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**Working Group on the Relationship  
between Trade and Investment**

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## **MULTILATERAL FRAMEWORK ON INVESTMENT: A REALISTIC APPROACH**

### Communication from the Republic of Korea

The following communication, dated 2 June 1999, has been received from the Permanent Mission of Korea with the request that it be circulated to Members.

#### **I. INTRODUCTION**

1. There are basically two schools of thought on foreign direct investment (FDI): the globalization school and the internalization school. The former emphasizes the benefits of economic integration resulting from the liberalization of FDI regulations while the latter contends that active government intervention is necessary to ensure sustainable economic development in the host country.

2. The globalization school sees the multilateral framework on investment (MFI) as an institution promoting and accelerating free flows of investment at the global level. The internalization school believes in the minimization of external intervention in establishing national regulations governing FDI while reserving maximum rights for governments to take appropriate actions whenever necessary.

3. An MFI should reconcile the objectives of both schools. An equilibrium must be reached between enhancing global welfare through freer flows of investment and respecting sovereign countries' right to formulate their own policies, in particular development policies in developing countries. This requires an optimal combination of flexibility and efficient resource allocation – not an easy task as the fifty years of the multilateral trading system have illustrated.

4. The overall balance of interests among Members is at the heart of all negotiations in the WTO. For an agreement to be reached on an MFI in the WTO therefore, the rules adopted would have to reflect the different realities faced by each Member so as to represent an overall balance of concessions – the best way to secure a consensus. This implies that an agreement on investment in the WTO should be different from the MAI of the OECD. The MAI's standards were unrealistically high and thus failed to get broad based participation.

5. Bearing this in mind, this paper offers a possible WTO approach to an MFI in terms of investment protection and liberalization. The paper is presented solely to facilitate discussions in the Working Group, and is without prejudice to Korea's views on the future work programme of the WTO.

## II. INVESTMENT PROTECTION

6. The purpose of concluding a bilateral investment treaty (BIT) is to protect investors from non-commercial risks by agreeing on mutual guarantees between the parties to the agreement. At present there are some 1,500 BITs world-wide, all of which differ in content. However, as most BITs include a provision for MFN treatment, they are by and large similar in essence, thereby facilitating their compatibility with an MFI.

7. Even if a country concludes a number of BITs, all with different terms, foreign investors will be granted the most favourable terms possible among all the agreements, thanks to the MFN clause. As such, the most important factor is not the uniqueness of terms within a specific BIT, but the guarantee of MFN treatment.

8. If a host country is bound by numerous BITs, a foreign investor must examine the details of all BITs signed by the host country to have a clear understanding of the level of protection guaranteed by the MFN treatment. An MFI is an appropriate remedy to such a lack of transparency inherent in the coexistence of multiple BITs.

9. If an MFI sets a standard higher than the one in any individual BIT, it could guarantee the highest level of protection and offer the most transparent standard of investment protection possible in the host country. Even if the standard set by an MFI is lower than those in some BITs, it may still be higher than those in a significant number of other BITs. Therefore, an MFI could enhance, to a great extent, the overall level of protection and transparency in host countries.

10. The level of protection in an MFI could be set at the highest, lowest and medium levels. Protection at the highest level would be the ideal one since the benefits of transparency would be maximized and the free-rider problem would be eliminated. Nevertheless, the most realistic approach would be the third approach aiming at achieving a reasonably high standard of protection based on a consensus of all participants.

11. The countries whose investment protection falls short of what is offered in an MFI could subsequently raise their level of protection. This would not only benefit investors but also the host country, in terms of improving its investment environment.

## III. INVESTMENT LIBERALIZATION

12. The GATS could serve as a model for multilateral rules on the liberalization of foreign investment in sectors that it does not already cover, e.g. the manufacturing sector.

13. Complications arising from the application of the GATS model to sectors other than services could be minimal. For the manufacturing sector in particular, applying the GATS model would hardly create complications as there are relatively fewer restrictions on foreign investment in this sector than in services in general.

14. In the case of primary industries such as agriculture, fisheries and mining, the application of the GATS model could give rise to problems related to the unique nature of the industries, the technicalities involved, and the particularities of a country's situation. Nevertheless, a flexible approach could offer solutions to these problems.

15. The modality of liberalization adopted by GATS is different from the one used in the negotiations for the MAI at the OECD. The OECD MAI employed a top-down approach which had aimed, in principle, at comprehensive liberalization in all areas. In contrast, GATS adopts a bottom-up approach (a "positive list") which allows each country to choose the level of liberalization

depending on its domestic situation. Thus, given its flexibility, the bottom-up approach should be favoured during MFI negotiations.

#### **IV. CONCLUSION**

16. Briefly introduced in this paper are two basic concepts that should be factored in an MFI within the WTO framework: an optimal standard of protection and a bottom-up approach in liberalization. These two concepts may raise a myriad of questions when scrutinized. However, they could offer ways to devise an MFI that reconciles the need for flexibility left to national governments with the necessity to enhance transparency and predictability and ultimately global welfare.

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