

WORLD TRADE ORGANIZATION

RESTRICTED

WT/WGTI/M/9

19 July 1999

(99-2965)

Working Group on the Relationship between Trade and Investment

REPORT ON THE MEETING OF 3 JUNE 1999

Note by the Secretariat

1. The Working Group on the Relationship between Trade and Investment met on 3 June 1999 under the Chairmanship of Ambassador Man Soon Chang (Korea). The Working Group adopted the agenda as proposed in WTO/AIR/1083.

A. **IMPLICATIONS OF THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT FOR DEVELOPMENT AND ECONOMIC GROWTH (ITEM I OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)**

2. With respect to the contribution introduced by Korea at the last meeting on the role of foreign direct investment ("FDI") in the Asian financial crisis (WT/WGTI/W/69), the representative of the United States stated that Korea's experience and empirical studies demonstrated that FDI could serve an important cushioning effect in the event of a currency crisis. Unlike portfolio investment, FDI involved assets such as plant and equipment which were not easily repackaged or transferred abroad. While many observers had faulted foreign investors for precipitating currency crises through capital flight or, in the case of banks, through a refusal to rollover short term instruments, it had become clear in the aftermath of the financial crisis that foreign direct investors who chose to make long-term commitments in a host country and who in doing so risked exposure to the same financial storms as any domestic firm staid put. At the same time, it was not easy to attract one type of investor while discouraging the other. Direct and portfolio investment tended to take place together. Portfolio investment made an important contribution to economic growth by adding to national savings, broadening the array of lending terms available to domestic businesses and stabilizing the local economy by spreading credit risk. It was encouraging that Korea was using the financial crisis as an opportunity to correct structural problems, open the banking industry and other financial services to FDI, and reduce the differential treatment of foreigners in market access, ownership and financing.

3. The representative of the European Communities pointed to the observations made in Korea's contribution on the relationship between, on the one hand, the weakness of a country's financial infrastructure and its vulnerability to financial instability in international markets and, on the other, a low level of FDI. He also welcomed the steps taken by Korea to strengthen its regulatory framework in a way that encouraged greater FDI flows and thus strengthened Korea's financial infrastructure.

4. The representative of Korea, referring to contributions introduced at the last meeting by India (WT/WGTI/W/72 and 73), stated that as a matter of principle his delegation did not disagree with India's observations regarding the importance of policy intervention in relation to the role of FDI in the transfer of technology and intangible assets, but that research by the analysts mentioned by India also provided examples of negative effects of policy intervention on the transfer of technology. For example, a study by Grieco in 1984 had found that as India moved away from mandatory shared ownership in the computer industry, abandoned attempts to create a national champion and allowed international companies to engage in partner and alliance relationships, India's technological lag – the difference in years between the introduction of technology in the advanced countries and its

introduction in India – had decreased and that the cost of technology acquisition had declined. A study by Mansfield and Romero in 1980 showed that technology transfer through joint ventures or licensing agreements took longer than technology transfer from parent companies to their affiliates. A recent study by Kokko and Blomström found that mandatory transfer of technology might cause adverse effects on the actual transfer of technology, and that increased competitive pressures in host country markets were the most important incentive for the transfer of technology. While these studies did not necessarily indicate that national policy intervention always resulted in negative effects on the transfer of technology, they provided some empirical evidence that technology transfer through non-market mechanisms could cause unexpected negative effects, and that local conditions in host countries, such as a high level of technical skills, infrastructure and a competitive environment, were more important determinants of technology transfer and spillovers. This was consistent with the conclusion drawn in the Note by the Secretariat in WT/WGTI/W/65.

5. The representative of the European Communities noted that a number of delegations had expressed concern that even where investors brought in the best technology and were willing to share it with local partners, there might not be local firms with capacity to absorb such technology. This concern illustrated the fundamental point that had been raised by his delegation on several occasions regarding the need to complement the FDI regime of a country with steps to increase the competitiveness of the domestic market. It was only with a competitive market that it was possible to create a sufficient number of domestic enterprises that were able to absorb and reap the benefits of transfer of technology or managerial skills. The contribution by Korea in WT/WGTI/W69 showed that Korea had chosen to make its own domestic market more efficient and competitive as a means of increasing the benefits of FDI.

6. The representative of the United States stated that there was a disturbing suggestion in the Indian contributions in WT/WGTI/W/72 and 73 that governments should step in and force technology transfer. Given that the WTO rules placed restraints on governmental intervention, it seemed to her delegation that this suggestion was contrary to the disciplines and motivations underlying the WTO.

7. The representative of India stated that his delegation did not dispute Korea's observation that in some circumstances national policy intervention could have adverse consequences. Rather, the fundamental point made in the contributions by his delegation was that it was for each country to decide what were the appropriate policies to adopt in light of its own circumstances. The comment made by the United States reflected an oversimplification of the views expressed in India's contributions. India was not arguing that governments should intervene to ensure that transfer of technology took place at any cost. Rather, the point was that, if one left it completely to market forces, transfer of technology might not happen at all. For example, a number of African countries had completely liberal investment regimes but technology transfer did not occur. Thus, to say that a liberal FDI regime would automatically give rise to FDI and associated transfer of technology seemed a very simplistic approach. Equally simplistic would be to draw the conclusion from the Indian contributions that there was only a role for governmental intervention. India was an emerging market and interested in attracting FDI but did not wish to see the space for policy intervention severely restricted. In light of the existence of provisions on the transfer of technology in several WTO agreements, for example in the TRIPS Agreement, it could not be said that the WTO had nothing to do with the subject of technology transfer. His delegation believed that these existing WTO provisions on technology transfer needed to be strengthened to encourage technology transfer on reasonable terms.

8. The representative of the Philippines, speaking on behalf of ASEAN WTO Members, agreed with India's comments and pointed to the observations made in the Note by the Secretariat (WT/WGTI/65) that 80 per cent of the global stock of FDI originated in a few developed home countries which dominated world-wide research and development; that the multinational enterprises of these countries accounted for most of the demand for and use of technology developed in these

countries; and that formal technology transfer arrangements had not proven to be a significant channel for the dissemination of modern, advanced technology.

9. The representative of the European Communities, in response to India's comments, stated that it was important to make a distinction between the issue of the factors which determined a country's capacity to attract FDI, on the one hand, and the issue of appropriate policies regarding transfer of technology, on the other. The capacity of a country to attract FDI depended in the first place upon the existence of profitable investment opportunities. While the existence of an open investment regime did not mean that a country would automatically be able to attract FDI, instability and lack of transparency of the investment regime could increase the perceived risk of the investment and thus deter investment decisions. Policies involving the compulsory transfer of technology which did not give sufficient guarantees to the investor that it would reap a legitimate profit from using that technology could deter investment decisions.

10. The representatives of Chile and Argentina observed that their countries had benefitted substantially from the transfer of technology associated with FDI, notwithstanding the absence of legislative provisions requiring technology transfer. The positive impact of such transfer of technology was evident in the growth and diversification of exports and the improvement in the quality of the domestic infrastructure. Thus, the benefits of FDI that arose from its contribution to the transfer of technology could be achieved through the operation of market forces.

11. The representative of Japan stated that, in respect of the concern expressed that technology transfer might not be achieved without government intervention, account should be taken of the fact that the process of globalization augmented the contribution of FDI to technology transfer in that the competitive pressures facing multinational enterprises in international markets compelled such enterprises to enhance the efficiency of their operations. An important example of this phenomenon was the transfer of technology in the context of sub-contracting arrangements with local suppliers of parts and components.

