Moving toward a Common Set of Multilateral Investment Rules: Lessons from Latin America

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INTRODUCTION

While investment rules are mostly absent from the multilateral system, the past decade saw a phenomenal increase in the number of bilateral and regional investment agreements concluded worldwide. The last ten years also witnessed an acceleration in the liberalization of foreign direct investment (FDI) regimes and strong growth in FDI inflows. This is particularly true in Latin America and the Caribbean. The 1990s marked the return of private capital to the region. FDI inflows increased by almost 1,000 per cent between 1990 and 1999, from US$8.9 billion in 1990 to US$90.5 billion in 1999. The region has become as attractive as developing Asia, which received US$106 billion in FDI inflows in 1999. Brazil, the Latin American leader, competes advantageously with the People’s Republic of China (PRC), having obtained US$31 billion in FDI inflows in 1999 whereas the PRC received US$40 billion.1 After years of imposing controls excluding or restricting the entry of foreign firms, Latin American and Caribbean countries embarked on a series of ambitious economic reforms in the mid-1980s and early 1990s. They abandoned the import-substitution model and at the beginning of the twenty-first century most countries in the region are now seeking to attract investment from abroad as a way to foster economic growth and development and to stimulate transfer of technology and competition.

The 1960s and the early 1970s were characterized by a shortage of private flows to Latin America and the Caribbean. Countries had to rely essentially on multilateral lending by international financial institutions. The oil crises of the 1970s fundamentally changed this. As prices soared, earnings from oil exporters were deposited in commercial banks and recycled by these banks in developing countries. In Latin America, several countries, including Mexico and Brazil, saw an opportunity to finance their ever-growing fiscal deficit. Higher commodity prices and relatively low real interest rates encouraged this trend. But as the real exchange rate appreciated, exports became less competitive and the balance of payments worsened. When Mexico had a debt crisis in August 1982, the whole region experienced a severe flight of capital. Even Colombia and Chile, two countries that played by the rules, suffered from the ‘neighbourhood effect’.2 It would take almost an entire decade for private capital to return to the region.

The 1980s were a rather difficult period for Latin America and the Caribbean. Low commodity prices, high interest rates, and a strong dollar compounded the difficulties relating to the outflow of capital due to negative resource transfers to pay interests on the commercial debt. Schemes devised to solve the debt problem included debt swaps, buybacks, and initiatives such as the Baker and Brady Plans. Market-focused and outward-oriented reforms implemented as early as the mid-1980s paved the way for attracting private capital to the region in the 1990s. Foreign direct investment and portfolio investment increased significantly, whereas official flows dropped in relative terms, with the exception of 1995 and the Mexican ‘tequila’ crisis.

Type of FDI Flows

The type of FDI flows varies a lot throughout the region. Mexico, Central America and the Caribbean are mostly home to efficiency-seeking investors for whom these countries served as an export platform in sectors such as automobiles, electronics, and textiles. Some Caribbean countries (Trinidad and Tobago and Jamaica, for example) also receive resource-seeking investments. It is worth noting that several smaller countries (Costa Rica being a prime example) have been very successful in attracting high-tech companies, therefore taking advantage of the positive externalities associated with such investment.3

In the 1990s, economic reforms, in particular the liberalization of trade and investment regimes and new privatization policies played a key role in encouraging long-term capital flows and in improving the region’s economic fundamentals. Moreover, low interest rates in developed countries triggered a substantial increase in portfolio investment, a new phenomenon in Latin America and the Caribbean, as international investors, including institutional investors, sought better returns in the region and bought stocks and bonds. Sebastian Edwards notes that the 1990s most probably signalled the end of the ‘neighbourhood effect’. The ‘cross-market contagion’ declined during the decade although at the turn of the century this trend is
presently changing. Strong fundamentals matter and 'international investors were quick to realize that there are significant differences among Latin American countries'. In addition to laws and regulations that are more investment-friendly, Latin American and Caribbean governments also entered, bilaterally and regionally, into binding obligations to improve their investment climate. The multilateral system has not provided such opportunity yet. In fact, there is no comprehensive agreement on investment at the World Trade Organization (WTO). Its investment framework is rather limited in scope since it is primarily confined to performance requirements in the Agreement on Trade-Related Investment Measures (TRIMs), which covers goods only, and to the provisions of the General Agreement on Trade in Services (GATS) through commercial presence and movement of natural persons as the third and fourth modes of supply of a service. The current system lacks 'modal neutrality', that is, in the words of Patrick Low and Arvind Subramanian (1996), 'equality of policy treatment regardless of the means by which producers choose to supply a given market - whether through imports, foreign direct investment, temporary presence of natural persons, or the licensing of domestic producers'.

