India, *supra* note 63, para. 14.

<sup>79</sup> It should be noted that there are also some developing WTO Members that support the launch of negotiations on the Singapore issues. These include, *inter alia*, Costa Rica, Chile, Korea, Mexico, Hong Kong – China, and Chinese Taipei.

<sup>80</sup> See e.g. African, Caribbean, and Pacific Countries (ACP), *Conclusions of the 8<sup>th</sup> Meeting of ACP Ministers of Trade*, Grand Baie, Mauritius, 11 July 2004, para. 4; ACP, *Ministerial Declaration on the WTO Doha Work Programme*, Grand Baie, Mauritius, 11 July 2004, para. 45; ACP, *Ministerial Declaration on the Fifth Ministerial Conference of the WTO*, WT/MIN(03)/4, 21 August 2003, paras. 39-40; African Union (AU), *Report of the Conference of African Ministers of Trade*, Grand Baie, Mauritius, 18 June 2003, Part VI; African Union, *Kigali Consensus on the Doha Work Programme*, AU/TD/MIN/Decl.1(II), Kigali, Rwanda, 28 May 2004, para. 7 ; Caribbean Community, *Caribbean Declaration on the Fifth WTO Ministerial Conference*, WT/MIN(03)/6, 29 August 2003, para. 19 ; Least Developed Countries (LDCs), *Dakar Declaration by LDC Trade Ministers*, Dakar, Senegal, 5 May 2004, para. 25 ; ACP-AU-LDC (G-90), *Elements of a G-90 Platform on the Doha Work Programme*, Grand Baie, Mauritius, 13 July 2004, para. 20 ; LDCs, *Dhaka Declaration*, Dhaka, Bangladesh, 2 June 2003, paras. 27-28 ; West African Economic and Monetary Union (UEMOA), *Declaration of Ministers of Trade of the Member States of the UEMOA on the Singapore Issues at the Fifth Ministerial Conference of the WTO at Cancun*, WT/MIN(03)/17, 13 September 2003 ; ACP-AU-LDC, *Position of the African Union, Least-Developed Countries, African, Caribbean and Pacific Countries, on the New (Singapore) Issues*, WT/MIN(03)/W/19, 12 September 2003; Bangladesh (on behalf of the LDC Group), Botswana, China, Cuba, Egypt, India, Indonesia, Kenya, Malaysia, Nigeria, Philippines, Tanzania, Uganda, Venezuela, Zambia and Zimbabwe, *Paragraphs 13, 14, 15 & 16, Dealing with Singapore Issues of the Draft Cancun Ministerial Text Contained in Document Job(03)/150/Rev. 1*, WT/MIN(03)/W/41, 4 September 2003.

that in order for them to be able to ensure that FDI serves their developmental interests, they need to be able to have the policy space and flexibility to ensure that FDI is regulated and channeled appropriately towards meeting their developmental goals. They also believe that negotiating and implementing new binding multilateral rules on investment regulation in the WTO context would minimize their policy space and flexibility to the detriment of the achievement of their developmental goals.

#### IV. CONCLUSION: AN AGENDA ON INVESTMENT FOR DEVELOPING COUNTRIES

70. Developing countries need larger capital inflows to raise the level of investment and GDP growth and to create jobs. Inflows of foreign direct investment can contribute to these objectives and developing countries understand that investors are looking for rules that would reduce the risks to investment. By the same token, the developing countries are looking for rules that would ensure that these flows provide development benefits. The quality of the flows of foreign investment is equally or even more important than the quantity.
71. The opposition of developing countries to the proposals for the negotiation of new binding international rules and disciplines to govern FDI arises out of their experience of the negative effects of the trade and investment liberalization initiatives that many have undertaken as a result of World Bank loan conditionalities or IMF structural adjustment programs. Developing countries have also experienced the adverse social, environmental, economic and financial effects of unregulated FDI and portfolio investments by TNCs. These concerns were inadequately addressed in WDR 2005.
72. The demand for policy space to pursue development objectives also needs to be considered by the developed countries and the World Bank. This concept has been formally recognized at the international level, most recently at the Eleventh Session of the UN Conference on Trade and Development (UNCTAD XI) which stated that the development process cannot be satisfactorily undertaken and its objectives achieved unless the role of the State in such a process is preserved. UNCTAD XI stresses that “[t]here is a need to strike a balance between the objectives of efficiency and equity. Both the market and the state have an important role to play in the development process, and it is essential to ensure that their respective roles are complementary.”
73. UNCTAD XI recognized that an important role of the State is to ensure that development benefits are distributed equitably through sound development policies, strategies, infrastructure development, and regulatory frameworks.<sup>81</sup> “Policy space”, for UNCTAD XI, refers to “the scope for domestic policies, especially in the areas for trade, investment and industrial development.”<sup>82</sup> Essentially, it reflects the idea that governments should have the leeway to

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<sup>81</sup> UN, *UNCTAD XI: Sao Paulo Consensus*, TD/410, 25 June 2004, available at [http://www.unctad.org/en/docs/td410\\_en.pdf](http://www.unctad.org/en/docs/td410_en.pdf), para. 7.