12. The representative of Brazil stated that the notion of governmental intervention with regard to the transfer of technology was not necessarily incompatible with WTO principles. For example, the GATS allowed Members to make specific commitments tailored to their needs in given sectors and areas. Similarly, transfer of technology in some areas could be regulated in full compliance with basic WTO principles. A distinction should be made between the question of how to attract FDI and the question of how that FDI contributed to the transfer of technology. While it could be argued that, if a country forced a company to transfer technology, this would diminish a country's attractiveness for FDI, one should also take into account that what was involved was a bilateral contract between an enterprise and a government. Since a company would not engage in transfer of technology if it felt that the conditions imposed were too strict, host-country governments knew exactly the risk of applying such conditions. Another issue was the distinction between the use of a particular technology in a country and the transfer of that technology. Brazil's experience was that, especially in regard to high technology, transfer of technology often did not occur even though the technology was actually being used in Brazil by a particular company. This did not mean that governments should step in and force the transfer of technology but his delegation had some sympathy for the views of India regarding the difficulty experienced by developing countries with respect to access to high technology and the limitations of market forces to promote this transfer.

13. The representative of Venezuela recalled that on several occasions her delegation had observed that markets for technology were not perfectly competitive but were characterized by conditions of oligopolistic equilibrium, and that this justified active policies to promote transfer of technology. At the same time, experience also demonstrated that policies involving the compulsory transfer of technology did not achieve the intended results because the technology transferred was often limited to process technology instead of core technology. It was therefore necessary for

governments to be able to implement active policies which were not compulsory but which tended to promote the transfer of technology on reasonable commercial terms, including promotion of research and development activities and the formation of productive clusters. These policies could be pursued with market-oriented instruments and did not need to be incompatible with WTO obligations. In fact WTO agreements left a broad margin for the implementation of such active policies. Venezuela had gained positive experience with this kind of policy in the petroleum sector. Rather than focusing on the question of whether or not countries should oblige multinational enterprises to transfer technology, the Working Group should concentrate its study on the identification of market-friendly and WTO-consistent policy instruments to promote the transfer of technology.

14. The representative of Pakistan observed that there appeared to be two grounds on which there was opposition to government policies aimed at encouraging the transfer of technology. The first was that such policies were not effective; the second was that such policies might deter FDI. Whether such policies were effective was essentially an empirical question on which evidence appeared to be mixed and for which further study was required. There was no conclusive evidence to justify a sweeping assertion that technology transfer measures taken by governments had in all cases been counterproductive. As to the argument that technology transfer policies would deter FDI, this was essentially a matter for governments to consider in light of their experience. The experience of some developing countries was that in certain cases it might be useful to institute policies which might encourage transfer of technology. If a country found that this had a negative impact on FDI inflows, it would obviously reconsider its policies and seek to restore the balance between attracting investment and regulating investment to promote development. In this sense it could be said that the opposition to transfer of technology requirements because of their alleged negative effects on FDI flows showed a certain lack of faith in market forces.

15. The Working Group took note of the statements.

B. THE ECONOMIC RELATIONSHIP BETWEEN TRADE AND INVESTMENT (ITEM II OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)

16. Statements were made on investment incentives and on the relationship between investment and competition policy.

Investment incentives

17. The representative of Hong Kong, China stated that, from an economic efficiency perspective, his delegation had reservations on the use of investment incentives but that it considered that it might be inappropriate to seek to prohibit all investment incentives as some of them might be justified on policy grounds, for example in a context of positive externalities. His delegation therefore saw merit in exploring in the Working Group the question of whether and how investment incentives might be classified into allowable and prohibited incentives and in considering the operational criteria that could be used in making such a distinction. A key consideration in this regard was the importance of non-discriminatory market access for investors and the interest of all Members in minimizing economic distortions arising from the discriminatory use of investment incentives. Investment incentives, if any, should therefore be provided on a non-discriminatory basis.

18. The representative of Mexico recalled her delegation's views on the distortive effects of certain kinds of investment incentives, especially fiscal incentives. Mexico agreed that the Working Group should study this subject in more detail with a view to identifying different kinds of incentives and their effects and to exploring the scope for international cooperation.

19. The representative of Korea, referring to his delegation's contribution in WT/WGTI/62, stated that his delegation had taken the position that the costs of investment incentives often outweighed

their benefits but had also cautioned against the extreme view that all kinds of incentives should be prohibited. A more cautious approach was desirable which focused on how to achieve a balance between the potential benefits of incentives as a domestic policy tool and the need to minimize their distortive effects. His delegation supported the idea of exploring the possibility of distinguishing between allowable and non-allowable incentives, possibly along the lines of the approach embodied in the Agreement on Subsidies and Countervailing Measures ("the SCM Agreement").

20. The representative of Argentina supported the suggestion for further work on investment incentives aimed at identifying different kinds of such incentives and their effects.

21. The representative of Malaysia, speaking on behalf of the ASEAN WTO Members, stated that his delegation's views on the role of investment incentives as an important policy instrument in the process of economic development were well-known, and disagreed with the suggestion to attempt to classify incentives into allowable and non-allowable incentives. Such an attempt was not appropriate given that the SCM Agreement already contained a distinction between allowable and non-allowable subsidies. In addition, a consideration of allowable and non-allowable incentives would be incompatible with the educational nature of the mandate of the Working Group. Finally, while the developed countries provided very substantial up-front grants to firms, developing countries, which did not have the financial resources to provide such grants, usually granted performance-based incentives. A comprehensive consideration of this subject should therefore include the grants offered by developed countries.

22. The representative of Brazil wondered on what basis distinctions would be made between various types of incentives, and how the proposed classification of incentives would relate to distinctions made in the SCM Agreement. He shared the view of Malaysia that work aimed at identifying allowable and non-allowable incentives was not within the mandate of the Working Group, and that the discussion on incentives needed to cover the wide variety of forms in which governments provided support to enterprises.

23. The representative of Egypt shared the views of Malaysia and Brazil. Given the sensitivity of the issue of investment incentives, it was not desirable to try and distinguish between acceptable and non-acceptable incentives. It was self-evident that any consideration of this issue should be comprehensive and should include all kinds of incentives, whether provided by developing countries or by developed countries. The negotiations on a Multilateral Agreement on Investment ("MAI") in the OECD had shown that the issue of investment incentives was a controversial subject even among developed countries. His delegation therefore favoured a cautious approach but did not object to further study aimed at achieving a better understanding of various aspects of investment incentives.

24. The representative of the European Communities agreed with Malaysia on the need for work on investment incentives to be comprehensive in scope. His delegation thus favoured a full discussion of the effects of different kinds of incentives granted by all countries. The fact that the Working Group was not a negotiating forum should not be seen as a reason not to consider whether at a conceptual level a distinction was possible between desirable and undesirable incentives. With respect to the reference made to the SCM Agreement, he recalled that on previous occasions his delegation had stated its view that the SCM Agreement applied to some extent to investment incentives but that its trade-oriented remedies were of limited effectiveness in an investment context. There was no reason why the Working Group could not discuss this aspect of the existing rules of the SCM Agreement. At the same time, he agreed that it was not the task of the Working Group to consider the design of possible future rules on incentives. The debate at this meeting had shown the need to clarify the meaning of the concept of incentives. His delegation interpreted the term incentives as covering any actions by governments that provided a financial advantage to a recipient. In this sense, the concept of incentives was similar to the notion of subsidy as defined in the SCM Agreement. If the term incentives was interpreted in this manner, it was self-evident that the kind of

measures referred to by some delegations, such as grants, were included. Similarly, under this interpretation of incentives, there was no basis for distinguishing between fiscal incentives and other kinds of incentives.