The WTO framework suffers from a clear imbalance. It includes disciplines on trade in goods and services. Investment in services is included but investment in goods has yet to be fully covered. Moreover, the traditional components of an investment agreement, such as investment protection, are not addressed by WTO rules.

At a time when 34 countries in the Americas are negotiating a hemispheric investment agreement within the Free Trade of the Area (FTAA) process, the issue of 'how and when' the WTO system will tackle the whole set of multilateral investment rules remains to be resolved. After reviewing the numerous endeavours to negotiate investment rules in the GATT/WTO framework, from the early attempts (and the failed Multilateral Agreement on Investment (MAI) negotiated by members of the Organization for Economic Co-operation and Development (OECD) to the disciplines of the WTO Agreements). This chapter discusses the challenges of negotiating multilateral investment rules at the WTO in the current policy context, building on the experience of Latin America in their bilateral and regional investment agreements and the FTAA negotiations.

INVESTMENT RULES AND DISCIPLINES IN THE WTO

As mentioned earlier, there is no comprehensive WTO agreement on investment but a number of agreements resulting from the Uruguay Round that include investment-related provisions. These agreements are: the Agreement on Trade-Related Investment Measures (TRIMs), the General Agreement on Trade in Services (GATS), the Agreement on Subsidies and Countervailing Measures (SCM), the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), and the Plurilateral Agreement on Government Procurement (GPA).

Agreement on Trade-Related Investment Measures (TRIMs)

The TRIMs Agreement does not go beyond the GATT since it establishes an illustrative list of prohibited performance requirements, those contrary to the principle of national treatment (Article III of GATT 1994) such as local content and trade-balancing requirements and those inconsistent with the general obligation of eliminating quantitative restrictions (Article XI of GATT 1994). These include trade and foreign exchange-balancing restrictions and domestic sales requirements. Member countries had 90 days from the date of entry into force of the WTO Agreement to notify all inconsistent TRIMs to the Council for Trade in Goods. Developed countries had to eliminate these TRIMs within two years of the date of entry into force of the WTO Agreement, whereas developing countries had until 1 January 2000. Least-developed countries are required to undertake the same commitments within seven years, that is by 1 January 2002. The Council may extend the transition period for developing and least-developed countries. On 31 July 2001, the Goods Council adopted decisions granting extension of the transition period for the elimination of TRIMs to the following countries: Argentina, Columbia, Malaysia, Mexico, Pakistan, the Phillipines and Romania. The WTO General Council approved a waiver for Thailand. The new decisions extend the deadline for these countries for eliminating the TRIMs notified under Article 5.1 of the TRIMs Agreement by two years (from 1 January 2000 to 31 December 2000) with a possible further two years.

General Agreement on Trade in Services (GATS)

The GATS is not an investment agreement, but it includes several investment-related provisions. First, the definition of services incorporates four modes of supply, one of which, the third mode, 'commercial presence in the territory of any other member', is essentially an investment activity and a right of establishment. Commercial presence means, under GATS Article XXVIII, 'any type of business or professional establishment, including through the constitution, acquisition or maintenance of a juridical person, or
the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service. It is worth noting that such definition is not as comprehensive as the definition of investment found in most bilateral investment treaties and free trade agreements signed in the Americas. The fourth mode, which is the supply of service through presence of natural persons of a Member in the territory of any other Member, is also linked, albeit indirectly, to investment issues because it implies the temporary entry of managerial and other key personnel.

The GATS is the WTO Agreement with the most far-reaching implications for a multilateral investment agreement because of its all-encompassing most-favoured-nation (MFN) provision (GATS Article II), applies across the board to all members and services sectors. Although MFN exemptions are allowed, if listed in an Annex at the time of the entry into force of the Agreement, they are temporary in nature and subject to multilateral review. The GATS also provides that preferential treatment may be granted to a foreign service supplier who is a member of an economic integration agreement if such agreement has substantial sectoral coverage and provides for the absence or elimination of substantially all discrimination through the elimination of existing discriminatory measures, and/or prohibition of new or more discriminatory measures (GATS Article V). Other GATS provisions of a general nature that are investment-related include transparency obligations, general exceptions, and security exceptions. Unlike the North American Free Trade Agreement (NAFTA), the GATS do not contain a right of non-establishment promoting services trade along lines of comparative advantage. Such right ensures that no Party may require a service provider of another Party to establish or maintain a representative office or any form of enterprise, or to be resident, in its territory as a condition for the cross-border provision of a service. A right of non-establishment prohibits regulators to require establishment as a precondition for delivery of a service.

