DEVELOPING COUNTRIES AND FOREIGN DIRECT INVESTMENT

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A thesis submitted to the Faculty of Graduate Studies and Research in partial fulfilment of the degree of Master of Laws (LL.M)

 February 1999

0-612-50916-8

To Zuhdi Asfour,

a great man whose decency, perseverance and devotion inspired many.

May God have mercy on your soul, grandfather.

ABSTRACT

Along with international trade, foreign direct investment (FDI) has been the engine driving the current economic globalization of the world economy. The growth rate of FDI, which exceeded that of international trade and world output throughout the 1990s, raises important questions regarding the value of FDI to developing countries as host countries to FDI and the role it can play in their development.

In an attempt to answer these questions, this thesis tackles the main issues underlining FDI and developing countries. After analysing the pros and cons of FDI for developing countries and other interested parties, this thesis scrutinizes the regulation of FDI as a means to balance the interests of the concerned parties, giving an assessment of the balance of interests in some existing and potential FDI regulations. Furthermore, this thesis highlights the case against the deregulation of FDI and its consequences for developing countries. It concludes by formulating regulatory FDI guidelines for developing.

RÉSUMÉ

Tout comme le commerce international, l'investissement direct étranger est devenu le moteur de la mondialisation actuelle de l'économie. Le taux de croissance des investissements directs étrangers, lequel a excédé celui du commerce international et de la production mondiale pendant les années '90, soulève d'importantes questions concernant la valeur des investissements directs étrangers pour les pays hôtes en voie de développement et le rôle que de tels investissements peuvent jouer dans leur développement.

Afin de répondre à ces interrogations, la présente thèse aborde les principaux points sous-jacents aux investissements directs étrangers et aux pays en voie de développement. Après avoir soupesé les avantages et les inconvénients des investissements directs étrangers pour les pays en voie de développement et les autres parties intéressées, cette thèse examine la réglementation existante et potentielle des investissements directs étrangers comme moyen d'équilibrer les intérêts des parties concernées. De plus, cette thèse met en lumière la tendance à une déréglementation des investissements directs étrangers et ses conséquences pour les pays en voie de développement. Elle conclut en formulant, pour ces derniers, des lignes directrices pour réglementer les investissements directs étrangers.

ACKNOWLEDGMENTS

Around this time last year, I was writing the acknowledgments for my last LL.M thesis. And now I am writing the acknowledgments for yet my second LL.M thesis at McGill University. As much as I feel honoured to have the opportunity to complete two masters at McGill, I feel burdened with gratitude to people whose support helped the successful completion of this stage of my life. I hope these people find in the following words an expression of the thankfulness I owe them.

First and foremost, I would like to express my gratitude to Professor Richard Janda whose wise supervision and support contributed significantly to the successful completion of this thesis. Further thanks are certainly due to all of McGill's staff whose pleasant cooperation and patience have furnished invaluable support to the submission of this thesis.

My deepest gratitude goes, without saying, to my family who was, as always, the torch that lightened my darkest nights and the everlasting love spring that guided my way.

And last but not least, I would like to thank the wonderful friends who helped in polishing this thesis, particularly Sanam Salem-Haghighi for the useful substantive discussions we had, and Melissa Knock, Chia-Lee Wei and Yumi Nagae for assisting in editing this thesis.

TABLE OF CONTENTS

DEVELOPING COUNTRIES AND FOREIGN DIRECT INVESTMENT

CHAPTER 2

THE REGULATION OF FDI

CHAPTER 3

LIBERALIZATION OF FDI

INTRODUCTION

We are in an era of globalization of the world economy. The gradual lifting of trade and investment barriers since the 1930s and the revolutions in telecommunications, transportation, and data processing technologies have, indeed, accelerated the process of both market and production globalization, shrinking our world to a "global village".[1]

The globalization of markets, which used to exist only in economists' theories, has been translated into reality. National markets are increasingly losing their distinct statuses and integrating into a single global market. The globalization of production has further become an undisputed fact. Firms from all around the world are breaking up their production processes and distributing the components thereof to several countries in order to take advantage of extra-national location benefits (*e.g.*, labour, tax, etc.).

Along with international trade, foreign direct investment (FDI)[2] is the means by which this globalization of the world economy is being accomplished. The increasing volume of the latter underlines its importance to the world economy.[3] In the last two decades there has been a remarkable increase in FDI; the average annual outflow of FDI[4] surged from $76.8

[1] See F.M. Abbott, "Symposium on Global Competition and Public Policy in an Era of Technological Integration: Public Policy and Global Technological Integration: An Introduction" (1996) 72 Chi.-Kent. L. Rev. 345.

[2] Foreign Direct Investment (FDI) can be defined as an investment made directly in facilities to produce or market a product in a country by a foreign investor. Or as the WTO Secretariat defines it, FDI occurs "when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset". See *World Trade Organization Secretariat, Trade and Foreign Direct Investment*, PRESS/57 (9 October 1996) at 6.

[3] See G.T. Ellinidis, "Foreign Direct Investment in Developing and Newly Liberalized Nations" [Summer 1995] 4 D.C.L. J. Int'l L. & Prac. 299 at 300.

[4] Outflow of FDI is the flow of FDI out of a country as opposed to the inflow of FDI, which is the flow of FDI into a country. This should be distinguished from the flow of FDI and the stock of FDI; the flow of FDI "refers to the amount of FDI undertaken over a given time period (normally a year)",

billion per annum during the period 1983-1987 to reach $208.5 billion per annum during the period 1988-1992.[5] FDI outflows continued to grow through the 1990s to reach $225.5 billion in 1993, $230 billion in 1994, $317.8 billion in 1995 and a record high of $347 billion in 1996. Furthermore, the growth of FDI, throughout the 1990s has exceeded that of international trade and of the world output.[6]

Two important trends in the growth of FDI are worth noting: 1) The significantly high FDI outflows from developed countries as compared to the low FDI outflows from developing countries. As shown in the following table,[7] the outflows of FDI from developed countries have averaged 88.2 percent of the total FDI outflows per annum during the period 1983-1995, while the outflows of FDI from developing countries have only averaged 11.8 percent of the total FDI outflows per annum during the same period. 2) The high inflows of FDI to developing countries and the relatively low outflows of FDI from developing countries. As the following table illustrates,[8] the annual average inflows of FDI to developing countries was $62.9 billion during the period 1983-1995 (30 percent of the total FDI inflows), whereas the annual average outflows of FDI from developing countries was only $27.6 billion during the same period (11.8 percent of the total FDI outflows).[9] This means that there is a gap

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while the stock of FDI refers to the total accumulated value of foreign-owned assets at a given time". C.L. Hill, *International Business: Competing in the Global Marketplace*, 2d ed. (Chicago: Irwin, 1997) at 177.