25. The representative of India expressed reticence as regards the notion of drawing distinctions between allowable and non-allowable incentives. Instead of focusing on whether incentives were good or bad, the first question to be asked was why both developing and developed countries granted investment incentives. While it was understandable why developing countries sometimes needed to use investment incentives, it was more difficult to understand why developed countries used incentives, in particular in light of the fact that these countries generally took the view that market forces should decide on allocation of resources.

26. The representative of Hong Kong, China, responding to the observations by Malaysia, stated that his delegation did not make any distinction between what might be called post-establishment incentives and pre-establishment incentives. All forms of incentives should be discussed, including grants. While the work of this Working Group was only of an educational nature, an examination of whether it was possible to differentiate between desirable and undesirable incentives was useful as a way to further the Group's understanding of this subject.

27. The representative of the United States stated that the Working Group was a forum for discussion in which anything that pertained to investment could be raised. In response to India's question as to why many countries used investment incentives, notwithstanding that market forces might be a preferential approach, she observed that governments did not always do what was best for themselves and did not necessarily learn from their mistakes. She agreed that incentives was a very sensitive and highly charged subject, given that it involved questions about the use of tax payers' money, and that that this was an area where the Working Group should proceed cautiously. An approach aimed at classifying different kinds of incentives might be useful.

28. The representatives of Costa Rica and Venezuela expressed their support for a comprehensive examination of all different kinds of investment incentives, including incentives granted at different levels of government. The representative of Costa Rica suggested that a possible classification of investment incentives might contain four categories: (1) financial incentives; (2) fiscal incentives; (3) subsidized services; and (4) market privileges.

Investment and competition policy

29. The representative of Hong Kong, China, stated that in a globalizing economy trade and investment policies were closely interlinked. Anti-competitive trade policies might have adverse effects on investment and vice versa. It was therefore essential that trade policy and investment policy should be mutually reinforcing and be based on a common foundation with regard to the goals of an effective competition policy. One of the goals of competition policy was to make markets as contestable as possible so as to promote economic efficiency and consumer welfare. This concept of market contestability could serve as a common reference point for a review of existing trade, investment and competition policies and for identifying priorities for future work in these areas. An approach aimed at promoting market contestability focused on the process of competition itself rather than competition of certain origins or attributes. Performance requirements and investment incentives were two examples that might require attention in the WTO because they might impede market contestability. Similarly, trade policies and trade measures, for example abusive use of anti-dumping measures and restrictive rules of origin which protected competitors at the expense of market operation, might be regarded as anti-competitive investment policies which, by impeding market contestability, would lead to sub-optimal investment decisions that were not conducive to global welfare. While further work was necessary to develop a better understanding of the complicated relationship between trade, competition and investment policies, the challenge was to ensure that

existing and evolving WTO rules related to trade and investment policies were consistent with competition principles. A competition-oriented reform of WTO rules with a view to increasing the synergies between trade, competition and investment policies was essential to ensure that WTO rules remained valid and credible in a technology driven globalized economy.

30. The representative of India seconded the comments of Hong Kong, China.

31. The Working Group took note of the statements.

C. STOCKTAKING AND ANALYSIS OF EXISTING INTERNATIONAL INSTRUMENTS AND ACTIVITIES REGARDING TRADE AND INVESTMENT (ITEM III OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)

(i) *WTO provisions on matters related to investment*

32. The representative of the European Communities observed that there were many WTO provisions that were related to investment but that they addressed only limited aspects of investment. Thus, notwithstanding that the TRIMs Agreement explicitly mentioned the term investment, it dealt only with a very narrow aspect of investment. The GATS was limited to investment in services and addressed the question of access to investment opportunities in the area of services in a particular manner. It did not address any other aspect of investment in service sectors. The SCM Agreement was limited in its coverage because it did not apply to services and its remedies were applicable only once trade in a subsidised product took place.

33. The representative of Japan observed that the WTO provisions most directly relevant to investment were contained in the TRIMs Agreement and the GATS. Rules on investment in the service sector were more developed than rules in the manufacturing sector. This was an important gap in the coverage of investment issues in the WTO as FDI in manufacturing had contributed significantly to economic development in host countries. As investment in manufacturing was becoming increasingly linked with trade in goods, the WTO could offer an appropriate forum for investment rule-making due to its strong expertise in the area of trade in goods. In considering possible future WTO rules on investment, it was useful to review the approaches that had been adopted in existing WTO rules on investment. For example, the GATS provided a wide range of rules related to investment in services but also contained provisions aimed at balancing liberalization with development, notably the positive list approach to the identification of sectors covered by market access and national treatment commitments. Another relevant concept embodied in the GATS was that of a progressive approach to the development of rules which left some issues, such as safeguards, to be decided at a later time.

34. The representative of Brazil stated that one should not lose sight of the fact that the focus of the study in this Working Group was on how investment affected trade, and not on investment *per se*, and he wondered how the statements made by the European Communities and Japan reflected that distinction.

35. The representative of the European Communities responded that the relationship between trade and investment was evident in the GATS which treated investment as a modality of trade because of the peculiarity of trade in services. In manufacturing, WTO rules addressed the trade aspect of the trade-investment interface, as exemplified by the rules of the SCM Agreement which were relevant to investment incentives to the extent that subsidized investment had an effect on trade in goods. What was missing from the existing rules were rules on the other side of this relationship, i.e. the impact of incentives practices on investment.

- (ii) *Bilateral, regional, plurilateral and multilateral agreements and initiatives; implications for trade and investment flows of existing international instruments*

36. The representative of the United States posed several questions on a written contribution (WT/WGTI/W/71) introduced by India at the last meeting on India's bilateral investment treaties. First, sub-paragraph 4 (d) of this contribution stated that foreign investments were accorded the same treatment as domestic investments in the post-establishment phase but that such national treatment was not accorded to foreign investors. She asked for an explanation of the reason for this distinction between foreign investments and foreign investors and how this distinction operated in practice. Second, in regard to the description in sub-paragraph 4 (g) of the provisions in India's bilateral investment treaties on repatriation facilities, she asked if these provisions also covered payments, such as interest payments and payments for goods. Finally, she asked whether India's bilateral investment treaties contained a structure for exceptions.

37. The representative of India stated that he would refer the questions raised by the United States to his authorities and make the responses available to the Working Group.

38. The representative of UNCTAD informed the Working Group of relevant recent activities of UNCTAD. On 21-22 April, a seminar had been organized jointly with the WTO Secretariat for Geneva-based delegates to UNCTAD and the WTO while on 17-18 May a regional symposium on key concepts and issues pertaining to international investment agreements had been held in Cairo for Arab decision makers. The reports on these two meetings had been made available to the Working Group. As part of UNCTAD's activities to involve civil society in its work, a roundtable on international investment frameworks and their implications for civil society had been held in Cairo on 19 May. In addition, a meeting had taken place in Geneva to discuss with representatives of non-governmental organizations the content and format of a series of seminars which UNCTAD would organize for non-governmental organizations. UNCTAD had recently completed two new papers in its Issues Papers Series, on national treatment and fair and equitable treatment. The national treatment standard, while being a core element in international investment agreements, was difficult to achieve as it touched upon economically- and politically-sensitive issues. The paper examined the scope of national treatment and its application to both the pre- and the post-establishment phases of investment. It also reviewed the effects of granting exceptions to national treatment and the development implications. The fair and equitable treatment standard was contained in most international investment agreements. The recent UNCTAD paper discussed the different possible meanings of this standard and its implications for the host countries and foreign investors.