The GATS provisions regarding national treatment (Article XVII) and market access (Article XVI) are conditional, a clear departure from common practice in investment agreements with respect to the national treatment provision. They are granted according to specific commitments listed in members’ schedules indicating to which sectors and modes of supply these provisions apply. The GATS thus makes use of what is known as a ‘positive list’ by identifying which sectors are covered by the agreement. More specifically, this means that ‘new discriminatory measures’ are allowed in sectors not included in a member’s schedule. Moreover, in sectors where commitments have been made, existing measures inconsistent with the agreement do not have to be eliminated as long as they are listed in a member’s schedule.

Schedules include a number of ‘unbound’ entries for each mode of supply, which means that a WTO member is not bound by any commitment in the GATS for a particular mode in a particular sector with respect to either national treatment or market access. Commercial presence is the mode with the lowest percentage of unbound commitments. When commitments are unbound, countries are not obliged to maintain the same level of openness or to further liberalize. Commercial presence has been scheduled for full liberalization by about 20 per cent of WTO members. Liberalization movement of natural persons (mode 4) was much less prevalent with full liberalization by less than one per cent of WTO members. The GATS includes commitments to further liberalize trade in services. WTO members are currently engaged in a second round of negotiations, which began in January 2000.

Agreement on Subsidies and Countervailing Measures (SCM)

The Agreement on Subsidies and Countervailing Measures (SCM) contains disciplines covering investment-related issues. In fact, some examples of investment incentives (fiscal, financial or indirect) fall under the meaning of subsidy, as defined in the SCM. Except as provided in the Agreement on Agriculture, such investment incentives are prohibited if they are given upon export performance or use of domestic or imported goods (Article 3). Others, which may not be prohibited but are found to cause adverse effects, are subject to compensation. However, as noted by the WTO, ‘the underlying concepts of the SCM are oriented toward trade in goods, and as such may not in all cases be easily applied to investment incentives’. For example, an investment incentive is usually granted before any production begins, which means that ‘neither a recommendation to withdraw or modify a subsidy, nor a countervailing duty applied to the exported goods, will be able to “undo” or to change an investment that already has been made’.

Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) is the first ever comprehensive multilateral agreement to set minimum standards protecting all areas of intellectual property rights, to include domestic enforcement measures, and to be covered by a dispute settlement mechanism. Its impact on investment issues, although indirect, is nonetheless significant. The TRIPS Agreement contributes to strengthening the protection afforded to foreign investment by reinforcing the protection of
intellectual property rights, one of the key elements often listed in the definition of investment found in most recent bilateral investment treaties (BITs) and free trade agreements currently in force worldwide.

**Plurilateral Agreement on Government Procurement (GPA)**

The Plurilateral Agreement on Government Procurement (GPA) also includes investment-related provisions. The GPA is one of the plurilateral agreements set out in Annex 4 of the WTO Agreement, which means that not all WTO members are bound by its obligations. The cornerstone of the GPA is non-discrimination, either with respect to domestic products, services and suppliers (national treatment), or with respect to goods, services and suppliers of other Parties (most-favoured-nation or MFN treatment). With regard to all laws, regulations, procedures and practices regarding government procurement covered by this Agreement, each Party shall ensure that its entities shall not treat a locally-established supplier less favourably than another locally-established supplier on the basis of degree of foreign affiliation or ownership; and that its entities shall not discriminate against locally-established suppliers on the basis of the country of production of the good or service being supplied, provided that the country of production is a Party to the Agreement. The GPA applies to government procurement of entities selected by each Party and covers central government entities, sub-central government and other entities, services and construction services.

**POST-URUGUAY ROUND: WTO AND OECD INITIATIVES**

Shortly after the end of the Uruguay Round, two initiatives were undertaken by the WTO and the OECD to address the issue of investment in a multilateral context. At the Singapore Ministerial Meeting in December 1996, WTO members agreed to create a Working Group on the Relationship between Trade and Investment (WGTI). The mandate of the Group was not to negotiate an investment agreement but rather to begin analytical and exploratory work on the linkages between trade and investment. Earlier, in May 1995, the OECD Ministers had launched negotiations on a Multilateral Agreement on Investment (MAI).

