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Working Group on the Relationship between Trade and Investment

REPORT ON THE MEETING OF 30 AND 31 MARCH 1998

1. The Working Group on the Relationship between Trade and Investment held its fourth meeting on 30 and 31 March 1998.
2. The Working Group agreed that, in the absence of its Chairman, Ambassador Krirk-Krai Jirapaet, the meeting would be chaired by the Chairman of the General Council, Ambassador Weekes, with the assistance of Mr. Otten of the Secretariat.
3. The substantive agenda for this meeting comprised items I-III and the factual aspects of the first indent of item IV of the Checklist of Issues Suggested for Study (WT/WGTI/M/1, Annex 1).
 - A. IMPLICATIONS OF THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT FOR DEVELOPMENT AND ECONOMIC GROWTH (ITEM I OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)
4. The Chairman drew attention to documents relevant to this item, including contributions by Members and by international intergovernmental organizations that had been discussed at previous meetings and an informal note from the Chairman (Job No. 6004/Rev.1), the first section of which contained a list of issues identified in discussions on this item at previous meetings of the Working Group as requiring further study.
5. The representative of Costa Rica introduced a submission (WT/WGTI/W/31) on the impact of foreign direct investment ("FDI") on the Costa Rican economy and on Costa Rica's investment policy. He highlighted the considerable increase in FDI inflows to Costa Rica in recent years, both in real terms and as a percentage of GDP, the positive correlation between FDI and indicators of human development, which reflected the importance of the level of development of human resources as a determinant of FDI, and the contribution of FDI to employment creation and growth of industrial exports. No specific FDI legislation existed in Costa Rica, as Costa Rica's policy toward FDI was based on a constitutional principle of non-discriminatory treatment of foreign and domestic investors. There were no requirements for prior authorization or registration of FDI in any sector or restrictions on transfers related to FDI. In addition to access to domestic courts, means of legal recourse for foreign investors were provided for in international agreements to which Costa Rica was a party, including the ICSID Convention, the Interamerican Convention on Commercial Arbitration, the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards and a number of bilateral investment treaties.
6. The representative of the United States, recalling the interest that had been expressed in the Working Group in a further examination of the role of FDI in technological development of host countries, introduced a submission (WT/WGTI/W/27) which contained the results of an empirical study of the effects of the operations of foreign-owned firms in the United States on science and technology development in the United States, an issue which had received increasing attention in the

light of rising globalization. Three key conclusions that could be drawn from this analysis were: first, that between 1987 and 1994 research and development spending by foreign manufacturing affiliates in the United States had grown almost twice as much as research and development spending by all United States firms; secondly, that the contribution of foreign affiliates to technology development was particularly significant in high-technology industries, as evidenced by the fact that over three fourths of total research and development spending by the foreign affiliates was by those in high-technology industries; and, thirdly, that there had been a large net inflow of technology to foreign affiliates in the United States from their foreign parents, as shown by data on royalties and licence fees.

7. The representative of Mexico, referring to the relationship observed by Costa Rica between FDI and indicators of human development, emphasized that, in analysing the contribution of FDI to development, a comprehensive approach should be taken in order to take into account the human and social dimensions of development. The representative of Hong Kong, China underlined the importance of the questions raised in the first paragraph of the submission by the United States. Noting that most of the analysis in this submission seemed to be based on data which did not go beyond 1994, he asked whether more recent data were available. The representative of the European Community pointed to the strong positive relationship which this submission showed to exist between FDI and technology development as a result of the research and development spending of foreign affiliates and the net inflow of technology from foreign parents to their affiliates.

8. The representative of the OECD introduced a submission (WT/WGTI/W/26) which analysed the relationship between FDI and economic development through case studies of six developing countries, Argentina, Brazil, Chile, Indonesia, Malaysia and the Philippines. The key point emerging from the analysis in this submission was that the overall policy framework in host countries was a critical factor in maximizing the gains from FDI. Trade policy was of particular relevance in this regard. Policies pursued in the past by some developing countries with large domestic markets to attract FDI on the basis of a protected home market had lost their effectiveness as they had ran into market saturation and foreign investors had shifted to more dynamic countries and markets. Recent evidence showed that trade liberalization had a positive effect on the volume of FDI inflows. This was due to three main reasons. First, trade liberalization made domestic markets more dynamic, leading to higher growth and an expansion of demand in host countries. Secondly, a reduction of import barriers meant that multinational enterprises could import better or lower cost inputs which made export-oriented production in the host country viable. Thirdly, regional or multilateral agreements implied that these exports would face fewer barriers abroad. Successful regional integration schemes had often provided a boost to inward investment. Even more important than the impact of trade policy liberalization on the level of FDI was its impact on the quality of FDI. Several studies had shown that FDI in a highly protected environment could have a negative effect on host countries. Trade protection created economic rents which could be captured by foreign investors and transferred abroad. It also dampened the transfer of technology as the lack of competition in host country markets made it unnecessary for a parent firm to transfer the most advanced technology to its affiliate. This perpetuated the relative backwardness of the affiliate and in turn made it less likely that the affiliate would contribute to host country exports. Trade liberalization could reverse this process by encouraging technology transfer and exports. In addition, given that certain restrictive FDI policies, such as ownership restrictions and performance requirements, had often been put in place in order to compensate for the negative consequences of trade protection on the behaviour of foreign firms, trade liberalization called into question the rationale for maintaining such policies in the present context.

9. The representatives of the United States, the European Community and Hong Kong, China endorsed the findings of the OECD submission and identified a number of points made therein as particularly relevant: the contribution of FDI to economic restructuring and to export growth and diversification; the role of FDI in improving the capacity of host countries to respond to the opportunities offered by global economic integration; the convergence between the policies of the six countries in question toward greater openness to FDI; the need for liberalization of FDI policies to

be an integral part of comprehensive economic reforms; the declining effectiveness of policies aimed at attracting FDI to protected home markets and the declining rationale and rising costs of FDI restrictions and performance requirements in an environment of trade liberalization and increasing orientation of FDI toward production for export to regional or global markets; the importance of trade liberalization in attracting FDI and enhancing the contribution of FDI to economic development; the counter-productive effects of certain policies pursued by host countries in the past aimed at augmenting transfer of technology, for example through mandatory joint venture or transfer of technology requirements; the important role of FDI in the context of privatization, notably in infrastructure; and the beneficial effect of FDI liberalization in financial services in promoting the efficiency and the stability of the financial sector of host countries. The point was also made that the evidence provided in the OECD submission of the positive effects of FDI on the trade and current account balances of host countries contradicted an argument mentioned in a submission by Japan (WT/WGTI/W/11) that repatriation of profits from foreign affiliates to a home country could have a serious effect on the balance of payments of a host country.

10. The representative of Australia disagreed with the point made in the OECD submission that the presence of a screening mechanism was the most important barrier to FDI. While an inappropriate screening mechanism could retard investment flows, the problem in such cases was more likely to be associated with non-transparent procedures. A properly administered screening mechanism, however, which provided for an expeditious assessment of an investment proposal on the basis of transparent criteria was not a hindrance to investment flows. The representative of Egypt agreed with this comment and noted that screening could serve important purposes, such as the collection of statistical information. The representative of the United States concurred with the view expressed in the OECD submission that the most important barrier to FDI was the presence of a screening mechanism.