39. The representative of the OECD stated that the OECD Committee on International Investment and Multinational Enterprises had recently adopted a new work programme on international investment which envisaged analytical work on five specific issues: (1) analysis of OECD member countries' investment rules, including the definition of investment in relation to issues raised by financial crises; (2) non-discrimination and social policies; (3) non-discrimination and environmental policies; (4) non-discrimination, investment protection and national sovereignty; and (5) investment incentives and investment promotion. The aim was to complete this work programme by Spring 2000. A workshop on the relationship between FDI and economic development would take place in the autumn. With regard to the ongoing review of the OECD Guidelines for Multinational Enterprises, a special working group had been established for the purpose of considering the suggestions that had been made concerning possible changes to the scope of application, substantive provisions and implementation procedures of the Guidelines. In connection with this review, there had also been a meeting with representatives of civil society. At the recent OECD ministerial Meeting, the OECD Secretary-General had submitted a report on the OECD activities on international investment, which stated, *inter alia*, that OECD member countries continued to believe in the desirability of international investment rules as a vehicle for encouraging investment flows beneficial to economic growth and development and as a contribution to a rules-based system for managing

globalization. Member countries also believed that further policy-oriented analysis and discussion were needed to support the development of international investment rules by the international community. In pursuing this activity, the experience of recent negotiations and the concerns raised in public debate should be taken into account. The OECD had an important role to play in this effort. The report also stated that member countries supported the work on investment in the WTO. The Ministerial communiqué adopted at this meeting included a statement that the current work programme on trade and investment and on trade and competition in the WTO had been constructive and that, in the preparation for the Seattle Ministerial Conference, the results of these Working Groups should provide the WTO General Council with a basis for building consensus on appropriate recommendations to the Ministerial Conference that might be desirable to enhance the rules-based multilateral trading system.

40. The Working Group took note of the statements.

D. ITEM IV OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY

41. The representative of Korea introduced a written contribution on a "Multilateral Framework on Investment: A Realistic Approach" (WT/WGTI/W/79) by stressing that his delegation understood that the Working Group was meant to be a forum for an educational process, and that this contribution was therefore presented only to facilitate the discussions in the Working Group, without prejudice to the views of Members, including his delegation, on the future work programme of the WTO. He recalled that at the last meeting there had been a fairly substantive discussion on the benefits and costs of multilateral rules on investment. While many delegations had shared the view of his delegation in favour of such a framework, others had indicated that they remained to be persuaded of the merits of a multilateral framework on investment. These conflicting views could be seen as representing two different schools of thought on FDI, a "globalization" school and an "internalisation" school. In order to reach agreement on multilateral rules on investment in the WTO, the objectives of these different schools of thought needed to be reconciled. This meant that an equilibrium had to be reached between, on the one hand, the objective of enhancing global welfare through freer flows of investment and, on the other, the need to respect the right of sovereign countries to formulate their own policies, in particular with respect to economic development. This required an optimal combination of flexibility and efficient resource allocation. As the overall balance of interests among Members was at the heart of all negotiations in the WTO, the feasibility of a multilateral framework on investment in the WTO would largely depend on whether and how the different realities faced by each Member could be reflected in an overall balance of concessions. A multilateral framework on investment in the WTO should therefore be different from the MAI, the standards of which were unrealistically high and had failed to secure broad-based participation. Korea's contribution did not attempt to provide any concrete proposals for key elements of a multilateral framework with respect to the question of policy flexibility for development purposes. The contribution was intended to offer a possible WTO approach to investment protection and liberalization, taking into account the conflicting views among WTO Members. In relation to investment protection, the contribution suggested that the level of protection in a multilateral framework should be set at the medium rather than the highest level and should be aimed at achieving an optimal standard of protection that was reasonably high, based on a consensus among all participants. With respect to investment liberalization, the contribution suggested that the bottom-up approach adopted by the GATS, as opposed to the top-down approach envisaged in the MAI negotiations, should be favoured. While the two basic concepts proposed in this contribution might need to be developed further, his delegation believed that they could offer ways to devise a multilateral framework on investment that reconciled the need for policy flexibility with the need to enhance transparency and predictability.

42. The representative of Japan highlighted the main points of a contribution which his delegation would submit in the near future on the issue of dispute settlement. The creation of investment rules in the WTO would allow for the use of the WTO dispute settlement mechanism to resolve investment

disputes. Since the essential function of dispute settlement was to eliminate or modify measures found to be inconsistent with an agreed set of rules, the WTO dispute settlement system could be applied to investment disputes without the need to make major adjustments. This would make it possible to settle such disputes promptly and fairly, in accordance with well-developed and efficient procedures. To the extent that the GATS and the TRIMs Agreement applied to investment, the WTO already had acquired some experience in settling investment-related disputes. While investment disputes might involve technical questions, existing WTO dispute settlement procedures enabled panels to seek the necessary advice on matters requiring special expertise. An important question was whether the WTO provisions on compensation and suspension of concessions should be applied to investment disputes. In this regard, it was notable that these provisions were already applicable to investment-related disputes that might arise under the GATS and the TRIMs Agreement. Another question requiring attention was the relationship between the application of WTO dispute settlement procedures to investment and the application of dispute settlement provisions contained in the numerous existing bilateral and regional investment agreements. Since the WTO mechanism was more efficient, it appeared preferable to use the WTO procedures but this should not preclude recourse to provisions of bilateral or regional investment agreements if the parties to a dispute so decided. In any case, the coexistence of various dispute settlement procedures was not unique to investment but also occurred in the field of trade. For example, regional trade agreements often contained their own dispute settlement procedures. The availability of various dispute settlement mechanisms in the area of trade did not appear to have caused serious problems. Indeed, the coexistence of dispute settlement procedures in different agreements could enhance the complementarity of such procedures. However, it might be necessary to design specific rules to avoid inefficiency and duplication.

43. The representative of Egypt stated that the distinction proposed in Korea's contribution between a globalization school and an internalization school was too stark since many countries, including Egypt, found themselves somewhere in the middle between these schools. For example, Egypt believed that there were important benefits associated with integration into the global economy but also believed that there was a need for governmental intervention. Similarly, while Egypt did not consider that there was a need for multilateral rules on investment, it was prepared to assume obligations on investment in various settings, including on investment protection. A fundamental issue that was not addressed in the contribution by Korea was the question of why it was considered necessary for the WTO to play a role as a forum for rules on investment *per se*, as distinguished from the role of the WTO in regard to issues concerning the relationship between trade and investment. His delegation would revert at a later stage to the specific suggestions made in Korea's contribution with regard to investment protection and investment liberalization.

44. The representative of Hong Kong, China stated that, if there were to be multilateral rules on investment, MFN, national treatment, transparency and dispute settlement would be key elements of such rules. Under the GATS, the extent of national treatment was determined by the scope of the commitments made by individual Members. While this provided for flexibility, it also considerably weakened the scope of the national treatment principle.

45. The representative of Switzerland stated that the contribution by Korea identified what was the main difficulty arising in regard to multilateral investment rules, namely how such rules could enhance security and transparency of the conditions for FDI while also taking into account legitimate policy concerns of host-country governments.