**OECD-Multilateral Agreement on Investment (MAI)**

The United States successfully convinced its OECD partners to start negotiating in 1995, a multilateral agreement on investment. It would be a free-standing international treaty open to non-member countries, with high standards of liberalization, investment protection and effective dispute settlement procedures. The 1997 deadline to complete the negotiations was extended to the 1998 Ministerial Meeting held in Paris on 27 April. However, the MAI negotiations ended in failure in the Fall of 1998, after the French government had announced that it was pulling out. For some analysts, the reasons for this failure were attributed to the numerous issues which remained to be resolved (exceptions, culture, the coverage of sub-national levels of government, extra-territorial measures, labour and environment, among others). Others highlighted that a coalition of non-governmental organizations (NGOs) had campaigned against the agreement and successfully used the Internet trying to convince everyone that the MAI was a bad deal only benefiting multinational corporations. Finally, others closer to the negotiations, have suggested that the MAI failed because the agreement did not generate the benefits necessary to motivate the body politics and the business sector 'to bite the bullet' and push for the conclusion of the negotiations. In the United States, the Administration had no political appetite to fight for the MAI in early 1998, after having been unable to convince Congress to renew the fast-track negotiating authority in November 1997.11

The business sector in most OECD countries was also not very enthusiastic because the MAI would not have eliminated the very few investment barriers currently in place in these countries. Members were prepared at best to bind existing liberalization. Another element played against the agreement. The MAI was a single-issue negotiation, which meant that the trade-offs needed to be made within the context of the investment provisions.12 In the Americas, the United States, Canada and Mexico participated from 1995 to 1998 in the MAI negotiations, whereas Argentina, Brazil, and Chile took part in these negotiations starting in 1997.

**Investment Rules: Do We Need Them?**

The fact that investment liberalization has taken place at the national level without a multilateral framework, and the failure of the OECD-based MAI negotiations, may suggest to some analysts and countries that such framework is unnecessary or too difficult to achieve. However, the objective of 'modal neutrality' mentioned earlier would call for multilateral rules and disciplines to liberalize investment. In the past, investment was essentially seen as a substitute to trade. High tariffs would encourage firms to invest in a country and serve the national market. But this relationship is not as significant today, as trade liberalization is now a worldwide phenomenon.
The globalization of the world economy and the internationalization of production have shown that investment has also become a complement to trade.\textsuperscript{13} Firms have more choices. They can choose which ‘modality’ (trade, FDI licensing, land, and so forth) to use to maximize access to resources and markets, and, in the process, increase their competitiveness. Firms often combine investment and trade to exploit, in the most optimal manner, opportunities offered by their ‘portfolio of locational assets.’\textsuperscript{14}

Before discussing the arguments in favour of a multilateral investment framework, this section addresses the potential impact of bilateral and regional investment rules, and describes succinctly the agreements that Latin American countries have entered into at both the bilateral and regional levels, as well as the objectives of the investment negotiations within the FTAA process. The region have adopted a three-pronged approach with respect to investment issues they have:

- Unilaterally liberalized their domestic investment regimes;
- Concluded numerous bilateral investment treaties;
- Negotiated bilateral and regional trade agreements, which include an investment framework.

They are currently involved in the FTAA negotiations and are participating, with other WTO members, in the reflection on whether to negotiate comprehensive investment rules at the multinational level or deepen the WTO investment regime.

**BILATERAL AND REGIONAL TRADE AGREEMENTS**

**Bilateral Investment Treaties (BITs)**

Traditionally, investment agreements have set standards for the treatment and protection of the investment and investor, in addition to including an admission clause and providing an effective dispute settlement mechanism between the investor and the Host State. These agreements, most of them bilateral in nature, do not include a market access component and do not \textit{per se} attract investment flows. Rather, they act as a complement to the economic determinants of these flows. BITs are therefore ‘enabling in character’, which means that, ‘by themselves, they have little or no effect’.\textsuperscript{15} This is not to say that BITs are irrelevant. In fact, they contribute to improving the investment climate of the Host State and reducing the risk of investing in that country.

During the last decade, a growing number of Latin American and Caribbean countries concluded bilateral investment treaties that go beyond the traditional BIT approach. These new agreements include a right of establishment with no admission provision, and therefore add a ‘market access’ component to the ‘protection element’ of a typical BIT. More than 70 bilateral investment treaties have been signed between countries of the Americas since the early 1990s. Of these treaties, all those signed by the United States, and by Canada after negotiating the North American Free Trade Agreement (NAFTA), include a right of establishment and a list of reservations, for instance sectors that are not covered by some investment provisions such as national treatment and MFN treatment. These treaties exert a positive influence on the investment regime of a country by locking in the liberalization achieved at the national level.

**Regional Trade Agreements: The Signalling Effects of Investment Liberalization**

Regional trade agreements contribute in a similar fashion to improving the investment climate. They represent a commitment to a transparent, stable and predictable policy environment. The signalling effect of unilateral trade and investment liberalization, particularly for small countries, is much more powerful when bound in international agreements. Countries gain in credibility when narrowing the gap between bound and applied levels of market openness. In addition, it is also worth emphasizing that small countries stand to benefit from a liberalized regional trade and investment framework because market-seeking foreign firms interested in a region will no longer exclude countries with a small domestic market when analyzing locational advantages.