11. The representative of Argentina agreed with the findings of the OECD submission regarding Argentina's experience with FDI. Referring to comments made at previous meetings on the need to take account of the possible negative effects of FDI, he stressed that, notwithstanding that Argentina had a very open FDI regime, as described in the OECD submission, it had not experienced any negative effects of FDI liberalization. In the latter regard, he endorsed the view expressed in the OECD submission that the presence of foreign firms had contributed to the stability of Argentina's financial sector. Referring to the different conclusions drawn in the OECD submission and the Secretariat Note in WT/WGTI/W/7 and Corr.1 on "The Relationship between Trade and Foreign Direct Investment" on the question of whether the recent increase in FDI flows to Argentina was due to domestic reforms or to regional integration, he explained that the relative importance of these two factors had changed over time. During the period 1989-1994, most FDI inflows had been related to privatization, whereas since 1994 FDI inflows had been driven more by the effects of regional integration, as illustrated by the rise of FDI in the automotive industry.

12. The representative of Korea recalled that at the previous meeting, when some delegations had pointed to the need for a balanced approach which would also take account of the negative effects of FDI, his delegation had indicated that it would consider submitting a paper on negative experiences with FDI in Korea, if any. His authorities had concluded, however, that Korea had not been confronted with any particular problems from a development perspective resulting from FDI. Instead, the active policy of liberalizing since the early 1980s had contributed to rectifying the structural problems the Korean economy had faced over the past decades. A more active and aggressive FDI liberalization policy would have contributed more to this restructuring process. At the initial stage of Korea's economic development, Korea had relied heavily on foreign public and commercial loans rather than FDI to procure investment resources and stabilize the balance of payments. Public and commercial loans had accounted for almost 90 per cent of foreign capital inflows throughout the 1960s and into the late 1970s. However, since the late 1960s Korea had encountered many problems arising from foreign loans, such as the increasing burden of repayment of foreign borrowing. As a result, since the early 1970s, Korea's basic foreign capital policies had involved more selective foreign borrowing and greater reliance on FDI as a source of financing which did not create repayment problems. In the 1980s, the Foreign Capital Inducement Law had been revised to introduce a negative

list system for FDI approval in which any industry not specified on the list was open to foreign investment. In the early 1990s, the Law had been amended to allow for FDI without prior approval, upon the simple filing of a report to the relevant Ministry. In the context of the current financial crisis, Korea attached high priority to attracting FDI and, to this end, was in the process of amending its FDI legislation to facilitate FDI and capital inflow. Under the new legislation, hostile mergers and acquisitions would also be allowed. Two main conclusions could be drawn from Korea's past experience with FDI. First, an active FDI liberalization policy contributed to economic development but strong economic fundamentals as well as effective management of macroeconomic policies were essential for investment liberalization to produce the expected outcome. Secondly, to maximize the positive effects of FDI, liberalization policies should be tailored to meet the needs and priorities of each country's economic development policy.

13. The representative of Hong Kong, China agreed with the conclusions drawn by the representative of Korea. The representative of India echoed the comment made by the representative of Korea that FDI policies needed to be tailored to the needs of individual countries. The representative of the European Community observed that it was significant and reassuring that Korea had not found any negative effects of FDI on economic development and welcomed the announcement of impending changes to Korea's FDI legislation with regard to mergers and acquisitions.

14. The representative of Canada pointed to the significant increase in FDI inflows to Canada that had occurred over the last decade, both in real terms and as a proportion of GDP, the substantial economic contribution of foreign firms in Canada, especially in technology-intensive industries, and the important role of inward FDI in creating employment. In addition, significant economic benefits resulted from outward FDI from Canada, which had recently risen to record levels. Stocks of Canadian investment abroad surpassed total stocks of FDI in Canada for the first time in 1997 and Canada was now one of the group of net capital exporting countries. Canadian FDI abroad was diversifying and developing countries were becoming increasingly important destinations for Canadian investors. Many of the investments abroad by Canadian firms, in both developed and developing countries, took the form of cooperative ventures, or strategic alliances. Outward FDI was important from the perspective of employment creation given that FDI and trade were strong complements and that trade was an important creator of Canadian jobs. Canada's outward-oriented firms outperformed those focused only on the domestic market in the areas of sales growth, asset growth, capital productivity, research and development intensity and average returns on assets. In summary, both inward and outward FDI stimulated economic growth and job creation in Canada through several mechanisms: increasing capital formation, enhancing trade flows, enhancing technology flows, improving the competitiveness of Canadian firms in international markets, raising incomes through direct investment abroad and increasing competition in markets.

15. The representative of Norway stated that FDI had played a crucial role in Norway's economic development for more than 100 years, in particular in the development of local resources, including hydropower, and oil and gas. Norway's experience showed that there was a positive correlation between the openness of international economic relations and inflows of FDI and that there was a tendency towards more greenfield investment in resource-based activities than in manufacturing, where mergers and acquisitions played a bigger role. National control had always been and remained a hotly debated issue but it had become clear that, in general, national control was not enhanced by discrimination between domestic and foreign economic actors. Finally, even though Norway had become a net capital exporter in 1994, in the same year it had established an agency aimed at promoting inward FDI.

16. The representative of the European Community pointed to three general themes that emerged from the contributions presented so far to the Working Group. First, there was growing evidence that realities had changed and that the debate on FDI regimes and the effects of FDI must be seen in a different light than in the past. The recent submission by the OECD and earlier submissions by Korea and Japan were particularly relevant in that they provided empirical evidence that policies pursued in

the past on grounds of infant industry protection were no longer applicable in the current context. Secondly, there was growing empirical evidence to suggest that there was a globally positive relationship between trade and investment. Thirdly, there was a close interaction between FDI reform in several countries and generic economic reform as mutually reinforcing trends. In commenting on a submission from Bolivia in WT/WGTI/W/20, he said that this submission provided concrete evidence of the benefits of FDI liberalization were measurable empirically.

17. The representative of Canada stated that Canada's perspective on the issue of the link between FDI and economic development was close to that presented in submissions by Korea and Japan (WT/WGTI/W/16 and W/18). Korea had pointed out that inward FDI had a positive effect on economic development, with positive impacts on employment, productivity, transfer of advanced technology and the competitiveness of the domestic market. Korea had also found that "the export inducement effect was larger than the import inducement effect". Japan's submission pointed out that under the era of globalization and sophisticated technological innovation which described conditions today, restricting foreign investment leads to "the weakening in the competitiveness of domestic industries". In respect of the submission by the United States in WT/WGTI/W/14, he observed that Canada did not generally take a balance-of-payments perspective in looking at the economic impacts of inward and outward investment on its economy. The submission by the United States took such an approach and concluded that foreign-owned firms accounted for 70 per cent of the total United States trade deficit in 1994, largely due to the greater propensity of these foreign-owned firms to import. The submission explained that the trade imbalances appeared to be driven by the parent-affiliate relationship, as parent firms tended to export to their foreign affiliates. It supported the assertion that access to markets was an important motivation for foreign investors. A significant part of international trade today was carried out on an intrafirm basis, and its importance was increasing, suggesting that FDI and trade went hand in hand.