[5] See G. De Jonquieres, "Rocky Road to Liberalization" *Financial Times* (10 April 1995) 15. See also UNCTAD, *World Investment Report 1996: Investment, Trade and International Policy Arrangements* (United Nations Publication, Sales No. E.96.II.A.14) [hereinafter *UNCTAD World Investment Report 1996*].

[6] See *ibid.*

[7] The data contained in this table is based on *UNCTAD World Investment Report 1996*, *supra* note 5. The 1996 information is based on UNCTAD, *World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy* (United Nations Publication, Sales No. E.97.II.D.10) at 4 [hereinafter *UNCTAD World Investment Report 1997*]. Note that the 1990 total out flow of FDI figure for all countries in the original text was "204.3". As this appears to be a miscalculation, this figure was corrected and put between brackets in this study.

[8] *Ibid.*

[9] Although the growth rate of FDI outflows from developing countries exceeded the growth rate of FDI inflows to developing countries, ten-times for the earlier as compared to five-times for the latter, inflows of FDI to developing countries still exceed FDI outflows from them by more than half.

between FDI outflows from developing counties and FDI inflows to developing countries, rendering the majority of developing countries net recipients of FDI.

Year	1983-87	1988-92	1990	1991	1992	1993	1994	1995	1996
Inflows (billion dollars)									
Developed countries	58.7	139.1	169 8	114.0	114 0	129.3	132.8	203 2	
Developing countries	18.3	36 8	33 7	41.3	50.4	73.1	87.0	99.7	
Central & Eastern Europe	0.02	1.36	0.30	2.45	3.77	5.59	5.89	12.08	
All countries	77.1	177.3	203.8	157.8	168.1	207.9	225.7	314.9	349
Outflows (billion dollars)									
Developed countries	72.6	193.3	222.5	201.9	181.4	192.4	190.9	270.5	
Developing countries	4.2	15.2	17 8	8.9	21.0	33.0	38.6	47.0	
Central & Eastern Europe	0 01	0.04	0.04	0 04	0.20	0 20	0.55	0.30	
All countries	76.8	208.5	[240.3]	210.8	203.1	225.5	230.0	317 8	347
Shares in Total Inflows (percentage)									
Developed countries	76	78				62	59	65	
Developing countries	24	21				35	39	32	
Central & Eastern Europe	0 02	0.77				2.70	2.60	3.80	
Shares in Total Outflows (percentage)									
Developed countries	95	93				85	83	85	
Developing countries	5	7				15	17	15	
Central & Eastern Europe	0.01	0 02				0.09	0.24	0.09	

The increasing flow of FDI to developing countries raises important questions regarding the economic benefits of FDI for developing countries, as host countries, and their positions towards FDI. In an attempt to answer these questions, this thesis tackles the main issues underlining FDI and developing countries.[10] After defining FDI, Chapter 1 analyses the advantages and disadvantages of FDI for developing countries and other interested parties. Chapter 2 covers the regulation of FDI as a means to balance the interests of the concerned parties, giving an assessment of the balance of interest in some of these regulations. Finally, Chapter 3 highlights the case against deregulation of FDI and its consequences on developing countries and formulates regulatory FDI guidelines for developing countries.

[10] It should be noted at the outset that the subject of this thesis is not purely legal, as it involves several economic and political intertwined aspects. Being a legal thesis, this study deals with the legal aspects of FDI and developing countries in light of the economic and political aspects of the subject.

CHAPTER I

THE MIXED BLESSING OF FDI

I. Introduction

FDI is investment made directly in facilities to produce or market a product in a country by a foreign investor.[11] FDI is classified to: (1) horizontal FDI, which is investment in the same industry as that which the investor has at home; and (2) vertical FDI, which is investment in an industry that provides inputs for the investor's production at home. Both forms of FDI entail advantages and disadvantages for firms and States alike.

II. FDI and Firms

From the standpoint of a firm, FDI is regarded as a mode of entry to foreign markets. Besides FDI, there are four other modes of market entry: exporting, turnkey projects,[12] licensing and franchising.[13] As a mode of entry, FDI can be effected either through a joint venture or through a wholly owned subsidiary. In the case of a wholly owned subsidiary, the investment, *i.e.*, the facilities to produce or market products in the foreign country, is owned completely by the firm undertaking the investment. Whereas in joint ventures, the ownership

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[11] See *supra* note 2. Foreign indirect investment or foreign portfolio investment (FPI), on the other hand, is "investment by individuals, firms, or public bodies (*e.g.*, national and local governments) in foreign financial institutions (*e.g.*, government bonds, foreign stock). Foreign portfolio investment does not involve taking a significant equity stake in a foreign business entity." Hill, *supra* note 4 at 176.

[12] In turnkey projects, a contractor builds a plant in a foreign country and hands the "keys" of that plant to the party in the foreign country, against payment of an agreed amount of money. See *ibid* at 406.

[13] In both licensing and franchising, a foreign firm grants intangible property rights, such as patents, inventions, and copyrights, to a party in a foreign country in return for royalty fees. However, franchising goes beyond the selling of such rights by subjecting the franchisee to certain rules specifying the operation of the business. See *ibid.*

of these facilities is shared with a local partner in the country where the investment is made.

When deciding on a mode of entry, firms take several economic, social and political factors into consideration. The main economic factors in choosing a mode of entry are:[14]

1. Transportation Costs:

The value-to-weight ratio of a firm's products determines the mode that a firm choses to enter foreign markets. Usually, exporting is not appropriate for products with a low value-to-weight ratio (*e.g.*, Pepsi and other soft drinks), because the high transportation cost would render the operation unprofitable. In such cases, it would be more economical to resort to other modes of entry, such as FDI or licensing, to produce such products in the foreign market. For products with a high value-to-weight ratio, such as computer chips and automobiles, exporting remains as an option since transportation costs are comparatively trivial.

2. Market Imperfection:

Market imperfection is a term that refers to market conditions that hinder free competition, market entry and exit by firms. Accordingly, impediments on one mode of entry is another factor that plays a role in choosing a mode of entry.[15] For example, having impediments on exporting and the sale of technology, such as tariffs or quotas, can rule out exporting as a mode of entry and justify FDI; and the existence of impediments on FDI can justify licensing and so on. Thus, when the US, for instance, imposed import quotas on Japanese automobile companies in the 1980s, the latter abandoned exporting and resorted to FDI by building plants in the US.[16]

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[14] See *ibid* at 185-190.

[15] Ellinidis, *supra* note 3 at 300.

[16] See Hill, *supra* note 4 at 186.