46. The representative of the Philippines, speaking on behalf of the ASEAN WTO Members, stated that his delegation would carefully study Korea's recent contribution and reserved its right to revert to it at a later stage. As a preliminary comment, he expressed concern regarding the notion which appeared in paragraph 14 of the contribution of the unique nature of certain primary industries like agriculture.

47. The representative of the European Communities welcomed the submission by Korea as a very concrete and substantive contribution to the work of the Working Group. While it was true that it focused on a limited number of issues, he wondered whether any delegation was ready at this time to present a comprehensive blue-print of a possible multilateral framework on investment. Korea's contribution set a very good example to start the process of identifying elements of such a framework. In respect of the criticism that the categorization into two schools of thought was oversimplified, he observed that this kind of attempt at conceptualising key concepts and ideas was useful as a tool to advance the discussion in the Working Group.

48. The representative of Pakistan agreed with Egypt that the conceptual framework set out in the introductory paragraphs of Korea's contribution was somewhat oversimplified, and that there were countries which would subscribe to the globalization school without necessarily supporting the creation of multilateral rules on investment. Members were still far from reaching a consensus on the assumption underlying the suggestions made in this contribution that a multilateral framework on investment in the WTO was desirable. With respect to the proposals made on investment protection, he pointed to the lack of precision of the concepts used. The meaning of the "high", "medium" and "low" levels of protection was not explained, and the notion of "a reasonably high standard of protection" begged the question of what was an optimal level of protection that would also take into account developmental concerns. He was intrigued by the admission that the standards of the MAI were unrealistically high and had thus failed to secure broad-based participation. In this regard, he reiterated a suggestion made by his delegation at the last meeting that the Working Group could benefit from a factual note on the difficulties which had been encountered in the MAI negotiations.

49. The representative of Japan stated that, in respect of the concept of a "medium" level of investment protection, account should be taken of the inclusion in recent investment agreements of provisions aimed at ensuring transparency of the legal environment of host countries. The positive list approach proposed by Korea merited further consideration.

50. The representative of the United States agreed with the comment that the world was not quite as starkly divided into globalization and internalisation economies. The bottom-up approach to investment liberalization that was advocated by Korea was very novel for the United States. The United States had avoided this approach in its investment agreements because it believed that, while countries might negotiate exceptions under a top-down approach, a bottom-up approach was certainly tilted towards preserving distortions and distinctions between foreign and domestic investors, which resulted in a misallocation of investment resources and ultimately deterred investment.

51. The representative of Korea stated that most countries were somewhere in between the extremes of the globalization school and the internalisation school, and that it was precisely for this reason that it was possible to envisage a reconciliation of these different perspectives through a cautious approach to the negotiation of multilateral rules on investment. Regarding the criticism concerning the lack of precision of certain suggestions made in the contribution, he agreed that further elaboration of these suggestions was necessary through in-depth discussions in the Working Group.

52. The representative of Brazil welcomed the contribution by Korea, in particular with regard to the approach it took to investment liberalization through a bottom-up and progressive approach. Though certain elements were missing from the contribution, it could not be expected that any single delegation would comprehensively deal with all the elements of a framework on investment. His delegation believed that any framework should take into account the specificities of developing countries and that consideration should be given not only to investment protection but also to investment promotion.

53. The representative of Venezuela observed that at this juncture it was impossible to predict whether there would be negotiations on investment in the WTO but that the Korean contribution was

a very constructive and realistic proposal which represented a major step forward in the work of the Group.

54. The representative of Malaysia asked Korea to explain how its contribution enhanced the Group's understanding of the need for global rules on investment.

55. The representative of Argentina stated that the contribution by Korea helped to focus the work of the Group. Though the Working Group was not in a negotiating mode, it could usefully discuss specific elements of a possible multilateral framework on investment. It would be interesting to see if studies could be made available on the two different schools of thought described in Korea's contribution. In regard to paragraph 14, he observed that certain sectors might be special for some countries but not for others. Thus, instead of industries with special characteristics it was preferable to refer to sectors that were sensitive for some countries.

56. The representative of India stated that, since his delegation was not convinced of the need for negotiations on investment in the WTO, he would refrain from commenting on the suggestions in the Korean contribution on specific elements of such a negotiation, such as the proposal to adopt a bottom-up approach. The distinction between the globalization school and the internalisation school, which was perhaps more appropriately called interventionist school, gave rise to two complications. First, a country like India might actually seek to integrate its economy into the world economy, consistent with the globalization school of thought, but at the same time it could have grave doubts about binding itself in the WTO because it was not convinced that it would receive anything in return. Second, a country could be interventionist in some sectors and more open to international competition in other sectors, depending upon the competitiveness of its domestic industries. Regarding the issue of the rationale of a multilateral set of rules on investment, a basic problem was that one could understand that if some countries belonged to a special multilateral agreement on investment and others did not, countries which were parties to that particular agreement were in a better position to attract FDI. However, if all countries were parties to a multilateral agreement on investment, it was difficult to see how adherence to such rules ensured that individual countries had a better chance of attracting FDI. In that case, a country's attractiveness to foreign investment would be determined by fundamental factors such as market size, infrastructure, and the availability of skilled labour, and not by its adherence to multilateral rules on investment.

57. In response to the question posed by Malaysia, the representative of Korea stated that much had been heard in this Working Group about the alleged potential costs of FDI but not about the real costs of multilateral rules on investment *per se*. His delegation believed that such costs of multilateral rules were yet to be proven. All issues involved should be identified and solutions to them sought in in-depth discussions, and he hoped that his delegation's paper could make a contribution in this regard. In response to India's comments, he observed that the fundamental rationale for multilateral rules on investment lay in the efficient allocation of resources by enhancing transparency and predictability and providing for a climate which was more conducive to making FDI. Multilateral investment rules would contain flexibility, and it was for each country to take advantages of the possibilities offered by its adherence to multilateral rules.

58. The representative of the European Communities, responding to the question posed by India, stated that in the absence of multilateral rules, the advantages enjoyed by a country in attracting FDI such as those deriving from the quality of its institutional framework, skilled labour force etc., could be negated by practices of other countries, notably the use of incentives. As in the case of international trade, common rules on investment would ensure equality of competitive conditions so that individual countries could better exploit their competitive advantages. While there was no guarantee that common rules on investment would by themselves lead to increased investment flows, the experience with the multilateral trading system suggested that by improving investment opportunities such rules would have a positive impact on the level of international investment. The

alternative to common rules was the law of the jungle or a patchwork of separate rules, which resulted in a problem of confusion and lack of transparency. Though there was no guarantee that with common rules a given country would reap more benefits than another country, in the absence of such rules an individual country's ability to attract investment would be adversely affected by distorting practices of other countries.

59. The representative of the United States stated that in order to understand the benefits of common investment rules, it was useful to think of a hypothetical example in which an investor was considering investing in India versus investing in its neighbouring countries which applied export performance requirements, or a situation in which an investor was required as a condition for making the investment to build computers in India's neighbouring countries that would otherwise have been made in India.

60. The representative of Brazil stated that India's question could not be answered in a simple manner as there was a whole range of factors that came into play in determining a country's attractiveness to FDI, of which the regulatory framework was only one. Adherence to a multilateral set of rules on investment would mean that all countries were bound by a common set of rules but would not necessarily imply that all countries would behave in the same manner. For example, the fact that all WTO Members were bound to the rules of the SCM Agreement did not imply that they had identical subsidies. Brazil had not come to a view on whether or not multilateral rules on investment were needed, but was willing to discuss this matter further. In any event, his delegation did not believe that the creation of such rules would mean that countries would behave identically and that investors would no longer differentiate between countries.