18. The representative of the Philippines, speaking on behalf of the ASEAN WTO Members, stated that FDI on the whole played an important positive role in transferring intangible assets to recipient countries, especially developing countries, but that developing countries had sometimes also been confronted with negative effects of FDI. For example, foreign affiliates were sometimes prevented from undertaking certain activities by restrictions imposed by their parents in technology transfer agreements, which might have an adverse impact on competition and corporate development. Furthermore, some developing countries faced the risk of becoming locations for simple assembly operations. Referring to the analysis of possible negative effects of FDI in the contribution submitted by Japan in WT/WGTI/W/11, he observed that the instability of the balance of trade and balance of payments on account of FDI movements was a very real risk, as could be seen in the recent experience of some ASEAN countries, and that there was also a risk of foreign companies exercising undue political influence. Foreign affiliates could also negatively impact on domestically available financing and competition in the domestic market, including on small and medium enterprises, as discussed in a submission by UNCTAD (WT/WGTI/W/8/Add.1) which had found that FDI might in certain circumstances need to be phased in at a slower rate than the rate determined solely by market forces. In the face of these possible negative consequences of FDI, industrial policy, including sectoral targeting, was a necessary element of national investment regimes in order to optimize the benefits from, and to minimize, if not eliminate, the negative effects of FDI and as an exercise of the sovereign right of each country to pursue development policies in accordance with its domestic needs and priorities. Sectoral targeting had proved its effectiveness in addressing not only national but also regional or locational and sector-specific objectives. ASEAN Members believed that sectoral targeting policy should be pursued in a complementary relationship with a policy of general openness toward FDI. Regarding the relationship between trade and investment, while there was ample evidence to confirm that openness was a determinant for the attraction of investments and that more investments encouraged further openness, account should also be taken of restrictive features of particular business practices and strategies. In the case of FDI which targeted the domestic market of host countries, foreign affiliates sometimes ended up dominating the domestic market, especially during the early stages of product and market development. In other cases, foreign affiliates attempted to secure tariff and other forms of protection or were subject to restrictions on export

imposed by their parent firms. Thus, business strategies and practices, by themselves, had an equally important, if not determinative, role in the flow of investments. Therefore, the view that trade and investment went hand in hand, reinforcing one another, and were largely determined by a host country's degree of openness needed to be qualified.

19. The representatives of Egypt and India supported the views expressed by the representative of the Philippines. The representative of India pointed to the need for further analysis of restrictions on transfer of technology in transactions between parents and affiliates and the impact of such transactions on trade and competition. In regard to the reference by the representative of the Philippines to the comment in WT/WGTI/W/11 on the possible negative balance-of-payments implications of FDI, the representative of Japan explained that this comment reflected an argument sometimes made in economic literature but that his delegation doubted that there was empirical support for this argument. Regarding the concept of sectoral targeting, he recalled the point made in his delegation's submission in WT/WGTI/W/18 that restrictive FDI policies based on infant industry protection grounds would, in the current context, seriously impede technological innovation, given the rapid pace of technological change in today's world.

20. The representative of Egypt, referring to comments made by the representative of the European Community, considered that the statement that FDI policies and policies inspired by the infant industry argument were unlikely to be effective in the present context required further qualification and analysis in order to determine in detail which specific policies had been effective in the past and would no longer be relevant in the present context. As regards the question of positive and negative effects of FDI, he stressed that whether FDI had positive effects on the whole was not at issue in the Working Group, as shown by the efforts of all Members to attract FDI, and that the key question to be addressed was how host countries could minimize possible negative effects and maximize positive effects of FDI through appropriate policies. Examples of possible negative effects that had been identified related to the possibility of political interference by foreign firms and adverse effects of FDI on trade balance and balance of payments. It was also necessary to take into account factors that might limit the potential benefits of FDI, such as restrictions on transfer of technology between parents and affiliates.

21. The representative of the Philippines, speaking on behalf of the ASEAN WTO Members, distinguished sectoral targeting from the concept of infant industry protection, which he had deliberately refrained from using in his earlier statement as his delegation did not consider that infant industry protection was a basis for sound policies.

22. The representative of the European Community, reacting to the comments made by the representative of Egypt, observed that the OECD submission in WT/WGTI/W/26 showed that many of the policies discussed therein had been proved not to have worked in terms of attracting FDI or channelling FDI to particular sectors and that even where those policies had worked in the past their effectiveness had not lasted very long. The European Community's own experience with sectoral targeting and protective policies also confirmed that these policies were not effective. Regarding the reference made by some delegations to possible negative effects of FDI arising from anti-competitive practices of foreign affiliates or from arrangements between parents and foreign affiliates, as in the case of restrictions on transfer of technology, he wondered whether there was specific empirical evidence to substantiate these concerns. In the experience of the European Community, restrictive practices were not a typical feature of foreign firms and were adequately dealt with through a non-discriminatory application of competition law. At the same time, the presence of foreign firms enhanced competition in domestic markets and was an important factor to be taken into consideration in the application of competition law.

23. The representative of UNCTAD drew attention to a recent study on the Asian financial crisis which confirmed that FDI was a more stable source of financing than portfolio flows and commercial lending. An important theme raised by the comments made at this meeting was the changing relative weight of particular determinants of FDI in a liberalizing and globalizing economy. In particular,

market size had been a predominant determinant of FDI in the past but was less important in the context of trade liberalization in a regional or global context. Regarding the issue of positive and negative effects of FDI, he agreed that the central question was not whether FDI on the whole was beneficial but how to maximize the positive and minimize the negative effects. Like all investment, FDI had both positive and negative effects and appropriate policies were needed to ensure that, on balance, the positive effects outweighed the negative effects. Competition policy was particularly important in this connection to ensure the contestability of markets. As public restraints on FDI were reduced, attention shifted to private anti-competitive practices. The relationship of FDI and competition policy had been the subject of a special study contained in the *World Investment Report 1997*.

24. The representative of the European Community responded that, while it might be true that FDI like domestic investment could have positive and negative effects, it was not clear that there were negative effects specifically associated with FDI, including in the area of competition policy.

25. The representative of Brazil noted that the debate at this meeting had raised many important aspects of the relationship between FDI and economic development, including the role of FDI in the context of the Asian financial crisis, the effects of FDI on balance of payments and transfer of technology, the appropriateness of sectoral targeting and infant industry policies, and the effect of screening systems. He requested that the Chairman's note in document No. 6004/Rev.1 be revised to reflect these points. The representative of Mexico stated that the synthesis paper under preparation by the Secretariat would be an important tool to advance the work on this item of the Working Group's agenda.

26. The representative of the Philippines, speaking on behalf of ASEAN WTO Members, proposed that the Secretariat compile an analysis of negative effects of FDI, especially in regard to transfer of technology. In the light of comments made on this proposal, he indicated that he would await the synthesis paper under preparation by the Secretariat before considering how to proceed further on this matter.