<sup>82</sup> *Id.*

“evaluate the trade-off between the benefits of accepting international rules and the constraints posed by the loss of policy space.”<sup>83</sup>

74. A more balanced view of the trade and investment debate by the WDR 2005 would have taken into account some of the views of the developing countries for the agenda on investment. These ideas could be summarized from submissions that developing countries have made in the WTO discussions on the relationship between trade and investment and include the following:

- Discussions relating to the development of new disciplines or rules on investment should look at the relationship between trade, investment, and development, including the impact of FDI on domestic economic factors, technology transfer, capacity-building, and national industrialization policies, and the relationship between capital and labor mobility;<sup>84</sup>
- Short-term capital or portfolio investments should be excluded from the scope of any framework agreement on investment;<sup>85</sup>
- An international framework agreement on investment should not require developing countries to provide confidential information relating to state security or any other information, the disclosure of which would have negative impact on the protection of the public interests;
- Account should be taken of the disparities of levels of development among different categories of countries, particularly the special difficulties of the developing countries in fulfilling their obligations on transparency; to increase the capabilities of developing countries in implementing provisions on transparency, developed countries have the obligations and should commit themselves to provide corresponding technical and capacity-building assistance to developing countries;<sup>86</sup>

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<sup>83</sup> Id. In this regard, see also UNCTAD, *Notes on the concept of economic policy space*, 4 March 2004, para. 1, in which the UNCTAD Secretariat described the concept of economic policy space as referring to “the extent to which national governments have the authority to make decisions concerning economic policy and, correspondingly, the extent to which such authority is constrained by international disciplines and processes.” This concept is also linked, according to the UNCTAD Secretariat, to the concept of “open nationalism” which “suggests policies and approaches that take appropriate account of the pursuit of national objectives and goals but are consistent with the growing integration of the world economy and the increasing participation of developing countries in its challenges and opportunities. Such policies and approaches are conceived primarily as efforts to upgrade the capabilities and skills of the national labour force, as well as of national capital, in order to better integrate into the global economy.” See UNCTAD, *A conceptual note on “open nationalism”*, 4 March 2004, para. 26. See also South Centre, *The UNCTAD XI Sao Paulo Consensus: Defining UNCTAD’s Mandate*, supra note 57, paras. 14-19.

<sup>84</sup> WTO, *India – Communication*, WT/WGTI/W/3, 17 June 1997; WTO, *India – Global Relationship Between the Mobility of Capital and the Mobility of Labour: Selected Issues for Consideration*, WT/WGTI/W/39, 4 June 1998; WTO, *India – Communication*, WT/WGTI/W/74, 13 April 1999; WTO, *India – Relationship between Trade, Investment and Development*, WT/WGTI/W/72, 12 April 1999; WTO, *India – Communication*, WT/WGTI/W/86, 22 June 2000; WTO, *India – FDI Flows and Technology Transfer*, WT/WGTI/W/105, 26 June 2001; WTO, *India – Investment, Development and Technology Transfers*, WT/WGTI/W/73, 13 April 1999.

<sup>85</sup> WTO, *China – Scope and Definition*, WT/WGTI/W/159, 15 April 2003.

<sup>86</sup> WTO, *China – Transparency*, WT/WGTI/W/160, 15 April 2003.

- An international framework agreement on investment should preserve the policy space of developing countries to impose host country obligations and performance requirements on foreign investors;<sup>87</sup>
- The concept of non-discrimination is not an absolute and fundamental international trade or legal principle and may not be appropriate in an international framework agreement on investment because it could limit policy space. For example, the concept of national treatment would not be applicable to pre-establishment commitments on investments because host countries normally preserve their right to make or modify rules and regulations governing the entry of foreign investments (e.g. provide for rules governing the entry and establishment of investments of foreign firms that would be different from those governing investments of domestic firms);<sup>88</sup> and
- The right of developing countries to regulate foreign investors and the need for foreign investment to undertake obligations in line with their host country's interests should be preserved; and home countries should also undertake obligations to ensure that the investor's behaviour and practice are in line with and contribute to the interests, development policies and objectives of the host country.<sup>89</sup>

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<sup>87</sup> WTO, *India – Development Provisions*, WT/WGTI/W/148, 7 October 2002.

<sup>88</sup> WTO, *India – Non-Discrimination*, WT/WGTI/W/149, 7 October 2002; WTO, *India – Views on Modalities for Pre-Establishment Commitments Based on a GATS-Type Positive List Approach*, WT/WGTI/W/150, 7 October 2002.

<sup>89</sup> WTO, *China, Cuba, India, Kenya, Pakistan, and Zimbabwe – Investors' and Home Governments' Obligations*, WT/WGTI/W/152, 19 November 2002.