61. The representative of Singapore stated that he was puzzled by the example given by the United States. If country X had performance requirements and country Y did not, it was obvious that the investor would invest in country Y. If there were multilateral rules, which would circumscribe the ability to impose such requirements, there would be a level playing field between X and Y. However, the question was what advantage country Y derived from such rules and whether Y could not secure the advantage of not having performance requirements through other approaches, for example bilateral agreements or a predictable domestic legal system that clearly stipulated that performance requirements were not allowed.

62. The representative of the United States responded that, in the example she had described, the absence of investment rules meant that India's neighbours could take steps, for example, imposing value added or export performance requirements, that would deprive India of investment or that forced exports into India's economy rather than having an investment taking place in India that would have supplied India's economy.

63. The representative of Japan, responding to the question raised by India, pointed to the importance attached by Japanese firms in the manufacturing sector to outward FDI as a means of improving the efficiency of their operations. Multilateral investment rules which would improve the legal climate for FDI in host countries would lead to efficiency gains, lower costs and prices and would thereby be in the interest of both home and host countries. He agreed with the view that such multilateral rules would still leave ample room for individual countries to enhance their attractiveness to FDI, for example by improving the quality of their infrastructure and human resources.

64. The representative of Venezuela, referring to the statements by the European Communities and the United States, stressed that in considering the prospects for reaching agreement on future work on investment in the WTO, it was essential to bear in mind that there was an important distinction between investment protection issues and more sensitive issues relating to investment liberalization, which was often closely linked to industrial policies.

65. The representative of the European Communities stated that the benefits of multilateral investment rules did not depend upon whether such rules covered only investment protection or also dealt with investment liberalization. The issue of the benefits of such rules in establishing a level playing field was distinguishable from the question of the scope of such rules, which obviously would depend on what Members were able to agree on.

66. The representative of India stated that the alleged need to prevent practices which could distort investment between countries did not provide a compelling argument in favour of multilateral rules on investment. India's problems in attracting as much FDI as some other countries were due to internal factors, such as the quality of its infrastructure, and needed to be tackled through domestic policy measures. These problems were not caused by the absence of international rules to control distorting practices of other countries and would therefore not be solved by a multilateral framework of investment rules. In reality, the demand for multilateral rules in the WTO was not motivated by a need to constrain distorting measures used by countries competing to attract FDI but by a desire to seek market access for foreign investment. This posed a fundamental problem to India because it would not get anything in return for giving up its freedom of action.

67. The representative of Egypt stated that the references made by the European Communities and the United States to incentives and performance requirements to illustrate the benefits of investment rules indicated that market access, rather than transparency and predictability, appeared to be the key factor motivating the proposal for multilateral investment rules. Like India, his delegation did not share the view that there was a real problem of impediments to international flows resulting from a law of the jungle or from confusion caused by the existence of a multitude of agreements. In connection with the issue raised by Brazil regarding the limited role of investment regulations as a determinant of FDI, he observed that in many cases firms took investment decisions without regard to whether or not the country in question was a party to a bilateral investment agreement. Given the many factors which determined investment decisions, the situation described by the United States in which the only difference between the two countries was the use of export performance requirements or similar measures by one of them was unlikely to occur in practice. Caution was warranted with regard to the notion of a level playing field as applied to investment because of the many inherent differences between countries, for example with respect to the size of their economies. Finally, the consideration of possible benefits of multilateral investment rules should be balanced with a recognition of the significant costs of such rules in terms of reducing policy flexibility necessary for development purposes.

68. The representative of the Philippines, speaking on behalf of ASEAN WTO Members, commented on a written contribution presented at the last meeting by Japan (WTWGTI/W/75). ASEAN agreed that ensuring transparency and stability in legal systems and policies was a primordial concern of host countries including developing countries. It also agreed that transparency and stability, among other factors, reduced costs and risks for the foreign investor, the home country and the host country and thus encouraged investment and promoted growth. As pointed out by ASEAN in a statement at the meeting held in October 1998, in this age of globalization and openness each country being a potential recipient of FDI would do all it could through legislation and best practices to successfully compete for and attract FDI. Governments would not easily reverse policies or laws and thus risk damaging their countries' development prospects. Japan had cited a few problems faced by its companies in their international operations. These examples were serious and needed to be addressed immediately, where necessary by host countries. However, because of the lack of detail in the description of these examples it was questionable whether they could be considered to offer a justification for the development of international or multilateral investment rules. Without the necessary details, Members would not be in a position to determine if these cited examples were truly prevalent around the world or only intermittent problems that foreign investors would inevitably face in the routine operation of FDI. Indeed, as Japan had recognized in its contribution, companies might themselves be responsible for some of the problems that they faced. In the case of his delegation, he

knew that Japanese companies did not face these problems given the long history of close and successful economic and strategic partnership in Asia. In the event that these problems were only intermittent examples, they were more effectively dealt with through appropriate representation with individual governments of host countries, including through bilateral treaties, where they existed, which pragmatically addressed the specific circumstances surrounding the economic and trading relationship between bilateral partners. Bilateral investment treaties allowed countries to tailor fit the agreement according to their needs and objectives. As such, bilateral treaties provided the parties with flexibility, especially when they wished to pursue locational, sectoral and development objectives and advantages.

69. The representative of the Philippines further observed that the question arose as to whether multilateral rules, which Japan advocated in its contribution, would address all problems that might arise in the operation of FDI world-wide, or whether such rules would perhaps only compound such problems by overly emphasizing the protection of foreign investment. As stated by his delegation at the meeting in October 1998, the feasibility of multilateral rules on investment would hinge on whether or not they filled a void that must be filled, and on whether such rules, if necessary, addressed in a balanced manner the diverse and evolving interests of all countries. Any discussion of benefits of such rules could not be confined to only those that would accrue to the sources of the FDI. To balance the discussion, it should also be asked whether multilateral rules would translate into more investment flows and consequent net benefits for a host country or whether they were being mooted as a false panacea. Related to this, it appeared that the notion of multilateral rules on investment as advocated by Japan in WT/WGTI/W/75 lacked a development dimension. His delegation had elaborated on this issue at previous meetings and had stressed that the development dimension should be manifested in each of the elements of any set of multilateral rules on investment. His delegation had also put forward a number of specific elements in which the development dimension could be expressed, including the issue of the right of establishment, which should be left to the discretion of the host country, the ability of the host country to use policy instruments such as performance requirements and incentives to pursue legitimate sectoral, locational and development objectives, and the transfer of technology. In its contribution in WT/WGTI/W/75 Japan referred to the administrative cost of implementing legal systems to support new international investment rules and the possible deprivation of developing countries of their flexibility in formulating policies to assist their domestic industries. In this regard, Japan argued that developing countries needed to be given sufficient time before they were expected to implement commitments under international investment rules. ASEAN regretted this approach to the development dimension which only centred on extended timeframes for implementation. The issue at stake was not merely rules that would protect foreign investors and their home countries, but more importantly the development dimension of FDI. There was a substantial difference between the two. The crux of the matter was how multilateral rules on investment could take into account the development dimension so that development objectives were not just paid lip service in preambular aspirations and operationalized only in extended transition periods.