27. The Working Group took note of the statements made and agreed to revert to item I of the Checklist at its next meeting. It agreed that the Chairman's note in document No. 6004/Rev.1 would be revised to take into account additional points raised at this meeting as requiring further examination. At the next meeting, the Group would also have before it the synthesis paper which the Secretariat had been asked to prepare on the links between FDI and economic development.¹

B. THE ECONOMIC RELATIONSHIP BETWEEN TRADE AND INVESTMENT (INDENTS 1-7 OF ITEM II OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY)

28. The representative of Turkey, in introducing a submission subsequently circulated in WT/WGTI/W/37, described the liberalization of Turkey's FDI regime that had occurred in the early 1980s as part of the change in Turkey's economic policies from an import substitution-oriented approach to an outward looking development strategy. Turkey's current FDI legislation contained no sectoral or ownership restrictions and provided for non-discrimination between foreign and domestic investors, including with regard to the eligibility of investment incentives. Relevant international arrangements to which Turkey was a party included a number of bilateral investment treaties, OECD investment instruments, the ICSID Convention and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Although liberalization of FDI policy had resulted in a significant increase in FDI inflows, current FDI inflows were not commensurate with the potential of the Turkish economy, having regard to the abundant availability of relatively low-paid, skilled labour; the geographical proximity to western markets and those of Central Asia and the Middle East, the rapid growth of internal demand and liberal trade policies. Analysis of the role of FDI in the Turkish economy was complicated by the lack of adequate statistical information on

¹WT/WGTI/M/3, paragraph 10

foreign affiliates' trade. The limited data available showed that foreign firms accounted for significant shares of sales and exports of the largest 500 firms but that their contribution to employment creation was less significant. Further work on the linkages between trade and investment was necessary in order to develop a better understanding of how national trade policies and investment policies could be made mutually supportive.

29. The representative of Cuba introduced a submission subsequently circulated in WT/WGTI/W/35 on Cuba's experience with outward FDI. Cuban firms had engaged in outward FDI in a range of sectors, including seafood, cigars, nickel and cobalt, biotechnology and sugar cane. In many cases, such outward FDI was motivated by the need to establish channels for the distribution of Cuban exports abroad, in which context he mentioned the impact of the embargo applied by the United States on trade with Cuba. There were also examples of import-oriented outward FDI, as in the case of certain food products. In the light of various existing trade and investment measures applied by the United States, he expressed concern about possible future attempts by the United States to take action against the operations of Cuban firms in third countries.

30. A number of specific comments were made and questions raised with regard to Secretariat Notes on "Availability of Statistics on Foreign Direct Investment and on the Activities of Foreign Affiliates" (WT/WGTI/W/24) and on "The Relationship between Trade and Foreign Direct Investment: Foreign Direct Investment Originating In Developing Countries" (WT/WGTI/W/25), which had been prepared by the Secretariat in response to a request made by the Working Group at its meeting in December 1997.

31. The representative of Australia considered that in view of the progress achieved in regard to statistics on FDI and foreign affiliates trade, as summarized in paragraphs 39 and 40 of WT/WGTI/W/24, the remaining data limitations were not a serious obstacle to the progress of the work of the Working Group. The representative of Egypt requested further information on the progress of work of the Inter-agency Task Force on Statistics of International Trade in Services mentioned in paragraph 31 of this Note and on the status of work in the OECD on the preparation of a manual of indicators of globalization. He drew attention to the point made in the Note regarding the limited availability of statistics allowing cross-country comparisons. In regard to the annex to this Note, he considered it inappropriate for the Secretariat to have formulated recommendations. The representatives of India, Mexico and Hong Kong, China stressed that it was important that the manual on trade in services that was being prepared in the Inter-Agency Task Force on Statistics of International Trade in Services should cover all modes of supply covered by the GATS.

32. The representative of the Secretariat explained that the annex to WT/WGTI/W/24 was simply intended to provide additional factual information on the ongoing work on the preparation of a manual on trade in services by listing questions and recommendations that were under consideration in that context. Thus, the recommendations appearing in this annex had not been prepared by the WTO Secretariat. A first complete draft of the manual would be presented for consideration by the Inter-Agency Task Force at a meeting to be held at the WTO in June 1998. The manual on trade in services that was being developed in the Inter-Agency Task Force was intended to deal with all modes of supply covered by the GATS but further work was necessary to resolve specific methodological difficulties associated with statistics on the movement of natural persons within the meaning of mode four of the GATS. The Secretariat would contact the OECD for further information on the status of its work on indicators of globalization.

33. The representatives of Korea, the Philippines, speaking on behalf of the ASEAN WTO Members, and Hong Kong, China agreed with the conclusion drawn in WT/WGTI/W/25 that outward FDI from developing countries was driven by the same factors as outward FDI from developed countries. In this connection, they mentioned cost and efficiency considerations as explaining vertical outward FDI and the role of trade barriers, such as anti-dumping and voluntary export restraints, in explaining horizontal outward FDI. The representatives of the European Community, Korea and Hong Kong, China also highlighted the points made in this Note regarding the positive relationship

between trade and outward FDI from developing countries. The representative of Hong Kong, China considered that this matter required further examination in relation to horizontal, tariff-jumping FDI, while the representative of Korea pointed to empirical evidence discussed in paragraphs 18-19 of his delegation's submission in WT/WGTI/W/16 which showed that the export inducement effect of Korean horizontal outward FDI exceeded the import inducement effect.

34. The representative of Egypt expressed interest in a further consideration of the differences between the patterns of outward FDI from the economies studied in this note in terms of their geographical orientation, sectoral distribution and the role of small- and medium-sized firms; the impact of currency appreciation on outward FDI; and the distortive effect of non-tariff barriers in developed countries in diverting investment from developing countries. As in the case of the Secretariat's Note on "The Relationship between Trade and Foreign Direct Investment" (WT/WGTI/W/7 and Corr.1), his delegation did not share the basic assumption on which the analysis in the Note seemed to be based that increased trade generated by FDI was beneficial *per se*.

35. The representative of the Secretariat responded to the latter comment by observing that the request by the Working Group pursuant to which the Note had been prepared focused on the relationship between trade and investment. The Secretariat was not necessarily assuming that increased trade was beneficial *per se* in the sense of being welfare enhancing, although, to the extent that it resulted from a reduction in governmental obstacles, it usually would be.

36. The representative of India, referring to the indent of item II on "the relationship between the mobility of capital and the mobility of labour", pointed to the basic complementarity between capital and labour as production factors and between capital mobility and labour mobility as delivery modes for trade and investment in goods and services. Although this complementary relationship between capital and labour called for a liberal, integrated approach to the mobility of labour as part of the free global flow of capital, goods and services, in reality mobility of capital and mobility of labour had been treated quite differently. The GATS exemplified the inadequate treatment of labour mobility insofar as the supply of services through the movement of natural persons covered by its Mode Four applied only to narrowly circumscribed categories of persons. An examination by the Working Group of the limitations on market access and national treatment commitments made under the GATS could help elucidate the different barriers to mobility of capital and to mobility of labour. The failure to ensure mobility of labour more comprehensively as a complementary and critical factor to the mobility of capital had far-reaching adverse economic consequences, particularly by creating labour shortages which prevented the efficient use of capital. It was important for the Working Group to hold discussions to explore the nature and extent of issues in labour resources faced by different sectors. In considering ways to overcome the labour crunch and improve the productivity of capital by enhancing the mobility of labour, it would be useful to focus on selected categories of labour apart from the higher categories of personnel for which most Members had already undertaken commitments under the GATS. In this context, the Working Group could suggest ways for such selected categories of labour to move from surplus regions to deficit regions. His delegation would shortly present a submission on this matter.²

37. The representative of the European Community recalled that his delegation had submitted a communication relating to the indent of item II on "the impact of business strategies, practices and decision-making on trade and investment" based on a study of outward FDI from the United Kingdom (WT/WGTI/W/12). He would welcome further discussion of this study and similar contributions from other Members.