3. Location Specific Factors:

According to the comparative advantage theory,[17] some countries have comparative advantages in producing certain products; Colombia's climate, for example, gives it a comparative advantage in producing coffee, and Mexico's low-cost labour gives it a comparative advantage in labour intensive industries, such as textiles. So, firms that wish to benefit from such comparative advantages would normally rule out exporting and resort to FDI.

4. Firms' Strategy:

Multinational firms usually face two kinds of competitive pressures: the pressure to be locally responsive and the pressure to reduce cost. As one scholar explains,

> [t]hese competitive pressures place conflicting demands on a firm. Responding to pressures for cost reduction requires that a firm try to minimize its unit cost. Attaining such a goal may necessitate that a firm base its productive activities at the most favourable low-cost location, wherever in the world that might be. It may also necessitate that a firm offer a standard product to the global marketplace to ride down the experience curve as quickly as possible. In contrast, responding to pressures to be locally responsive requires that a firm differentiate its products and marketing strategy from country to country in an attempt to accommodate the diverse demands that arise from national differences in consumer tastes and preferences, business practices, distribution channels, competitive conditions, and government policies. Because customizing product offerings to different national requirements can involve significant duplication and lack of product standardization, the result may be to raise costs.[18]

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[17] R.M. Stern, "Conflict and Cooperation in International Economic Policy and Law" [Summer 1996] 17 U. Pa. J. Int'l Econ. L. 539 at 539-540.

> The simplest version of the theory of comparative advantage and the gains from trade - the central focus of international trade theory - assumes the existence of two industries located in each of two countries existing in isolation (autarky), with perfect competition in all markets for goods and factors of production. The theory assumes the productivity of factors (*e.g.*, labour and capital) employed in each country's industry to be different for unspecified technological reasons, resulting in different relative prices of the two goods under such conditions of autarky. This difference in autarky prices gives rise to the possibility of international specialization and mutually beneficial trade. Thus, each country engaged in trade specializes in the production and export of the good in which it has the greatest comparative advantage, or least comparative disadvantage, compared to the other country.

[18] Hill, *supra* note 4 at 364-365.

Accordingly, the competitive pressure that a firm faces determines the mode of entry it chooses. Generally, firms that face cost reduction pressure resort to exporting by concentrating their productive activities in a few locations or a single location, either at home or abroad, through FDI, so as to take advantage of their economies of scale and location economies. Firms that face local responsiveness pressure, on the other hand, seek FDI in order to disperse their productive activities to meet their diversified demand.

5. Control Over Core Competence:

The kind of know-how a firm possesses plays a significant role in the mode of entry it chooses. Generally, firms, the competitive advantage of which resides in technological know-how are keen to protect this know-how by restricting competitors access to it.[19] Thus, such firms usually resort to modes of entry that provide them with tight control over their know-how, such as exporting and wholly owned subsidiaries. Firms with management know-how, on the other hand, prefer to take the advantages of the other modes of entry, since the transfer of their know-how entails only a trivial risk.

The advantages of FDI to firms as compared to the other modes of entry are briefly summarized in the following table:[20]

Entry Mode	**Advantages**	**Disadvantages**
Exporting	Ability to realize location and experience curve economies	High transport costs Trade barriers Problems with local marketing agents

[19] See R.D. Robinson, *Direct Foreign Investment: Costs and Benefits* (New York: Praeger, 1987) at 125.

[20] See Hill, *supra* note 4 at 413.

Turnkey Contracts	Ability to earn returns from process technology skills in countries where FDI is restricted	Creating efficient competitors Lack of long-term market presence
Licensing	Low development costs and risk	Lack of control over technology Inability to realize location and experience curve economies Inability to engage in global strategic coordination
Franchising	Low development costs and risk	Lack of control over quality Inability to engage in global strategic coordination
FDI: - Joint Ventures	Access to local partner's knowledge Sharing development costs and risks Politically accepted	Lack of control over technology Inability to realize location and experience curve economies
- Wholly Owned Subsidiaries	Ability to realize location and experience economies Ability to engage in global strategic coordination	High costs and risks

Accordingly, it can be generally observed that, all other things being equal, firms prefer FDI when there are restrictions on the other modes of entry and when they wish to take advantage of location economies.

III. FDI and States

A. States' Positions Towards FDI

States' positions towards FDI vary considerably. One scholar classifies the positions of States towards FDI into three categories based on their political ideology: the radical view, the free market view, and the national pragmatic view.[21]

[21] See *ibid.* at 200-201.

1. The Radical View

The radical view has its roots in the Marxist theory. It basically considers FDI to be a tool for imperialist domination that should be completely forbidden since it entails no advantages for host countries. According to the radical view, FDI by firms of developed capitalist countries does not contribute to the development of developing countries since the latter remain dependent on developed countries who maintain control over the investment, jobs, and technology.[22] This view was dominant among communist, socialist and developing countries until the 1980s, but the number of countries adhering to it has been decreasing since the collapse of communism.

2. The Free Market View

According to the free market view, FDI has advantages for both home and host countries, and therefore FDI should not be restricted.[23] On this view, increasing FDI through the elimination of restrictions upon it would increase global wealth according to the comparative advantage theory (*i.e.*, each country should specialize in producing what it can produce most efficiently). Although until recently the free market view was influential only among developed capitalist countries, a considerable number of developing countries, mostly from Southeast Asia and Western Europe, have begun to accept this view.[24]

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[22] See S. Young, *The Economics of the Multinational Enterprise* (London: Longman, 1979) at 179.
[23] *See ibid.*
[24] It should be noted, however, that no country has followed the free market view in its "pure form". In fact, even the most capitalist countries still intervene to restrict foreign investment in some cases. A clear example can be drawn from the US, which still restricts and limits foreign investment in its air transport industry to 25 percent. See *ibid.* See also R.D. Lehner, "Protectionism, Prestige, and National Security: the Alliance Against Multilateral Trade in International Air Transport" [November 1995] 45 Duke L.J. 436 at 468.

3. The Pragmatic Nationalism View

A country adopting this view recognizes that FDI has advantages and costs. Such a country would implement a moderate policy that allows it to maximise the advantages of FDI and reduce or avoid its disadvantages. At present, the vast majority of countries adopt such policies.[25]

This leads to a discussion about the advantages and disadvantages of FDI for host and home countries.[26]

B. Advantages and Disadvantages of FDI for States

1. Advantages of FDI for Host Countries

1.1. Resource-Transfer

FDI can have a positive resource-transfer effect on host developing countries; FDI by multinational enterprises (MNEs) usually entails the transfer of capital, technology and management skills from MNEs to the host developing country, which usually lacks such resources.[27]

It should be noted, however, that the transfer effect is often more limited than it initially appears; first, the effect of management skills transfer can be restricted if MNEs choose to limit their management and high-skill positions to foreign employees. As for the technology transfer, it also can have a limited effect, depending on the form of FDI. If the investment takes the form of a joint venture, the technology transfer effect can still be possible. On the other hand, wholly owned subsidiaries create virtually no technology transfer effect.