Regional trade agreements are likely to have a significant impact on FDI flows when they result in a more liberal investment policy and the opening up of sectors which had in the past been closed to foreign investors. They may also have a positive influence on FDI inflows by speeding up investment liberalization either before the conclusion of the agreement or during the implementing phase. Economic growth generated by regional trade agreements may also encourage higher levels of FDI inflows. Trade barriers, such as stringent and restrictive rules of origin in a free trade area (FTA), which discriminate against non-member countries are another important – albeit undesirable outcome from an allocation of resources’ standpoint – factor that may lead to an increase in FDI flows into a region, more specifically tariff-jumping FDI in this case. Firms may wish to switch from exports to FDI in order to reap the benefits of the regional market.
It is fair to say that all countries do not benefit equally from a regional investment framework. States that choose to restrict access to some of their sectors or industries may not see much increase in FDI inflows. Similarly, countries which had a fairly open investment regime prior to the entry into force of the agreement, may not experience a surge in FDI flows. In fact, it is difficult to determine a priori which countries will benefit the most from a liberalized investment framework because other policy determinants and economic variables play a significant role in explaining an increase in FDI inflows. Each country must be able to exploit its own country-specific advantages, and, in that regard, policy choices still matter.

Regional or bilateral trade agreements concluded by Latin American countries generally include an investment chapter or protocol. The Free Trade Agreement (FTA) among members of the Group of Three (Colombia, Mexico, and Venezuela), and the bilateral FTAs signed respectively by Mexico with Bolivia, Chile, Costa Rica, Nicaragua, and the Northern Triangle (Guatemala, El Salvador, and Honduras), and between Chile and Canada, have all embraced the NAFTA model and incorporated a protection element and a market access component in their investment chapter. Meanwhile the free trade agreement between the Central American countries and the Dominican Republic includes an additional element, an admission clause that somewhat offsets the right of establishment of the national treatment provision. The Colonia Protocol for the Mercosur (the Common Market of the South) member countries also includes an admission clause, whereas the Buenos Aires Protocol for non-Mercosur members follows the traditional approach adopted in bilateral investment treaties as does the free trade agreement between Chile with each of the Central American countries. The investment agreement between Caricom (the Caribbean Community and Common Market) and the Dominican Republic also follow the traditional approach in bilateral investment treaties. The Andean Community’s Decision 291 contains a few investment provisions, and so does Caricom’s Protocol II, which establishes that members shall not introduce in their territories any new restrictions relating to the right of establishment of nationals of other Member States save as otherwise provided in the agreement.

Except for Mexico and the NAFTA, it is difficult to determine the impact of most of these agreements on FDI inflows because statistics are unavailable. Mexico greatly benefited from an increase in FDI inflows shortly before and after the entry into force of NAFTA. Flows doubled to over $4 billion annually before NAFTA was brought into effect and rose to over $10 billion in 1994. The liberalization of Mexico’s investment regime enshrined into the NAFTA the preferential access to the US market (as long as rules of origin are met), and low-cost labour led to a major increase of FDI flows into Mexico. Mercosur members, in particular Brazil and Argentina, also experienced a significant increase in FDI flows. Privatization policy, macroeconomic reforms, and investment liberalization at the domestic level, as well as the elimination of most tariffs between members, have also contributed to attracting more investment to the region.

Hemispheric Investment Negotiations: The Free Trade Area of the Americas

Latin American countries are taking part, along with the United States, Canada and the Caribbean, in a regional negotiation to create the Free Trade Area of the Americas (FTAA). In addition to investment, there are eight negotiating groups in the FTAA: market access; agriculture; services; government procurement; intellectual property rights; subsidies, antidumping and countervailing duties; competition policy; and dispute settlement.

The objective of the FTAA Negotiating Group on Investment (NGIN) is to establish a fair and transparent legal framework to promote investment through the creation of a stable and predictable environment that protects the investor and the investment, without creating obstacles to investments from outside the hemisphere. Essentially, the mandate of the NGIN is to develop a framework incorporating comprehensive rights and obligations on investment and a methodology to consider potential reservations and exceptions to the obligations.

Work prepared for the FTAA Working Group on Investment (WGIN), which met nine times between September 1995 and September 1998 and set the stage for the current negotiations, has shown that investment instruments in the Americas share important commonalities.