70. In response to the comments by the Philippines, the representative of Japan stated that he doubted whether this was the appropriate place to discuss the specifics of the problems identified in WT/WGTI/W/75. The intention of that contribution was to present concrete examples of problems faced by Japanese firms in order to illustrate the concerns that motivated his delegation's interest in multilateral investment rules. This kind of discussion of specific problems could make an important contribution to the study process in the Working Group. Regarding the observation that the Japanese contribution did not sufficiently take into account the development dimension, he stated that he would revert to this issue later in the meeting in conjunction with the discussion of the communications recently received from UNCTAD on flexibility in the interest of economic development.

71. The representative of the Philippines, speaking on behalf of the ASEAN WTO Members, expressed disappointment at the response by Japan. In its contribution Japan had cited very serious examples of problems allegedly faced by Japanese firms. If the Working Group was not the

appropriate forum to discuss these examples, they should not have been raised in the first place. With respect to the first example mentioned in Japan's contribution, which involved arbitrary actions of local authorities in host countries with regard to the calculation of income taxes of expatriates, he wondered in which countries such practices occurred, and noted that in the ASEAN countries which had centralized income tax laws local governments had very little flexibility in this regard. In addition, a relevant question was whether, in those cases in which local authorities had the competence to apply measures in the field of income taxation, such measures were necessary in order to avoid tax evasion by foreign nationals employed by foreign enterprises.

72. The representative of Japan responded that his delegation's contribution in WT/WGTI/W/75 did not reflect an official view of his Government that certain countries actually used the practices identified in the examples mentioned therein. Rather, these examples were illustrative of the kind of practices of which Japanese firms had complained. As such, the list of examples was a useful input to the work of this Group.

73. In respect of the comments made by the Philippines on the absence of the development dimension in some contributions, the representative of the United States stated that all countries, in no matter what stage of development, sought to enhance the benefits of investment to their country and to attract investment to different sectors. All countries also had sensitive sectors which they wanted – wisely or unwisely – to protect. The question was whether an investment agreement could be found which balanced the desire to protect such sectors with the protection of investors and which did not create beggar- thy-neighbour effects.

Definition of investment in international investment agreements

74. The Chairman drew attention to a recently circulated Note (WT/WGTI/W/76) which had been prepared by the Secretariat in response to a request made at the last meeting of the Working Group and which described the issues raised and views expressed so far in the discussion in the Working Group on the definition of the term investment in international investment agreements.

75. The representative of Australia stated that her delegation would shortly submit a contribution describing the definition of investment in Australia's model investment protection and promotion agreement.¹ This definition was fairly broad based, which in the view of her delegation was appropriate for post-establishment type arrangements but not necessarily for pre-establishment type arrangements.

The development dimension of international investment agreements

76. The Chairman drew attention to two recent communications from UNCTAD (WT/WGTI/W/77 and 78) on the question of how international investment agreements could provide for flexibility in the interest of promoting growth and development.

77. The representative of UNCTAD stated that on 24-26 March 1999 UNCTAD had organized an Expert Meeting on "International investment agreements: concepts allowing for a certain flexibility in the interest of promoting growth and development". A basic consideration was that the ultimate objective of international investment agreements was to promote growth and development, and that a stable, transparent and predictable investment framework, providing security for investment, could help to attract investment flows. A proper balance needed to be found between flexibility, on the one hand, and predictability and security, on the other. The means by which international investment agreements could provide the flexibility required by developing countries to pursue development policies in light of their specific circumstances needed to be determined. At the same time, it was also

¹ See WT/WGTI/W/80.

important to ensure that countries did not invoke such flexibility as a justification for unnecessarily restrictive national policies relating to foreign investment matters. The Note prepared by the UNCTAD Secretariat for this Expert Meeting analyzed the issue of how flexibility was dealt with in existing investment agreements from four main angles: objectives; substantive provisions; implementation; and structure. As regards the objectives of investment agreements, examples of preambular provisions that referred to development as an objective could be found in a number of investment agreements, while some agreements also contained general objective clauses dealing with development issues. In this regard, some of the questions that arose were whether the objectives of an investment agreement were in fact concerned with development; whether the objectives distinguished between different categories of parties, and whether principles referring to broad development issues were included and, if so, to what extent their formulation provided a degree of flexibility to the parties. Another relevant question was to what extent and under what conditions the development objective could be applied to all commitments undertaken in an agreement. The substantive provisions of international investment agreements were the principal means by which their development orientation could be made effective, both in terms of the issues that were addressed and also how they were addressed. Negotiating parties needed to make choices as regards the type of issues they wished to include and those they wished to keep outside the scope of an agreement to deal with them in specialized instruments, such as double taxation treaties, or as a matter of national law and policy. With regard to the issues that the parties agreed to include in an investment agreement, they might wish to retain some flexibility regarding the commitments they made. For example, they might wish to use formulations that allowed them some discretion to pursue national policies while keeping in line with the broad principles of an agreement. Recent investment agreements had sought to formulate these issues more or less flexibly in order to accommodate development concerns.

78. The representative of UNCTAD further noted that the nature of the implementation mechanism of an investment agreement depended on the particular characteristics of the agreement, including whether it was a stand-alone agreement or whether it was part of a larger body of commitments. The implementation process could be responsive to development objectives by providing for various exceptions or derogations from the obligations of an agreement to reflect the special circumstances of developing countries. It might also be necessary to put in place special arrangements for technical and financial assistance, including for the purpose of promoting investment and technology flows to developing countries through appropriate measures of home countries. Ultimately, the development orientation of an investment agreement needed to be reflected in its very structure. The structure of an agreement was important because it reflected and thereby determined the overall design of the relationship between the parties. For example, the structure of an agreement could reflect a recognition of the economic asymmetry between the parties to an agreement by distinguishing explicitly between rights and obligations of developed and developing countries. Perhaps even more importantly, parties could be allowed to assume gradually certain obligations by identifying those activities in relation to which they were prepared to assume certain obligations.

79. In concluding his comments on the Expert Meeting, the representative of UNCTAD pointed out that, like all international agreements, international investment agreements typically contained obligations which by their very nature reduced to some extent the autonomy of the participating parties. At the same time, such agreements needed to recognize the differences between the parties involved where such differences were substantial, as between developed and developing countries. More specifically, if international investment agreements did not allow developing countries to pursue the paramount objective of advancing their development and did not make a positive contribution to this objective, they ran the risk of being of little or no interest to developing countries. This underlined the importance of designing from the outset investment agreements in a manner that allowed their parties a certain degree of flexibility in pursuing their development objectives. To find the proper balance between obligations and flexibility – a balance that left sufficient space for development-oriented national policies – was indeed a difficult challenge faced by negotiators of investment agreements. In this respect, the Agreed Conclusions of the Expert Meeting stated that

"given the complex issue of flexibility in IIAs, there was a need for more work to shed further light on the interrelationship between IIAs and the promotion of growth" and that "In this context, the Expert Meeting noted favourably the work carried out by UNCTAD in the framework of its programme on a possible multilateral framework on investment, in particular as regards capacity building, including through training, seminars and the like. It welcomed the integrated nature of this programme, as it combines policy analysis (as exemplified in the IIA Issues papers), technical cooperation and consensus-building. It also recognized the usefulness of informal discussions aimed at dialogue and consensus building on matters concerning IIAs and their development dimension."