38. The representative of Australia proposed that there be further analysis in the Working Group of the trade effect of performance requirements and investment incentives. She recalled that her delegation had raised this issue on an earlier occasion, as reflected in WT/WGTI/W/23. The representatives of Switzerland, the European Community and New Zealand supported this proposal.

²See WT/WGTI/W/39

39. The representative of the Philippines, speaking on behalf of ASEAN WTO Members, observed that ASEAN Members regarded investment incentives as a necessary component of efforts to attract FDI. Incentives had an important role to play in compensating for certain distortions, for example distortions due to domestic regulation in the field of taxation and labour laws, and were particularly relevant to sectoral objectives of host countries. ASEAN Members realized, however, that in many situations the role of investment incentives was limited as compared to more fundamental economic factors and that incentives could lead to inefficiencies. Moderation in the use of investment incentives was therefore called for. In regard to the proposal for further study of performance requirements, he suggested that such a study also examine: how, if at all, performance requirements had contributed to the development process of developing countries; whether the existence of performance requirements had a negative impact on source countries of FDI; and the compatibility of the treatment of performance requirements in the WTO with those in other arrangements. In the latter regard, a key question concerned the economic rationale of the more lenient treatment of performance requirements in other arrangements, as compared to the strict prohibition under the TRIMs Agreement.

40. The representative of the Dominican Republic supported the view that the study to be undertaken by the Secretariat include special consideration of the development dimension. The representative of Switzerland said that at some future stage the Working Group should also look at the policy aspects of investment incentives.

41. The representative of UNCTAD, responding to a question from the Chair, drew attention to a study carried out by UNCTAD and summarized in the *World Investment Report 1996* of some 100 countries which had found that the use of investment incentives had increased considerably in both developed and developing countries. Although the granting of such incentives was sometimes justified on the grounds that they helped to compensate for certain distortions, it was difficult to determine whether incentives were positively contributing to development and were being applied in a cost-effective manner. The available evidence seemed to suggest that in many instances incentives were more like the icing on the cake and that economic fundamentals were more important in influencing investment decisions. There was scope for rationalizing investment incentives by granting them after investment projects had become profitable rather than up front. The study had not looked at the impact of incentives on trade. On performance requirements, the *World Investment Report 1996* contained a list of the main types of such measures in the context of a consideration of issues arising in regard to international investment arrangements but did not analyse their economic impact.

42. The representative of Egypt, referring to the points made in WT/WGTI/W/25 and in the submission by Australia in WT/WGTI/W/23 on the impact of trade barriers on FDI, proposed that the Secretariat also undertake a more detailed analysis of the effects of trade measures on investment flows. The representatives of the European Community and the United States commented that such an analysis should deal comprehensively with the effect of trade protection on investment and not focus on particular types of trade measures.

43. The Working Group took note of the statements made and agreed to revert to the first seven indents of item II of the Checklist at its next meeting. As previously agreed, the eighth indent, relating to FDI and competition, would be examined at a later stage, following discussion of this matter in the Working Group on the Interaction between Trade and Competition Policy. The Working Group agreed that the informal Chairman's note in document No. 6004/Rev.1 would be revised to reflect the issues raised during the discussion on item II at this meeting. It also agreed that the Secretariat would consider whether it could add to its analysis in WT/WGTI/W/7 regarding the effects on trade of investment incentives and performance requirements and the effects of trade measures on investment, possibly through a theoretical analysis or through a scrutiny of the material made available to the Working Group.

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*

44. No statements were made. The Working Group agreed to keep this indent on the agenda of its next meeting.

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

45. The Working Group had before it in document WT/WGTI/W/22 a Note by the Secretariat on "Bilateral, Regional, Plurilateral and Multilateral Agreements" which had been prepared in response to a request by the Working Group for a factual overview of existing investment agreements.³

46. The representatives of Costa Rica and Mexico pointed to several general conclusions that emerged from the Secretariat's overview of existing international investment agreements in WT/WGTI/W/22. The representative of Costa Rica observed that existing international investment disciplines had evolved autonomously, that it was only in recent years that investment disciplines had become integrated in trade agreements and that, although there were important areas of commonality between investment arrangements in regard to matters such as expropriation and compensation, national treatment, most-favoured-nation treatment and dispute settlement, none of these issues was treated in a uniform manner. The representative of Mexico identified among the areas of convergence between existing agreements the principle that foreign investors were to be accorded national treatment but subject to exceptions as provided for in national legislation. Areas of divergence included dispute settlement, the treatment of balance-of-payments issues, incentives, performance requirements, objectives, coverage and the role of promotion of development. There were a number of lacunae in existing arrangements, including with respect to the scope of the definition of investment, the lack of an integral approach to development, the lack of provisions on privatization, fiscal havens, technical cooperation, monopolies, state enterprises and concessions, corporate practices and technology development.

47. The representatives of the United States, Switzerland and Japan introduced recent submissions (WT/WGTI/W/29, 28 and 34) on the principal provisions of bilateral investment treaties concluded by these countries with third countries. In addition to highlighting specific elements of these treaties, the representative of the United States pointed to the relationship between bilateral investment treaties and adequate protection of intellectual property rights. The representatives of Canada, Japan and Mexico pointed to the fact that, while bilateral investment treaties concluded by Canada and the United States required, in principle, national treatment and most-favoured-nation treatment in regard to both post- and pre-establishment of an investment, in most other bilateral investment treaties these standards applied only to the post-establishment phase. In summarizing the results of UNCTAD's analytical work on international investment agreements, the representative of UNCTAD identified the following key themes that had emerged from this work in regard to bilateral investment treaties: the rapidly increasing number and diversity of countries that had concluded such treaties; the considerable uniformity in the broad principles of bilateral investment treaties along with numerous and important variations in the specific formulations; the lack of detailed information on and analysis of the actual application of bilateral investment treaties; the absence of evidence of a significant influence of such treaties on investment flows, as revealed by analysis of investment flows between parties to bilateral investment treaties; the significance of bilateral investment treaties as evidence of a certain convergence of approaches to the treatment and protection of investment, even though they had not given rise to the formation of new rules of customary international law; and the interaction between bilateral investment treaties and national laws.

³WT/WGTI/M/2, paragraph 49

48. In regard to regional investment agreements, the representative of UNCTAD stated that such agreements exhibited a greater degree of diversity in their content and purposes than bilateral investment treaties. The main objective typically pursued at the regional level was the liberalization of restrictions to entry and establishment of FDI, followed by the reduction of discriminatory operational restrictions. A pattern that appeared to be emerging in recent regional agreements was to consolidate in one instrument an expanded set of issues for liberalization and protection in combination with procedures for the gradual reduction of investment restrictions and for the settlement of investment disputes, including those between investors and host states. In addition to standards of treatment and protection of foreign investment, some regional agreements dealt with transfer of technology, competition, environmental protection, conflicting requirements and standards of conduct for multinational enterprises in areas such as disclosure of information, employment and labour relations. In respect of multilateral investment instruments, he stated that they mostly related to particular sectors or specific issues, including services, performance requirements, intellectual property rights, investment insurance, dispute settlement, employment and labour relations, consumer and environmental protection and competition.