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[25] See Hill, *supra* note 4 at 204.

[26] The analysis of this part will be restricted to the economic aspects of FDI. The socio-political dimensions of FDI are beyond the scope of this thesis.

[27] See Robinson, *supra* note 19 at 120. See also Young, *supra* note 22 at 198-202.

Accordingly, negotiations between MNEs and host governments often centre on the critical points of capital, technology and management skills transfers.

1.2. Employment

FDI can produce jobs in the host country both directly and indirectly and, thus, can help boost the economic development of host countries. Direct jobs are those offered directly by the firm undertaking the investment. Indirect jobs are those created in industries connected to the subsidiary, such as suppliers, or simply jobs generated by increased spending in the host country.[28]

The employment effect of FDI on host countries is, however, limited and can sometimes be misleading. This is because the jobs generated by the investment can be a replacement for the jobs lost in national firms, which may lose part of their market share to foreign investors. In other words,

> not all the "new jobs" created by FDI represent net additions in employment. In the case of FDI by Japanese auto companies in the United States, for example, some argue that the jobs created by this investment have been more than offset by the jobs lost in U.S.-owned auto companies, which lost market share to their Japanese competitors. As a consequence of such substitution effects, the net number of new jobs created by FDI may not be as great as initially claimed by an MNE. Not surprisingly, then, the issue of the likely net gain in employment may be a major negotiation point between an MNE wishing to undertake FDI and the host government.[29]

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[28] See *ibid.*, at 202.

[29] Hill, *supra* note 4 at 207.

1.3. Balance-of-Payments[30]

FDI can enhance a host country's balance-of-payments in three ways:

(1) The inflow of capital to the host country to initiate the investment can increase the credit on the capital account of the host country. But, obviously, this increase has a one time effect only.[31]

(2) The products produced domestically can reduce, or even substitute, importation of these goods, thus improving the credit on the current account of the host country.

(3) The goods produced locally in the host country can be exported to other countries, also improving the credit on the current account of the host country.[32]

2. Disadvantages of FDI for Host Countries

2.1. Negative Effect on Competition

FDI can have a negative effect on national firms of the host country and, thus, on competition in that country. In particular, developing countries that lack big firms fear that allowing competition between their domestic firms and the much larger MNEs can drive their national firms out of business.[33] This fear is aggravated when a foreign MNE engages

[30] The balance-of-payments is "a statement of a country's trade and financial transactions with the rest of the world over a particular period of time, usually a year. The account is divided into two main parts: (a) current account and (b) capital account (investment and other capital transactions)." So, if a country pays more than it receives, by importing more goods and services than it exports, it is said that this country has a trade deficit. See C. Pass, B. Lowes, L. Davies & S.J. Kronish, *The Harper Collins Dictionary of Economics* (New York: Harper Perennial, 1991) at 34.

[31] The other side of this transaction will be recorded as a debt in the capital account of the home country where the capital to initiate the investment has flown. See Hill, *supra* note 4 at 210.

[32] See Young, *supra* note 22 at 204.

[33] Accordingly, many developing countries use the "infant industry" argument to justify restricting FDI. One scholar notes that "[i]mport controls may be motivated by a desire to let a local industry develop to a stage where it is capable of competing in world markets. The same logic suggests FDI should be restricted. If a country with a potential comparative advantage in a particular industry allows FDI in that industry, indigenous firms may never have a chance to develop." Hill, *supra* note 4 at 210. See also Stern, *supra* note 17 at 543.

in restrictive business practices,[34] especially when it is a part of a large international organization that allows it to "draw on funds generated elsewhere to subsidise its costs in the host market".[35] This may result not only in the loss of domestic industries but also in the monopolisation of the national market, contrary to the interests of the national economy.

2.2. Balance-of-Payments

FDI can also have negative effects on a host country's balance-of-payments. First, the repatriated earnings of the subsidiary to its home country are recorded as debt on the current account of the host country. Second, the subsidiary can import inputs for its production resulting in a debt on the host country's balance-of-payment.[36]

2.3. Loss of National Sovereignty and Autonomy

The loss of national sovereignty is not, in itself, a disadvantage of FDI, rather, it is the loss of control over the national commercial activities that is disadvantageous. Host countries usually fear handing over economic decisions to MNEs that are not its nationals and which the host country has no control over. Indeed, the economic independence of a host country would be jeopardized if commercial decisions in the host country were taken by foreign MNEs based solely on financial considerations, without regard to the interests of its national economy.[37]

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[34] Restrictive business practices are "anti-competitive practices by enterprises, that aim at monopolizing markets, creating or abusing dominant position of market power, or both". *UNCTAD World Investment Report 1996*, *supra* note 5 at 185.

[35] Hill, *supra* note 4 at 210.

[36] An example of this effect can be drawn from the Japanese auto industry FDI, which has been criticized in the US for importing high percentage of its component parts from Japan. The US argued that "[t]he favourable impact of this FDI on the current account of the U.S. balance-of-payments position may not be as great as initially supposed". This criticism caused the Japanese auto industry to increase its local component part purchases to 75 percent. The same criticism has caused Nissan FDI in the United Kingdom to increase its local content first to 60 percent and later to over 80 percent. *Ibid.*, at 211.

[37] See Young, *supra* note 22 at 219.

3. Advantages of FDI for Home Countries

In a nutshell, the advantages of FDI for home countries lie in the balance-of-payments, employment, and resource-transfer effects.[38] First, the balance-of-payments of a home country can benefit from the inward flows of earnings repatriated by the subsidiary. Second, the potential demand for the home country's exports (inputs for the subsidiary's production) would help to generate jobs in the home country. Finally, the home country can benefit from the technological and management skills its MNEs acquire from their experience in foreign markets.[39]

4. Disadvantages of FDI for Home Countries

The disadvantages of FDI for home countries are twofold; first, the balance-of-payments of a home country can suffer from the capital outflow to establish the FDI and further from the decrease in exports, since the foreign subsidiary's production might substitute for direct exports from the home country. Furthermore, FDI can have a negative employment effect on the home country, since it can transfer jobs to citizens of the host country that would otherwise employ citizens of the home country.

IV. Conclusion

There is no straightforward answer to the question of the value of FDI to developing countries; indeed, FDI is a mixed blessing for developing countries. Just as FDI can benefit developing countries and contribute to their development, FDI also entails many costs for them. The controlling factor in determining the value of FDI to developing countries is, thus, dependent on the manner in which FDI is regulated. Indeed, the regulation of FDI determines the value of FDI to host developing countries. FDI regulation determines, for example, the percentage of local employment that MNEs have to undertake, the amount of

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[38] See Ellinidis, *supra* note 3 at 308.