- Most agreements have adopted a broad, open-ended, asset-based definition of the term investment, which is more encompassing that the traditional enterprise-based definition of foreign direct investment. They also provide for fair and equitable treatment, some form of protection, national treatment, and MFN treatment.
- They guarantee the free transfer of funds related to investment and include a non-exhaustive list of types of payments for which the transfer of funds is to be guaranteed. Investment agreements in the Americas prohibit expropriation unless it is done for a public purpose, on a non-discriminatory basis, in accordance with due process of law, and on payment of compensation.
Dispute settlement provisions are also included. State-to-state investment disputes are covered by the general dispute settlement mechanism in free trade agreements, while there are specific provisions to that effect in bilateral investment treaties. There are also provisions on investor–state disputes allowing Parties to submit their claim either to an ad hoc tribunal or a more institutionalized mechanism such as the International Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID).

Two different approaches have been adopted with respect to the entry of investments and investors of a Party into the territory of another Party. Newer instruments such as those included in the NAFTA, the Group of Three, and the bilateral free trade agreements concluded by Mexico with Bolivia, Chile, Costa Rica, Nicaragua, and the Northern Triangle, and by Chile with Canada, create a right of establishment for investors and investments of the other Party. In fact, these instruments have been designed with the purpose of assuring the free entry of such investments – albeit with country-specific reservations – into the territory of the host country.

MULTILATERAL INVESTMENT RULES

In analyzing whether to negotiate comprehensive multilateral investment rules, Latin American countries and other WTO members have to consider the arguments in favour of such undertaking and the results and signals that WTO rules on investment would send to foreign investors.

1. There is obviously no guarantee that a set of multilateral investment rules would result in an increase in FDI inflows in any individual country. There is no reason to believe that all countries would behave identically with respect to investment liberalization and other important policy determinants of FDI inflows such as privatization policy, competition policy, macroeconomic policy, and tax policy. As was mentioned above in the section on regional trade agreements, the economic policy framework of each country matters a great deal. States would not lose their policy flexibility by negotiating multilateral rules.

2. A multilateral investment framework would probably aim at locking in the liberalization achieved at the national level, and may also speed up investment liberalization. A built-in agenda for future liberalization would also encourage this trend. But it is entirely possible that some countries would engage in commitments that widen the gap between bound and applied levels of market openness, as this has been the case for tariffs at the GATT and the services commitments in the GATS. Although the signalling effects of such decision, particularly in the case of smaller economies, would not be lost on foreign investors, WTO members are free to exercise their sovereignty and decide whether a commitment at the WTO should reflect the status quo, as embodied in their domestic investment regime. It is also possible that the rules entailed in a multilateral investment regime be less liberal than those of a bilateral or regional agreement.

3. Apart from the importance of addressing the issue of ‘modal neutrality’ underlined above, a multilateral framework would ensure transparency, predictability and a degree of legal security of domestic FDI regimes. Moreover, a multilateral investment framework does not negate the ability of countries to enhance their attractiveness to FDI flows by improving their physical infrastructure such as telecommunications, roads, ports, airports, power, human resources, and technology. These economic determinants play a key role in encouraging foreign firms to invest in a country. In fact, a comprehensive multilateral investment framework would draw attention to these factors, and contribute to a more efficient allocation of resources, especially if it addresses, in some ways, distorting practices such as investment incentives and performance requirements.

Comprehensive WTO Agreement on Investment: Scenarios to be Considered

The development of a multilateral investment agreement within the GATT/WTO framework has been discussed since the mid-1940s. The current regime inherited from the Uruguay Round contains few investment provisions but no comprehensive coverage. The next WTO Ministerial Meeting will offer an opportunity for member countries to assess whether to negotiate a more coherent set of investment disciplines. In this regard, Latin American countries and other WTO members may wish to consider a number of scenarios in their reflection on how to expand the scope of investment disciplines at the WTO. Without prejudging the decision that these countries will make, these scenarios are briefly discussed below.

1. The first issue to address is whether to negotiate a comprehensive agreement that covers investment protection and liberalization or to choose a more modest approach and broaden the current regime. The objective of ‘modal neutrality’ explained earlier would suggest that there is a compelling case to be made for comprehensive multilateral investment
rules that cover goods and services. However, the decision to go ahead on that front, in a post-MAI environment, will be largely influenced by the political economy in member countries at the time of the Ministerial Meeting.

(2) Latin American countries must also decide whether they should primarily focus on a hemispheric investment agreement within the FTAA process, bearing in mind that such agreement could serve as a model for the WTO later, or whether they should adopt a two-track approach, that is to negotiate comprehensive investment rules hemispherically and multilaterally. A priori, it appears that a hemispheric negotiation on investment matters may be easier to bring to fruition because of the clear commitment from all participants that this issue belongs in the negotiation. Also, as was underlined earlier, common approaches have been adopted in investment agreements signed between countries negotiating the Free Trade Area of the Americas. The 1990s saw the emergence of a new consensus in the Americas over the rules governing foreign investment on issues such as scope and coverage, definitions of investment and investor, general standards of treatment, compensation for losses, transfers, and expropriation.