49. Several delegations made proposals for further work on specific themes. The representative of Mexico considered that, compared to the wide range of issues dealt with in international investment arrangements, the treatment of investment issues in the WTO was limited and unbalanced and proposed that the Working Group undertake a systematic review of international investment arrangements in order to determine their possible value added from the perspective of WTO disciplines. The representative of Switzerland identified as an area for further analysis the interaction between the various existing international investment agreements, notably in regard to the implications of most-favoured-nation clauses, including Article II of GATS. He also suggested, with reference to the discussion in WT/WGTI/W/22 of the Energy Charter Treaty, that it might be useful to have more detailed information on the supplementary treaty that was currently under negotiation. The representative of the European Community proposed that there be further analysis of regional investment agreements on the basis of contributions by Members regarding their experiences with the impact on their investment regimes of regional agreements. The representative of Australia proposed that the Working Group examine existing international investment arrangements from the prism of fundamental WTO principles, such as non-discrimination, most-favoured-nation and national treatment, fair trade, predictability of policies, encouragement of competition, special provisions for developing countries and transparency. She also pointed out that it could not be assumed that the principle of national treatment, which was well known in the WTO context, was readily transferable to the investment context, in which connection she raised the question of whether national treatment would differ depending on whether it was applied to the establishment or post-establishment phase of an investment. Another relevant consideration was that granting national treatment could not be equated with a liberal investment regime in all circumstances.

50. Several delegations provided information on developments in the context of regional agreements. The representative of Argentina, speaking on behalf of the WTO Members parties to MERCOSUR, summarized the main provisions of two Protocols for the Promotion and Protection of Investment that had been concluded by the parties to MERCOSUR in 1994. The Intra-Zone Protocol covered FDI originating in MERCOSUR countries and the Extra-Zone protocol covered FDI from non-signatory countries. The main objective of the Protocols was to create favourable conditions for investments into MERCOSUR countries. The Extra-Zone Protocol also aimed at preventing conflicting FDI regulations in MERCOSUR countries with respect to FDI from third countries. The two Protocols had much in common, notably in regard to provisions on fair and equitable treatment, national treatment, free transfer of funds related to investments and dispute settlement. He offered to provide in writing a more detailed description of the provisions of these two Protocols. The representative of Colombia stated that cooperation on investment matters in the framework of the Andean Pact dated back to the 1970s with the adoption of Decision 220 which had most recently been revised in Decision 291 adopted in 1991. This Decision, which was legally binding and directly applicable in the Andean Pact member states, applied to both investments from member states and investment from third countries. It provided for a framework of general rules for the conduct of

national investment policies and the settlement of investment disputes. The negotiation of more detailed rules to complement this framework was envisaged. Compared to the rules laid down by Decision 291, the investment rules of the Treaty on Free Trade concluded in 1994 between Venezuela, Mexico and Colombia were far more specific in that they essentially build on the model of the investment provisions of the NAFTA. Her delegation would shortly submit a detailed written explanation of the investment provisions of these two agreements. The representative of Venezuela explained that Decision 291 had been implemented in Venezuela by Presidential Decree 2095 which allowed for the entry of foreign investment, free transfer of funds related to investments and the conclusion of technology agreements without the need for prior authorization but subject to simple registration requirements. He also referred to Decision 292 of the Andean Pact which provided for the formation of Andean Multinational Enterprises. Although aimed at the encouragement of cooperation among investors from the Andean region, investors from third countries could within certain limits, participate in the capital of such enterprise. Various incentives existed for the creation of such enterprises, such as the right to invest in any sector of the economies of member states, including in sectors reserved to domestic investors, and the right of free transfer of funds.

51. The Chairman said it would be useful to have this information on developments in the context of regional agreements in writing and that more generally it was important for the Working Group to have as broad a picture as possible of the experiences of Members with the investment rules of regional and bilateral agreements. He therefore encouraged Members to make contributions on this matter.

52. The representative of Costa Rica informed the Working Group that in the context of negotiations on a western hemispheric free trade agreement likely to be launched at a summit meeting in April the establishment of a working group on investment was envisioned. The mandate of this working group would be to establish a fair and transparent legal framework to promote investment through the creation of a stable and predictable environment that protects the investor, his investment and related flows, without creating obstacles to investment from outside the hemisphere.

53. The representative of UNCTAD noted that, in addition to its work on the analysis of existing investment agreements, UNCTAD was elaborating a set of criteria to test the development-friendliness of international investment agreements. An UNCTAD expert meeting to be held on 1-3 April would examine regional and multilateral agreements from a development perspective, with a special focus on the objectives of such agreements and their definition of investment.

54. The representative of the OECD informed the Working Group of the state of play in the negotiations on a Multilateral Agreement on Investment. At a high level meeting held in February participants had reaffirmed their commitment to these negotiations and to the achievement of an agreement which would meet the original mandate for high standards of investment liberalization and protection, dispute settlement and openness to non-member countries. A statement by the Chairman of the Negotiating Group containing conclusions of this meeting identified three important areas where advances had been made but where conclusions had yet to be reached. The first area was labour and environment, subjects which had assumed growing importance in the past year. The Chairman's statement reported that there was a growing convergence of views regarding the need for the agreement to address social concerns, and in particular environmental protection and labour issues, and contained some observations on the nature of the provisions that were being developed on these matters. The second area where there was a need for further work was liberalization and exceptions. In this regard, the Chairman's statement identified as outstanding questions national security, public order, regional economic integration, culture, subsidies and government procurement. It noted that delegations were agreed on the need to reach solutions to these issues in a way which would preserve the quality of the agreement and achieve a satisfactory balance of commitments. Finally, the Chairman's statement indicated that a solution to issues relating to extraterritoriality seemed necessary to ensure a successful conclusion of the negotiations. The Chairman's statement concluded by referring to the commitment of participants to intensify their efforts to find solutions to the outstanding issues and to pursue dialogue with interested non-member countries to facilitate their

early participation in the agreement. It was clear that the negotiations would not be concluded by the time of the OECD Ministerial Meeting on 27 and 28 April, as originally planned, but that the participants remained committed to the negotiations. The issue of the programme and timetable for continuing the work would be discussed at a forthcoming meeting of the Negotiating Group in April.

55. The Working Group took note of the statements made and agreed to revert to these two indents of item III at its next meeting. It agreed that issues that had been raised at the present meeting as requiring further consideration would be incorporated in a revision of the Chairman's informal note in document No. 6004/Rev.1.

D. ITEM IV OF THE CHECKLIST OF ISSUES SUGGESTED FOR STUDY - FIRST INDENT

56. The Chairman recalled that at the meeting in December 1997 the Working Group had agreed that, at its next meeting, it would start its work under item IV of the Checklist by considering the factual aspects of the first indent of that item ("identification of common features and differences, including overlaps and possible conflicts, as well as possible gaps in existing international instruments").

57. In introducing a submission by the European Community and its member States (WT/WGTI/W/30), the representative of the European Community stated that there were three broad categories of existing international investment instruments to which the Community and/or its member States were parties: bilateral investment treaties of the member States with third countries; the rules on investment of the EC Treaty, the Agreement on the European Economic Area (EEA) and the Europe Agreements; and other regional and multilateral instruments. A basic element common to all instruments in these three categories was the key role of the principle of non-discrimination in combination with a recognition of the right of governments to take measures to attain public policy objectives. None of the instruments provided for an unqualified right of establishment of foreign investment but the EC Treaty and the EEA Agreement required non-discrimination in regard to the establishment of investments by any company established in the EEA regardless of its nationality. At the same time, they preserved the powers of member States and the Community to regulate any aspect of economic life subject to, the principle of non-discrimination.