[39] See Robinson, *supra* note 19 at 121.

profit they are allowed to expatriate, and the percentage of local component parts comprised in the final product they have to achieve.

Since an evaluation of the role FDI plays in the economic development of developing countries can only be made in conjunction with an evaluation of the regulation of FDI, the next Chapter of this thesis deals with FDI regulation. More precisely, it introduces the conflicting interests at stake, the ways in which they are balanced through the different forms of FDI regulation and the developing countries' position towards such regulations.

CHAPTER 2

THE REGULATION OF FDI

I. Introduction

There are primarily three parties whose interests are at stake with respect to the regulation of FDI: the MNE undertaking the investment and its home country, on one side, and the host country on the other.[40] Since FDI entails advantages and disadvantages for these parties, each party tries to maximize the advantages it can obtain from FDI and reduce the disadvantages through the regulation of FDI. However, more often than not, the interests of these parties conflict;[41] the desire of an MNE to expatriate its earnings, for example, can conflict with a host country's interest in preserving its balance-of-payments; the interest of an MNE to hire high-skilled foreign labour can conflict with a host country's interest to raise its local employment rate. Accordingly, the regulation of FDI aims at balancing these interests.[42]

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[40] Although the interests of an MNE and its home country are most often in line with each other, they sometimes conflict. The aim of an MNE to have access to low-cost foreign labour, for example, can conflict with its home country's interest to maintain a high employment rate; the interest of an MNE to purchase foreign low-cost component parts can conflict with its home country's interest in maintaining a good balance-of-payments. This type of conflict is usually settled by national laws and regulations and will not be dealt with in this thesis.

[41] In fact, "[s]ome argue that there is an "inherent conflict" between the MNE and the host country interests. The MNE seeks opportunities where the production costs are lowest and sales where the prices are highest, resulting in repatriation of profits to the home country. The host country, on the other hand, seeks to maximize benefits to its economy, which requires the retention of MNE profits within the host economy." E.M. Burt, "Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization" (1997) 12 Amer. Univ. J. Int'l L. & Pol'y 1015.

[42] See Stern, *supra* note 17 at 555.

The regulation of FDI is a sovereign matter governed by States through the enactment of national and international laws.[43] Thus, the regulation of FDI can be imposed unilaterally, bilaterally, regionally and multilaterally.

The following part of this thesis deals with these forms of FDI regulation. After giving a historic background of the evolution of some of these regulatory forms, it highlights the main controversial aspects in the regulation of FDI and analyses the balance of interests encompassed in some of these forms of regulation. In doing so, it examines the developing countries' approach in regulating FDI and their positions towards some existing and potential regulatory FDI instruments.

II. Forms of FDI Regulation

A. Unilateral Regulation

Unilateral regulation refers to domestic laws enacted by a host country so as to regulate FDI. These regulations are spread over a wide range of laws;[44] they include domestic laws that are enacted specially for regulating FDI as well as any domestic law that governs the operation of corporations, such as tax law, labour law, corporate law and environmental law. The net effect of this legislation represents a country's policy towards FDI.

Since most countries follow a pragmatic nationalist approach to maximize the advantages of FDI and reduce its disadvantages, they try to regulate FDI in such a way as to achieve this

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[43] However, MNEs can have a considerable influence on this regulation. For instance, an MNE can lobby its home country's government to influence regulatory issues, such as pushing its government to impose investment or trade barriers against a foreign country if the MNE received such treatment from that country. Furthermore, MNEs can enter into negotiations with a host country in order to determine the rules governing the specific investment it will undertake. The role of these negotiations can be so significant that they might result in changing the local FDI regulations or to create exceptions for the investment at hand.

[44] See C.W. Gray & W.W. Jarosz, "Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe" (1995) 33 Colum. J. Transnat'l L. 1 at 10-13.

goal. The formula for host developing countries is thus simple; the more FDI a country can attract and the more regulation it can impose in the direction of its interests, the more advantages it can harness from FDI. The amount of FDI a country can attract is, however, dependent on how strict its regulations are. MNEs prefer to operate on a free market basis and thus try to avoid heavily regulated environments.[45] Therefore, in regulating FDI, host countries try to achieve a balance between the benefits they can harness from regulating FDI and remaining attractive to MNEs as an investment site.[46]

FDI regulation entails imposing entry restrictions and operational requirements to assure that the investment be in line with a host country's policies. Through entry restrictions a country can ensure that FDI is suitable to its development objectives and its interests.[47] A host country can, for instance, require that the investment be located in a particular region, require a certain type of direct investment, such as a joint venture with local partners, or forbid investing in certain industries such as its oil or infrastructure industries. As for operational restrictions, they might include: "local content restrictions, trade balancing requirements, export performance requirements, limitations on imports, foreign exchange and remittance restrictions, minimum local equity restrictions, technology transfer requirements, local employment requirements, personnel entry restrictions, and product

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[45] K. Yelpaala, "In Search of Effective Policies for Foreign Direct Investment: Alternatives to Tax Incentive Policies" [Fall 1985] 7 J. Int'l L. Bus. 208 at 242: "According to the industrial organization theory, the more permissive the host country's environment towards greater control of FDI by MNEs, the more favourable that environment should be to MNEs. Therefore, one should expect a significant and positive correlation between host country legal permissiveness and flexibility towards control and MNE involvement in that country." See also Ellinidis, *supra* note 3 at 312.

[46] It should be noted, however, that domestic regulation and especially investment incentives are of lesser importance to the FDI location decision of MNEs. The latter "are only a minor element in the location decisions of TNCs [trans-national corporations]. More important factors are market size, growth, production costs, skill levels, political and economic stability, and the regulatory framework. Incentives can have an impact primarily in cases where two or more countries are directly competing with each other and one offers critical incentives while the other does not." M.A. Wiss, Book Review and Note, "World Investment Report 1995: Transnational Corporations and Competitiveness. Prepared by the UNCTAD Division on Transnational Corporations and Investment" [October 1996] 90 Amer. J. Int'l L. 713 at 715.