(3) Should WTO members decide to negotiate a comprehensive agreement on investment, they would need to determine the scope of that agreement and to address its three components.

(a) The substantive scope consists of the disciplines of the agreement, including the definition of key terms such as investment and investor, which investment and which investor will be entitled to benefit from the agreement. Countries would need to assess the impact of these definitions on the provisions of the agreement and an eventual liberalization process. Should the definition of investment include FDI, portfolio investment, real estate and intangible assets? Should it be broad enough to allow for the inclusion of new forms of investment, while providing for the definition of what is not an investment (in order to exclude short-term capital flows)? Should the definition also apply to commitments made in the GATS? As explained earlier, the definition of commercial presence under GATS Article XXVIII is much narrower but does cover pre- and post-establishment investment.

(b) The territorial scope refers to the territory of the Parties that fall under the agreement, including the application of the provisions at the sub-national level. The temporal scope informs on whether the agreement applies to investment made, and disputes that arose, prior to the entry into force of the agreement. The provision on scope may also include economic activities reserved to the state that Parties choose to exclude from the agreement.

(c) The provisions on national treatment and MFN treatment are another key element of a comprehensive agreement on investment. WTO members would need to decide whether to apply the MFN and national treatment provisions across the board to all members and sectors (with reservations), or to adopt the GATS approach, for instance to have an all-encompassing MFN provision with temporary exemptions and a conditional national treatment standard, which would apply to all sectors for which members would make commitments.

Members would also need to assess whether the Agreement on Investment would include commitments to investment liberalization in both goods and services, such as how would the current GATS commitments be affected by this new instrument? In fact, should WTO members adopt the 'positive list' or bottom-up approach of the GATS by identifying which sectors are covered by the agreement? Or, should they embrace a 'negative list' or top-down approach to lock in the liberalization achieved at the domestic level and ensure that all future measures are covered by the agreement? Another relevant question is whether the commitments made by WTO members would reflect the status quo, regardless of the approach adopted. As mentioned earlier, this has proved to be difficult in the GATS.

One of the main components of bilateral and regional investment agreements, investment protection provisions, is essentially absent from the WTO framework. There is no coverage of matters related to expropriation, an issue that has become politically very sensitive 'in countries with high levels of regulatory and NGO activism'. A comprehensive agreement on investment at the WTO could address this issue and define the concept of indirect expropriation in such a way as to reaffirm the rights of sovereign countries to regulate. WTO members could also decide to ignore this issue altogether and rely on their network of bilateral investment treaties and regional agreements.

Although payment and transfers, an important component of the provisions on investment protection, are covered in the GATS, the provision on this issue is commitment-specific, which means that it applies only to scheduled sectors and modes of supply. In contrast, the transfer provision in investment agreements is of a general nature. It usually states that the host country must guarantee the free transfer of funds related to investments of investors of another Party. Most agreements include an illustrative list of types of payments that are guaranteed – for example: returns, profits, interests, dividends, and other current incomes; repayments of loans; and proceeds of the total or partial liquidation of an investment. In addition, other types of payments are often listed – for example: additional
contributions to capital for the maintenance or development of an investment; bonuses and honoraria; wages and other remuneration accruing to a citizen of the other Party; compensation or indemnification; and payments arising out of an investment dispute. Most agreements also stipulate that the transfer shall be made without delay in a freely convertible currency or freely usable currency at the normal rate applicable on the date of the transfer. Some agreements allow for limitations or exceptions to transfers, for example in the case of balance-of-payments difficulties and prudential measures, as long as these restrictions are exercised for a limited period of time in an equitable way, in good faith and in a non-discriminatory manner.

Investment agreements include two dispute settlement mechanisms. One deals with disputes between states, and the other allows investors of a Party to bring a claim against another Party. It appears unlikely for the time being that investor-state arbitration would be exported to Geneva because of the burden it would impose on the current system and the political sensitivities it would generate.

A comprehensive agreement would also include provisions on performance requirements and may cover investment incentives. There has been intense competition among both developed and developing countries in trying to attract FDI by using investment incentives. Central and sub-national states (that is, provinces and states) in developed countries make great use of these instruments. Investment incentives – be they fiscal, financial, or of other types – often play a significant role in influencing the location of some specific investments. They may also lead countries to embark on costly ‘grant shopping’, resulting in discrimination and distortions in the allocation of production and resources, essentially in rent-seeking behaviour by investors. Countries with fewer resources may find it difficult to compete on a level playing field with other states using such instruments. Countries with federal structures have traditionally been hesitant to tackle this issue in international negotiations. They often feel they cannot or should not bind their sub-national states.