58. The representative of the United States introduced a submission (WT/WGTI/W/32) on the issue of forced divestiture, whereby some countries that maintained limitations on foreign equity ownership also required investors to reduce their equity interests after the passage of a certain amount of time. His delegation considered that this practice was inconsistent with an open and fair investment regime, ran counter to the fundamental objectives of the WTO, discouraged investment and hindered economic growth in the long term.

59. The representatives of Hong Kong, China and Canada, referring to submissions by their delegations (WT/WGTI/W/33 and 36), pointed to the diversity of existing bilateral, regional and multilateral investment agreements and the absence of a coherent set of rules at the multilateral level; the need for a more integrated treatment of trade and investment in international agreements; the limitations of current WTO provisions related to investment; the potential for conflicts arising from investment agreements that were designed to address the priorities and concerns of the parties involved without proper regard to the potential negative impacts on third parties; and the fact that, although there was a large degree of commonality between existing instruments in terms of basic principles, specific rights and obligations varied. In this connection, the representative of Canada underlined the close relationship between items III and IV of the Checklist and proposed that the Secretariat Note in WT/WGTI/W/22 also be used as the basis for consideration of the first indent of item IV.

60. The representative of Canada also considered that the Working Group's mandate required the Group to examine the rationale of international investment rules and that, in view of the extent to which WTO Members had already embarked on extensive rule-making at bilateral and regional

levels, the key question to be addressed by the Working Group concerned the desirability of multilateral rules. His delegation believed that a comprehensive set of consistent rules among all WTO Members would allow for a stable, transparent and consistent environment for firms operating in the global market, whatever their ownership structure or place of incorporation. A multilateral approach should also provide benefits to governments and the peoples they represent. The complexity for governments of administering a multitude of investment agreements, possibly with different standards for investors from different investment partners, and many with most-favoured-nation treatment commitments incorporated into them, was another strong argument for multilateralizing rules. Finally, implementing the central WTO principle of non-discrimination in international economic relations provided yet another argument.

61. The representative of Japan, referring to his delegation's submission subsequently circulated in WT/WGTI/W/34, proposed that the Working Group examine common elements of existing international investment instruments in order to determine whether or not such elements should be incorporated into future multilateral treaties. The third section of his delegation's submission contained suggestions for specific questions to be addressed in such an examination.

62. The representative of Switzerland noted that the contributions presented by various Members and the Secretariat Note in WT/WGTI/W/22 revealed certain common patterns. For example, there was no right to invest and guarantee of market access, except in the case of agreements like the EC Treaty and the EEA Agreement, and screening procedures existed in many countries. The principle of non-discrimination was well established at national and bilateral levels but few obligations of a multilateral nature existed in regard to national treatment. There was a certain reticence to adopt at the multilateral level what had been commonly accepted at national and bilateral levels. As discussed in the submission by Hong Kong, China, gaps in the existing legal framework were particularly evident at the multilateral level. The representative of Australia underlined the points made in the submission by Hong Kong, China that the majority of multilateral agreements encouraged investment through non-binding principles and guidelines, whereas most plurilateral instruments were legally binding, and that many investment instruments had failed to recognize fully the relationship between trade and investment in a globalized economy. She also endorsed the point made in that submission that it was essential for the Working Group to explore the relationship between trade and investment in terms of existing instruments. The representative of Costa Rica agreed that, although at the level of basic principles there were commonalities between existing investment instruments, there was a lack of uniform treatment of these issues and inadequate reflection of the relationship between trade and investment. Further consideration was required of the limited manner in which investment issues were dealt with in the WTO.

63. The representative of Australia wondered how the observation made in the submission by the European Community and its member States (WT/WGTI/W/30) that the distinction between establishment and post-establishment treatment of an investment may not be very meaningful and feasible could be reconciled with the importance of this distinction in bilateral investment treaties concluded by member States of the European Community, which reserved the right of the parties to regulate the entry of foreign investment.

64. The representative of the European Community responded that the relevance of the distinction between establishment and post-establishment treatment of investment depended upon the scope of the definition of investment. This distinction originated in investment agreements that defined investment narrowly in terms of the establishment or acquisition of enterprises and was more relevant in that setting than in more recent agreements which defined investment in terms of a wide range of assets. In addition, the fact that bilateral investment treaties concluded by member States of the European Community reserved the right of parties to regulate the entry of foreign investment was of little practical significance insofar as the member States had very open investment regimes to third countries, and any foreign company established in any Member State had the right to invest anywhere in the Community by virtue of the EC Treaty rules on freedom of establishment.

65. In a preliminary comment on the submission by the United States on forced divestiture, the representative of Malaysia said that the promotion of economic development was a basic policy objective of his country and that although FDI contributed to this objective, it also had other implications. The issue raised by the United States should be seen from the perspective of the need to ensure a general application of rules designed to serve important public interests.

66. The representatives of Switzerland, the European Community and Costa Rica echoed the views expressed by the representative of Canada regarding the benefits of multilateral investment rules, while the representative of Korea agreed that the issue of the desirability of a multilateral framework was a key theme for future consideration by the Working Group. The representative of Pakistan drew attention to a statement in the submission by the European Community and its member States (WT/WGTI/W/30) that "the picture to emerge from the analysis reveals that it is possible to have in place an extensive framework of far-reaching rules on investment, while at the same time striking a fair balance between the different, and sometimes seemingly conflicting, policy objectives of host countries". Significantly, this statement referred to "far-reaching" rather than "multilateral" rules. The fact that a range of instruments existed which, as stated in this submission, met the basic objective of striking a balance of rights and obligations for States and investors, might be interpreted as an argument for maintaining the status quo rather than striving for a multilateral framework. With respect to the submission by Hong Kong, China, he considered that, while it was true that, as observed in paragraph 17 of the submission, predictability was an important consideration in investment decisions, it was not obvious that a multilateral set of rules was necessary to ensure such predictability.

67. The representative of the European Community responded that the statement quoted by the representative of Pakistan should be viewed in its proper context of a factual analysis of existing agreements, as the submission did not deal with the issue of possible multilateral rules. Moreover, the statement purported to characterize the investment regime of the European Community and its member States, which was based on the uniquely far-reaching rules of the EC Treaty and the EEA, supplemented by the bilateral investment treaties of member States with third countries. The representative of Hong Kong, China stated that his delegation's submission did not argue that a multilateral set of rules was necessary to enhance predictability for investors. It contained an assessment of gaps in the existing international framework but did not draw any conclusions regarding the need for multilateral rules. The representative of Japan recalled the views of his delegation on predictability as an important determinant of FDI decisions, as discussed in particular in his delegation's submission in WT/WGTI/W/11 and on how a multilateral framework could help secure such predictability. The representative of Hungary observed that lack of predictability did indeed constitute an impediment to investment flows.