[47] See Burt, *supra* note 41 at 1015.

licensing requirements".[48]

However, unilateral FDI regulation is not carved in stone. Despite the existence of regulation, there is usually room for negotiation regarding the conditions of investment and the rules applied thereto. In fact, some developing countries enact strict investment laws to be used as a bargaining tool in their negotiations with foreign MNEs and their governments. To give but one example, Mexico enacted a law in 1973 that requires a minimum of 51 percent local ownership in any FDI in Mexico.[49] The practice of the Mexican government has proven that this requirement was not strict and that Mexico was willing to waive this requirement in return for other concessions by foreign MNEs.[50] For instance, in 1984 IBM sought to establish a plant in order to manufacture computers in Mexico to take advantage of cheap Mexican labour, but did not want to abide by the 51 percent local ownership requirement. IBM's initial proposal included the creation of 880 jobs (80 direct and 800 indirect jobs), $40 million investment ($7 million direct investment and $33 million to be financed from the Mexican capital market), and an annual export of 7,5000 computers from Mexico.[51] The Mexican government, however, insisted at the outset on the 51 percent local ownership requirement. Since 100 percent ownership of the investment was crucial to IBM, it agreed to make some concessions in other aspects to the Mexican government.[52] IBM finally came up with a proposal to increase its investment to $91 million,[53] to achieve 82 percent local content after four years of operation and to export 92 percent of its production

[48] *Ibid.*

[49] This requirement was waived after Mexico joined NAFTA in 1994. See Hill, *supra* note 4 at 202.

[50] See *ibid.*

[51] See J. Behrman & R.E. Grosse, *International Business and Governments: Issues and Institutions* (Colombia, SC: University of South Carolina Press, 1990).

[52] The reason why 100 percent ownership was crucial for IBM was that IBM wanted to maintain its technological advantage for itself and avoid passing it to potential competitors in Mexico.

[53] This increase was to be distributed between the "expansion of the Guadalajara plant ($7 million), investment in local R&D ($35 million), development of local component-part suppliers ($20 million), expansion of its purchasing and distribution networks ($13 million), contributions to a Mexican government-sponsored semiconductor technology centre ($12 million), and various other minor investments". Hill, *supra* note 4 at 203.

out of Mexico.[54] The Mexican government approved the offer and agreed to 100 percent ownership by IBM.

B. Bilateral Regulation

Bilateral regulation usually takes the form of a bilateral investment treaty (BIT), which is an agreement between two countries, usually one developed and another developing,[55] that regulates investment between them.[56] BITs have evolved from the earliest treaties known as treaties of friendship, commerce and navigation, which have been common since the 18th century.[57] Initially, these treaties did not deal with FDI. However, as FDI became common practice by the end of World War II, the treaties became more investment specific and provided rules for international investments by corporations. [58]

BITs, as such, however, are considered to be relatively new. The first BIT was signed only in 1959 between the Federal Republic of Germany and Pakistan.[59] The number of BITs, nonetheless, has grown so rapidly to 1,160 BITs as of June 1996.[60] This increase has

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[54] See *ibid.*

[55] Bilateral investment treaties between developing and developed countries do not specify which of the contracting States is the source and which is the recipient of the investment. Nonetheless, the outflow of FDI is, more often than not, unilateral from developed to developing countries. See J.W. Salacuse, "BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries" (1990) 24 Int'l Lawyers 655.

[56] "There are different objectives pursued by capital exporting States and host countries in BITs. The creation of clear rules and effective enforcement mechanisms to protect investment are the primary objective of capital exporting countries. The secondary objective is to facilitate the entry of their investment." The goals of host countries, on the other hand, are to encourage foreign capital flow to their territories and remain control over the entry and operation of FDI. S. Salem-Haghighi, Manuscript, *MAI and BITs: A Comparative Study* (Research Paper, Montreal: Institute of Comparative Law, 1998) at 3.

[57] See M. Sornarajah, *The International Law On Foreign Investment* (Cambridge: Cambridge University Press, 1994) at 229.

[58] See *ibid.*, at 230.

[59] See R. Dolzer & M. Stevens, *Bilateral Investment Treaties* (The Hague: Martinus Nijhoff Publishers, 1995) at 1.

[60] Two-thirds of these BITs were concluded during the 1990s. See K. Sauvant, "WTO: Beyond Singapore, the View from the UK" 7 Investment and Open Markets: The View from UNCTAD"

rendered BITs a critical source of FDI law. In fact, some commentators even go so far as to regard BITs as a source of customary international law.[61]

Although some countries have model BITs, which they adopt in their relations with other countries, there is no unified international model BIT. Nonetheless, the structure and provisions of BITs exhibit many similarities. It is this similarity that leads commentators to believe that BITs create customary international norms. The structure of BITs and their main provisions cover the:

- Aims of the treaty.
- Definition of basic terms of the treaty (*e.g.*, "investor", "investment", "profits").
- Conditions for the entry of foreign investments.
- General standards of treatment.
- Monetary transfers.
- Protection against and compensation for dispossession and losses from armed conflicts or internal disorder.
- Settlement of disputes.[62]

1. Scope of Application

A BIT's scope of application is determined by defining: investors, investments, nationals of the contracting States, companies and territories of the contracting parties.

(Speech). UNCTAD. http://www.cliffordchance.com/library/publications/wto_singapore/section7.html (date accessed: 10 August 1998).

[61] See in general B. Kishoiyian, "The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law" (1994) 14 J. Int'l L. Bus. 327. See also F.A. Mann, "British Treaties for the Protection and Promotion of Investment" (1981) 52 Brit.Y.B. Int'l L.241 at 249. Mann argues that "these treaties establish and accept and thus enlarge the force of traditional conceptions of the law of state responsibility for foreign investment". Other commentators, nonetheless, believe that each BIT is only a *lex specialis* between the two contracting States aimed at regulating bilateral investments.

[62] See Salacuse, *supra* note 55 at 4.

1.1. Investments

Most recent BITs have adopted an illusive open-ended definition of investment to cope with the evolving nature of the concept of investment. BITs often include an illustrative list of the kinds of investments (*e.g.*, movables and immovables property, shares in corporations, intellectual property, business concessions, etc.) and expressly provide that the list is non-exclusive.[63]

A controversial point in BITs' negotiations is the retrospective application of the treaty to investments made prior to its coming into force. Host developing countries, which regard BITs as an investment attracting tool, are keen on limiting the treaty's application to investments made after the BIT comes into force, since there is no point in attracting investors that have already invested in their territories. Home countries, which view BITs as a means to protect their national investors, on the other hand, are in favor of the retrospective application of BITs. Nonetheless, the majority of BITs extend to cover investments made prior to and after their coming into force.[64]

1.2. Investor

The inherent conflict of interests between host developing countries and home developed countries over restricting FDI also comes into play in defining the investor under BITs; host countries wishing to restrict the benefits of a BIT usually seek a narrow definition of invertors, while home countries seek a broad definition to cover as many of its nationals as possible.

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[63] See *ibid.*, at 664. It should be noted, however, that some BITs limit the term "investment" to the conditions under which the investment would be admitted by the host country. The 1991 BIT between Sweden and Argentina states that "the investment should be made in accordance with the laws and regulations of the other contracting party". *Ibid.* See also, for example, *Agreement on the Mutual Protection of Investments*, 15 July 1978, Sweden-Egypt, art. 1, 1979 S.V.O. 1.