80. The representative of the European Communities noted that many developing countries were liberalizing their investment policies and were entering into bilateral investment treaties, a primary objective of which was to promote investment in order to achieve economic growth and development. Flexibility should be seen as a means to allow countries to pursue their developmental policies and to enhance the positive effects of international investment agreements on development. The degree of flexibility provided for in investment agreements should be carefully balanced with the level of stability and predictability of the investment climate that the agreement intended to improve. While it could be argued that for countries with strong macroeconomic parameters and a sound political system, investment protection might not be a key factor in determining the location of investment, countries with weaker economies and a political situation perceived as being less predictable would benefit from a stronger investment regime. Countries wished to retain a large degree of flexibility with respect to the issue of the entry of foreign investment but at the post-establishment stage national treatment of foreign investment was usually provided for in bilateral investment treaties. This suggested that most countries did not consider that discriminatory treatment of foreign investment in the post-establishment phase was needed for development purposes. Referring to the example of the GATS, he agreed that the development dimension should be an integral part of international investment agreements. In this respect, he pointed out that the structure of the GATS structure allowed countries to undertake commitments commensurate with their level of development.

81. The representative of Japan stated that the promotion of investment through the creation of international investment rules would by itself contribute to the economic development of host countries. However, it was also important to ensure that international investment rules fully reflected developmental considerations. Several concerns of developing countries should be taken into account in this respect, including the lack of human resources necessary for the implementation of an agreement, development of local industries, lack of foreign currency, and the political and social risks of liberalization. A range of options existed to deal with these problems. For example, developed countries could provide technical assistance to address the problem of lack of human resources and expertise. How to deal with the need to develop local industries or the lack of foreign currency might be more complicated. Several government measures such as development of infrastructure and human resources would contribute to such policy objectives, and the promotion of investment through international rules itself would also make a positive contribution. However, it was also useful to consider ways of providing special treatment of developing countries with regard to the liberalization obligations of international investment rules. The options for such treatment would include less strict obligations for developing countries, limited sectors for liberalization and a grace period for the introduction of obligations. A rather progressive approach regarding liberalization for all Members would be another option. While political and social problems accompanied liberalization in both developed and developing countries, developing countries would be affected more than developed countries. This might also necessitate a progressive approach regarding liberalization. The background Note prepared by the UNCTAD Secretariat for the Expert Meeting was useful in that it indicated that a wide range of approaches existed in international investment agreements to take account of the development dimension. This was an important consideration in regard to discussions on investment rules in the WTO.

82. The representative of the United States observed that it would appear that a common assumption in recent UNCTAD papers was that government intervention in investment would assist or enhance the development process. There was a vast amount of empirical evidence that contradicted this assumption. In this regard, she referred to recent steps taken by the United States to deregulate a number of sectors in recognition of the high costs of government intervention. Regulatory reforms had been pursued in areas such as trucking, railroads, civil aviation, banking, telecommunications, natural gas and electric power industries. These reforms had yielded price reductions of 30-50 per cent in a ten-year period and had also improved service quality and product and service innovation. Thus, a basic consideration for both developed and developing countries was that development was sometimes better promoted by deregulation than by more regulation.

83. The representative of Hong Kong, China stated that a key element in exploring the possible development of WTO rules on investment was the need for flexibility to reflect the differing levels of economic development of Members. The GATS contained various ways to achieve such flexibility. At the same time, flexibility should not undermine the substantive rules in areas such as performance requirements and national treatment.

84. The representative of Pakistan stressed the need for an optimal balance between flexibility and predictability and transparency. While this issue had been considered at the UNCTAD Expert Meeting in respect of the objectives, structure and modalities of implementation of investment agreements, the question of the international forum in which an investment agreement was concluded was also relevant in this respect. More specifically, the question was whether this optimal balance could be arrived at in the WTO given the nature of the obligations undertaken in the WTO. He drew attention to the observation by the UNCTAD Secretary-General at the opening of the Expert Meeting that the basic objectives of developing countries in concluding investment agreements was to achieve more greenfield investment to generate technology, finance and access to markets and more flexibility to deal with foreign investment. The Secretary-General had also remarked that three recent international trade initiatives - the Uruguay Round (particularly in relation to trade-related investment measures and subsidies), the IMF initiative in pursuing its recent mandate to amend the Articles of Agreement, and the OECD MAI, seeking high standards of treatment and liberalization for FDI flows - had sought to impose limits on flexibility in national policy-making, and that it was necessary to ask what were the purposes of such limitations and whether these proposals would lead to the realization of the sought-after objectives. As reflected in the Agreed Conclusions adopted by the Expert Meeting, further work was needed to shed light on the interrelationship between international investment agreements and the promotion of development.

85. The representative of Mexico observed that it appeared that the concept of flexibility in relation to investment agreements was used to refer to the capacity of individual countries to pursue their individual development objectives. In view of the differing needs of individual countries, there was a risk that the concept of flexibility could undermine the fundamental objective of investment agreements to promote predictability and stability of the regulatory framework governing foreign investment. Her delegation therefore considered that the notion of flexibility needed to be defined carefully so as to ensure a balance between this concept and the substantive rules of an international investment agreement. It was also important to consider flexibility not as an end in itself but as a means to achieve development objectives and to have regard to the effectiveness of the policy instruments covered by the concept of flexibility. For example, as argued by her delegation in WT/WGTI/W/74, instruments such as fiscal incentives did not appear to be an efficient means of achieving regional or sectoral objectives. Finally, the concept of flexibility as discussed so far did not appear to take into account the problem of the regulatory competition between countries to attract FDI. This competition might lead to a lowering of regulatory standards and weaken the regulatory capacity of governments in various areas of national policy. Her delegation considered that international corporation could be useful to limit harmful competition for FDI and that this matter should be addressed as a key aspect of the relationship between flexibility and development.

86. The representative of Canada underlined the importance of a proper balance between flexibility for development, on the one hand, and the necessary level of predictability and stability, on the other. A possible approach, which had been adopted in Canada's bilateral investment treaties and in the NAFTA, was to develop precise rules on investment while accompanying such rules with reservations, which could be annexed to the text or built into it, which enabled each of the countries concerned, depending upon the level of development and their specific sensibility in certain areas, to reserve certain sectors or certain matters which they felt to be particularly sensitive. This approach had made it possible to take into account the particular policy concerns of individual countries while at the same time enhancing predictability and transparency for foreign investors.

87. The representative of Egypt stated that the development dimension should be an integral part of the design and structure of any investment agreement. The balance between flexibility and predictability was essential, in which respect he echoed the comments by Pakistan on the difficulty of achieving the necessary degree of flexibility for development purposes in the context of negotiations in the WTO. A key question was how an approach to flexibility could be developed which would take into account the needs of countries at different levels of development. In considering this question of flexibility, it should be borne in mind that the process of globalization already limited policy flexibility and forced governments to be more selective in their interventions.

88. The representative of Korea stated that the UNCTAD Secretariat Note was consistent with the approach adopted in the contribution by his delegation in WT/WGTI/W/79 as regards the need to find a proper balance between flexibility for development purposes, on the one hand, and transparency and predictability, on the other. This consideration should serve as the basis for future work, particularly when negotiating multilateral rules in investment in the WTO.

89. The Working Group took note of the statements.

E. OBSERVER STATUS FOR INTERNATIONAL INTERGOVERNMENTAL ORGANIZATIONS

90. In light of ongoing consultations in the framework of the General Council, the Working Group agreed to maintain the status quo.

F. DATES OF NEXT MEETINGS

91. The Working Group agreed to hold its next meeting in the week of 13 September 1999.² It also agreed that the Secretariat would circulate for consideration and adoption at that meeting a draft of the Working Group's annual report to the General Council. This report would be factual and would not contain any recommendations.

² The date has since been confirmed as 23-24 September 1999.