68. The representative of India stressed that it had been agreed that the consideration of the first indent of item IV at this meeting would be confined to its factual aspects and that one should consequently refrain from value judgments as to the desirability or otherwise of rules. A common theme that emerged clearly from the information presented so far to the Working Group and that was relevant to the factual examination of the first indent of item IV was that no country was presently providing for a free right of investment. Given that in discussions on investment prior to the Singapore Ministerial Conference the achievement of a right of establishment had been proposed as an objective of multilateral work on investment, it was significant that the study process in this Working Group had helped to clarify that in practice no country granted such a right. Also significant as a common element identified by the contributions presented to the Working Group was the fact that national treatment was not provided in regard to the pre-establishment phase of an investment. As far as differences between existing instruments were concerned, it seemed that prima facie there were wide variations in the definition of investment. While it had been argued that the distinction between pre- and post-establishment might be less relevant in the context of a wide definition of investment was adopted, he recalled that proposals made in the preparation for the Singapore Ministerial Conference for the launch of work on investment in the WTO had specifically focused on foreign direct investment.

69. The representative of Canada pointed to the existence of a right to invest and national treatment as central elements of a large number of existing investment agreements, including all bilateral and regional agreements to which Canada was a party. He wondered whether the representative of India perhaps meant that the right to invest and national treatment were sometimes subject to exceptions and limitations.

70. The representative of India responded that the statement that certain agreements provided for a right to investment and national treatment upon establishment, but subject to exceptions and limitations, confirmed that there was no automatic right to investment and automatic grant of national treatment in the pre-establishment phase. The large number of reservations proposed in the ongoing negotiations on a Multilateral Agreement on Investment highlighted the fact that even developed countries were not in a position to allow for an automatic right to invest.

71. The representatives of Brazil and Colombia stated that there was a tendency in the Working Group to discuss existing investment regimes and instruments in terms of overly broad generalizations. In this connection, the representative of Brazil observed that Brazil did not have any procedure for prior authorization of foreign investment, contrary to the suggestion that all countries had some form of screening mechanism, and did not distinguish between establishment and pre-establishment of foreign investment. The representative of Colombia mentioned the need for a more careful analysis of the treatment in existing instruments of issues such as national treatment, most-favoured-nation treatment, exchange matters and dispute settlement procedures. The representative of Switzerland observed that there was perhaps merit in clarifying, at some stage, the precise meaning of the concept of screening of investment.

72. The representative of Australia proposed that the Working Group undertake a detailed examination of the definition of investment in a range of existing investment agreements. The representatives of Pakistan, the European Community, Brazil, Colombia, India, Switzerland and the United States agreed with this suggestion. The representative of Australia suggested that this work could aim at identifying capital movements that would not be of interest from a WTO perspective. The representative of Brazil identified as an important issue to be explored the relationship between a broad definition of investment and the need for exceptions and safeguards, for example with regard to the balance of payments and portfolio capital movements, and pointed to the relevance of work on the definition of investment to the issue raised by Canada on the need for a more specific identification of development aspects of FDI issues. The representative of Pakistan endorsed the suggestion made in submission by the European Community and its member States for a detailed discussion by the Working Group of the philosophy and content of the OECD Guidelines for Multinational Enterprises. It would be especially instructive to study to what extent these Guidelines were actually observed by multinational enterprises from OECD countries; what were the impediments to the Guidelines being transformed into legally binding rules; and how the Guidelines compared to the draft Code of Conduct for Transnational Corporations that had been formulated in the framework of the United Nations. He also expressed interest in information on UNCTAD's work on the formulation of a set of criteria to test investment agreements from a development perspective.

73. The representative of Canada stated that the reference made by the representative of Pakistan to the work in UNCTAD on the development-friendliness of investment agreements raised the fundamental question of how to take into account the development dimension in the context of international investment agreements. While his delegation believed that the analysis under items I and II of the Checklist had shown that FDI flows were growth and development enhancing *per se*, it appeared that some Members were of the view that, aside from the role of investment agreements in promoting investment flows, there were particular subjects arising in regard to the development aspects of FDI that required specific attention. If so, such subjects should be identified and raised for discussion in the Working Group. He wondered whether the statement made by the representative of India under item B on capital mobility and labour mobility should perhaps be seen in this light.

74. In response to the reference made by the delegation of India to restrictions on FDI in the context of the ongoing negotiations on a Multilateral Agreement on Investment, the representative of the OECD explained that there was an understanding among participants to these negotiations that there would be no exceptions to provisions on the protection of investment which corresponded to the rules typically found in bilateral investment treaties and applied to investments once made (e.g. general treatment, expropriation and compensation, protection from civil strife). However, it was also understood that there could be exceptions with respect to the establishment of investment. The recent discussions of this matter had proceeded on the basis of exceptions lodged by participants which they considered necessary to protect measures that did not conform to the envisaged requirements in areas such as national treatment, most-favoured-nation treatment and performance requirements. There was a discussion of principle on the extent to which those exceptions would be accommodated in the agreement. One kind of exception involved the grandfathering and acceptance of a standstill commitment in regard to existing non-conforming measures. A second kind of exception involved areas where countries were not prepared to accept a standstill requirement. There was intense debate on whether this second type of country-specific exception should be allowed or whether it was perhaps preferable to have general exceptions addressing the underlying policy objectives. In addition to this debate on principle, discussion on exceptions also took place on a bilateral basis and in a technical group established to facilitate the comparison of exceptions proposed by participants by analysing exceptions lodged in individual sectors. In regard to the issue of the definition of investment, he stated that this matter had not been the subject of much discussion recently. As reflected in the consolidated text of the draft agreement, participants had agreed to adopt a very broad definition covering all forms of investment. They had also agreed that this broad definition necessitated inclusion of a safeguard clause for balance-of-payments difficulties. This clause would operate subject to a surveillance mechanism in which the IMF would play a prominent role.

75. The Working Group took note of the statements made and agreed to revert to this indent at its next meeting, at which it would also take up the other indents of item IV, as had been agreed at the meeting held in December 1997. The Chairman's note in document No. 6004/Rev.1 would be revised to take into account the issues raised at the present meeting as requiring more specific examination. The Working Group also agreed to request the representative of the OECD to provide information prior to the next meeting on the Guidelines for Multinational Enterprises, including the experience gained with their implementation, and to request UNCTAD to provide information on the progress of its work on the development of criteria to test the development-friendliness of investment agreements. The Working Group further agreed that at its next meeting it would have a detailed discussion of the definition of investment. The Chairman invited delegations to make contributions on this issue.

76. Following suggestions by the representatives of Switzerland and Mexico, the Working Group also agreed that in advance of the next meeting the Secretariat would issue an annotated agenda which would explain how specific agenda items would be dealt with and include a list of documents circulated.

E. OBSERVER STATUS FOR INTERNATIONAL INTERGOVERNMENTAL ORGANIZATIONS

77. The Chairman recalled that at its meeting held in December 1997 the Working Group had considered requests for observer status from a number of international intergovernmental organizations and had agreed to revert to these requests at a later stage in light of the ongoing consultations in the framework of the General Council. At that meeting, the Working Group had also agreed that those organizations that had been invited to attend that meeting be invited to attend the next meeting on the same basis. Given that the consultations in the framework of the General Council were still ongoing, he suggested that the Working Group maintain the status quo by taking the same decision as at the last meeting and that it agree to revert to this matter at its next meeting in the light of any developments in the consultations being held in the framework of the General Council. It was so agreed.

F. OTHER BUSINESS

78. The Working Group took note of the text of a statement that would be made by its Chairman at the meeting of the General Council scheduled for 24 April 1998 to update the Council on the work accomplished in the Working Group since December 1997.

Next Meeting

79. The Chairman recalled that it had been agreed at the meeting in December 1997 that the second meeting in 1998 would be held on 16 and 17 June.