[64] See Dolzer & Stevens, *supra* note 59 at 26.

BITs require a sufficient link between the investor, either natural or legal persons, and the contracting country. Thus, most BITs require that natural persons have the nationality of or permanently reside in a contracting State, in order for them to benefit from a BITs' protection. As for legal persons, most BITs require that they: (1) be incorporated in a contracting State; (2) have their seat, required office, or principle place of business in a contracting country; and/or (3) be substantially owned or controlled by nationals of a contracting State, in order to clarify problematic situations where nationals of a third country own or control a substantial share in a company of a contracting country and where nationals of a treaty country own or control a company in a third country.[65] Although most BITs require the existence of at least one of these conditions, some BITs require a combination of these requirements. The Japan-China BIT, for example, provides that companies "constituted under the applicable law and regulations of one Contracting Party and having their seat within its territories shall be deemed companies of that Contracting Party".[66]

2. Conditions for Entry

The developing countries' approach is to maintain flexibility and selectivity with regard to determining the conditions for entry applicable to foreign investments. In order to assure that FDI is in line with their national interests, developing countries seek the right to control, among other things, the timing, amount, and kind of investments allowed in their territories. Thus, a crucial characteristic of developing countries' BITs is that they do not grant absolute rights to entry.[67] Although BITs encompass some general entry provisions, the admission of FDI would still be, to differing extents, governed by the laws and regulations of the host

[65] See Salacuse, *supra* note 55 at 666.

[66] *Agreement Concerning the Encouragement and Reciprocal Protection of Investment*, 27 August 1988, Japan-China, 28 I.L.M. 575 at 585 (1989).

[67] See A. Akinsanya, "Protection of Foreign Direct Investment in the Third World" (1987) 36 Int'l & Comp. L. Q. at 59.

developing countries.[68]

Nonetheless, some BITs include provisions on entry that offer the other contracting State entry treatment that is no less favorable than the treatment given to the nationals of the host country or most favored nation entry treatment.[69] Most favored nation (MFN) and national treatment principles are not, however, without limitations; BITs that include such principles usually provide a positive list of the investments that are excluded from the application of these principles or prohibited under them.[70]

3. Treatment

Treatment provisions constitute the legal regime applicable to the investment after being admitted by the host country.[71] Neither BITs nor customary international law provide for a unified general standard of treatment.[72] Accordingly, the standards of treatment in BITs vary considerably.

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[68] In this regard, the World Bank's guidelines impose a transparency obligation on States. The guidelines propose that:

> Each State is encouraged to publish, in the form of a hand book or other medium easily accessible to other States and their investors, adequate and regularly updated information about its legislation, regulations and procedures relevant to foreign investment and other information relating to its investment policies including, *inter alia*, an indication of any classes of investment which it regards as falling under section 4 an 5 of this guideline.

World Bank, *Legal Framework for the Treatment of Foreign Investment* (1992) 7 ICSID Rev. 295.

[69] An example of such treaties is the US-Panama Treaty. Article II of this Treaty provides that "[e]ach party shall permit and treat such investment, and activities associated therewith, on a basis no less favourable than that accorded in like situations to investment or associated activities of its own nationals or companies of any third country, whichever is more favourable...". *Treaty Concerning the Treatment of Protection of Investment*, 27 October 1982, United States-Panama, 21 I.L.M. 1227 at 1229 (1982), art. II.

[70] Article II of the US-Panama BIT provides that its general national treatment and most favoured nation (MFN) treatment obligations are "subject to the right of each Party to make or maintain exceptions falling within one of the sectors to which the respective host countries may restrict investment by the country". *Ibid.*

[71] See Dolzer & Stevens, *supra* note 59 at 58.

[72] See Salacuse, *supra* note 55 at 667.

Most BITs incorporate the "fair and equatable treatment" standard as a general treatment obligation on States. This illusive standard, which exists as a general principle of international law, has been subject to several interpretations in international commentary and States' practices.[73] To clarify the illusiveness of this standard, some BITs refer to some concrete requirements, such as full protection and security, nondiscrimination, and treatment no less favorable than that required under international law.[74] Furthermore, the fair and equitable treatment obligation can be combined with other obligations, such as national treatment[75] and/or MFN treatment.[76] However, in order to attain the control over foreign investments needed to steer FDI in the direction of national development, developing countries tend to avoid such principles in their BITs or at least include as many exceptions to them as possible. The most common approach developing countries take to impose these exceptions is to exempt certain sectors from the application of these principles on the basis of protecting their infant industries.[77]

4. Monetary Transfers

The transfer of payments provisions of BITs regulate five basic issues: "(1) the general nature of the investor's right to make monetary transfer, (2) the types of payments that are covered

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[73] See *ibid.*

[74] See *ibid.*

[75] In some treaties the right to access the local courts of the host country is expressly granted to the investor under the national treatment provision. For example, such a provision was added to the BIT between Senegal and US in 1983. See *ibid.*

[76] An example of a typical most favoured nation treatment provision can be found in Article 3 of the Netherlands-Philippines BIT, which states that "[e]ach Contracting Party shall extend to investments, in its territories, of nationals of the other Contracting Party treatment no less favourable than that granted to investment of any other third country". *Agreement for the Promotion and Protection of Investment*, 27 February 1985, Netherlands-Philippines, Tractatenblad (Neth.) No. 86 (1985), art. 3 [hereinafter *Netherlands-Philippines BIT*].

[77]
> Some developing countries, recognizing the disparity in financial and technological resources between their own national enterprises and those of foreign multilateral enterprises, have sought to limit the scope of ... national treatment. At the very least, developing countries have created exceptions, as, for example, when a host country has reserved certain sectors for development by its own public enterprises or private entrepreneurs.

Salacuse, *supra* note 55 at 668.

by the right to make transfer, (3) the nature of the currency with which the payment may be made, (4) the applicable exchange rate, and (5) the time within which the host country must allow the investor to make transfer."[78]

All BITs oblige the host country to guarantee the right to transfer of funds related to the investment. For that, the host country must usually grant the necessary authorization to guarantee that monetary transfers are made without delay at the going exchange rate at the time the transfer is made.[79] Although the general rule in BITs is the free monetary transfer, some BITs, especially those involving developing countries, include some exceptions. For example, developing countries are usually granted exceptions in cases of balance-of-payments crises to deviate from their monetary transfer obligations.[80] Furthermore, some BITs require that big payments exceeding a certain amount be made in installments or over

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[78] Salacuse notes that:

> In most treaties the concept of "returns" determines the breadth of the monetary transfer rights, and it is usually given special meaning in the BIT's definition section. For example, article I, section (d) of the United States-Zaire BIT gives the term a broad, nonexclusive definition: "returns" means an amount derived from or associated with an investment, including profit; dividend; interest capital gain; royalty payment; management, technical assistance or other fee; or returns in kind.