Provisions on investment incentives could address issues related to their scope, codification, the prohibition of some types of incentives, and the principles of transparency and non-discrimination (national treatment and MFN treatment).

A second scenario is to expand the current WTO investment framework without negotiating a comprehensive agreement on investment. Several options are possible. WTO members could focus on investment liberalization in the GATS and ensure that the commitments reflect more closely the investment regime in place in each member country. Members could also elect to develop disciplines on investment in goods to address the market access component of an investment agreement. Disciplines on investment incentives promoting transparency and non-discrimination, as explained in the previous paragraph, could be added to the SCM, and commitments made in the Plurilateral Agreement on Government Procurement (GPA) could be multilateralized.

A third scenario would be for WTO members to negotiate a Plurilateral Agreement on Investment, which would be comprehensive in nature. The European Commission floated this idea in December 2000.

CONCLUSION AND RECOMMENDATIONS

Challenges Ahead for Latin America

Latin American countries must reflect on the role that an investment agreement should play, and what they want to achieve at the WTO and in the FTAA agreement. A lot of progress has been made with respect to the rules and disciplines governing investment in the region, and in the Americas as a whole. In fact, there are more commonalities at the regional level than multilaterally. By building on the existing consensus in the FTAA, countries of the Americas will strive for a balanced framework that will ensure mutual advantage and increased benefits for all participants. In so doing they may wish to review their recent experience with their own investment instruments and draw lessons to be applied in their negotiations. On investment matters, the FTAA offers an opportunity to show how regional agreements can contribute to building a stronger multilateral trading system.

More broadly, Latin American countries face numerous challenges at the beginning of the twenty-first century. A first challenge is to ensure that their market-oriented reforms implemented during the 1990s are sustained in the long run. A sudden change in policy towards protectionism could lead to massive capital outflows. A second challenge is to include in trade and investment agreements the liberalization achieved unilaterally. Both developed and developing countries benefit from the signalling effects of a negotiated agreement that provides legal security to international investors. Countries also gain in credibility if there is no gap between bound and applied commitments to market access. In the context of a hemispheric investment agreement, Latin American countries must decide, along with the United States, Canada, and the Caribbean, whether the FTAA investment chapter will represent a commitment that reflects the status quo or go beyond the current level of liberalization. They must also discuss whether
the agreement should aim at progressive liberalization with a built-in agenda for future liberalization. But more important, Latin American countries need to identify their objectives, priorities and interests in negotiating investment agreements, be they at the regional or multilateral level.

Notes

11. Since Congress is vested with authority over foreign commerce under the US constitution, a mechanism was engineered in the Trade Act of 1974 to allow the executive branch to fashion trade deals without having Congress pick them apart piece by piece thus requiring re-negotiation with foreign partners. The fast-track authority, now known as Trade Promotion Authority, gives the executive branch the leeway to negotiate a trade agreement, which is then accepted or rejected as a whole and without changes by Congress.
12. For more on the MAI, see Dymond (1999) and Graham (2000).
13. For an excellent discussion on this issue, see WTO (1996), pp. 52–5.
16. The free trade agreement between Chile and Central American countries was signed on 18 October 1999. Article 10.02 states that Parties may at any time decide – but must within two years of the entry into force of the agreement analyze the possibility – to broaden the coverage of the investment rules in the bilateral investment treaties between Chile and each Central American country.
18. The Trade Negotiations Committee (TNC), which is composed of trade vice-ministers, has the responsibility of guiding the work of the negotiating groups. A consultative group on smaller economies, a joint government–private sector committee of experts on electronic commerce, and a committee of government representatives on the participation of civil society, also meet regularly. The Administrative Secretariat of the FTAA and the Tripartite Committee institutions (Organization of American States (OAS)); Inter-American Development Bank (IADB); and UN Economic Commission for Latin America and the Caribbean (ECLAC) provide respectively administrative and technical support to the FTAA process. The Administrative Secretariat is located at the same venue as the meetings of the FTAA entities in Miami from May 1998 to 28 February 2001; Panama from March 2001 to 28 February 2003; and Mexico City from March 2003 to 31 December 2004.
21. There are five currencies, as defined by the International Monetary Fund, as freely usable: dollar, yen, DM, FF, pound sterling. See US Bilateral Investment Treaties, the NAFTA, the Canada–Chile and the Mexico–Chile free trade agreements.

Bibliography