Ibid. at 669.

[79] See F. Engering, "The Multilateral Investment Agreement" (1996) 5 Transnational Corporation 3 at 262.

[80] See, for instance, Article 7 of the Netherlands-Philippines BIT, which states that:

> Each Contracting Party shall in respect of investments permit nationals of the other Contracting Party the unrestricted transfer in free convertible currency of their investments and of the earnings from it to the country designated by those nations, subject to the right of the former contracting Parties to impose equitably and in good fath such measures as may be necessary to safeguard the integrity and independence of its currency, its external financial positions, consistent with its rights and obligations as a member of the International Monetary Fund.

Netherlands-Phillippines BIT, *supra* note 76, art. 7(1). It should be noted, however, that some BITs subject this exception to certain limitations. The US-Jamaica BIT, for example, in referring to a country's power to take exceptional measures to preserve its balance-of-payments, states that: "(a) Such powers shall not however be used to impede the transfer of profit, interest, dividends, royalties and fees; (b) as regards investments and any other form of return transfer of a minimum of 20% per year is guaranteed." Salacuse, *supra* note 55 at 670.

a period of several years.[81]

5. Protection Against Expropriation and Strife

Expropriation is permitted under international law under certain conditions.[82] The Western view of international law, which has been adopted in almost all BITs, is that States are only allowed to expropriate foreign investors' properties in their territories: "(1) for a public purpose; (2) in a non-discriminatory manner; (3) upon payment of compensation; and, in most instances, (4) with provision for some forms of judicial review."[83] This view has prevailed in BITs to differing extents, with some providing more protection to investors than others.[84]

The most difficult negotiations arise with respect to the standard of compensation. The most common compensation formula in BITs is the Hull formula, which requires that compensations related to expropriation be "prompt, adequate, and effective".[85] To clarify the vagueness of the Hull formula, most BITs also include definitions of the elements of the Hull formula.[86]

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[81] See *ibid.*

[82] The Draft United Nations Code of Conduct on Transnational Corporations provides: "It is acknowledged that States have the right to nationalize or expropriate the assets of a transnational corporation operating in their territories, and that adequate compensation is to be paid by the State concerned, in accordance with the applicable legal rules and principles." *United Nations Code of Conduct on Transnational Corporations* (U.N. Sales No. E.86.II.A.15) (1986) [hereinafter *UN Code of Conduct*]. It should be noted that the Code of Conduct was not adopted by the 1986 UN General Assembly, and other efforts in the UN General Assembly to adopt it in 1992 also largely failed.

[83] Salacuse, *supra* note 55 at 670.

[84] "This...is apart from the traditional view in many developing countries that the issue must be dealt with by reference to domestic law. In a few cases, BITs [stipulate] that expropriations be undertaken after an advance notification and a fair hearing by an unbiased official and after a passage of a reasonable period of time." W. Schacter, "Compensation for Expropriation" (1984) 78 Amer. J. Int'l L. 121.

[85] Salacuse, *supra* note 55 at 671.

[86] The UK-Costa Rica BIT, for instance, provides in elaboration of the Hull formula that "such compensation shall amount to the market value of the investment expropriated immediately before the expropriation or impending expropriation became public knowledge, shall include interest at a normal commercial rate until the date of payment, shall be made without delay, and be effectively

Although most BITs also regulate the issue of compensation for losses from strife, they "do not normally establish an absolute right to compensation" in that regard. [87] Rather, most BITs only grant investors of the other contracting State MFN and/or national treatment with regard to compensation resulting from strife.[88]

6. Settlement of Disputes

In light of the absence of effective investment dispute resolution regulations in international law, the majority of BITs incorporate a settlement of disputes mechanism. Most BITs regulate two types of disputes: disputes between the contracting States, and disputes between States and investors.

BITs' mechanism for settling disputes between States calls for the parties to first seek resolving their disputes regarding the application and interpretation of the treaty through negotiation. If this fails, then the mechanism to settle the dispute is an *ad hoc* arbitration.[89] Furthermore, most BITs include some basic rules of procedure to overcome the potential problems that might arise in deciding the procedural rules to be followed in the *ad hoc* arbitration.

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realizable and be freely transferable". *Agreement for the Promotion and Protection of Investment*, 7 September 1982, United Kingdom-Costa Rica, art. V(1).

[87] Salacuse, *supra* note 55 at 671.

> [A] key interpretational issue is the definition of the specific loss-causing damage that the BIT protects against. Some BITs are quite specific and broad, such as the Denmark-Indonesia Treaty, which protects against "losses...owing to war or other armed conflict, revolution, a state of national emergency, or revolt...["]: while others are more general, for example, the China-Japan Treaty that refers to "damages...owing to the outbreak of hostilities or a state of national emergency."

[88] *Ibid.*, at 672.

[89] See, for instance, *Treaty Concerning the Reciprocal Encouragement and Protection of Investment, with Protocol*, 26 December 1985, United States-Turkey, S. Treaty Doc. No. 99-22, 99th Cong., 2d Sess (1986), reprinted in 25 I.L.M. 85-101 (1986), art. VII.

As for the settlement of disputes between States and nationals of the other State, most recent BITs refer to the rules of the International Center for Settlement of Investment Disputes (ICSID).[90] According to Article 25(1) of the ICSID Convention, the ICSID has jurisdiction over "[a]ny legal dispute arising directly out of an investment, between a contracting State (or any constituent subdivision or agency of the contracting State designated to the centre by that State) and a national of another contracting State, which the parties to the dispute consent in writing to submit to the centre".[91] The conclusion of a BIT usually provides the sufficient consent needed to establish the ICSID's jurisdiction for future disputes.

ICSID rules require the parties in dispute to resolve the dispute through negotiation. If this fails they have the right to resort to compulsory arbitration. This means that private investors, without needing their government's consent, can invoke compulsory arbitration against States party to the treaty.[92]

C. Regional and Multilateral Regulation [93]

Regional and multilateral regulation is undertaken by a group of States either by enacting or joining international law instruments aimed at regulating FDI. In that sense, there is a considerable body of international FDI law scattered in several international instruments aimed at regulating FDI. The following table lists the main regional and multilateral

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[90] See *International Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 18 March 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159, reprinted in 4 I.L.M. 532 (1965). The first BIT to include an ICSID clause was the Netherlands-Indonesia Treaty of 1968. A number of BITs have also referred to UNCITRAL Rules or the International Chamber of Commerce (ICC) arbitration mechanism.

[91] *Ibid.*, art. 25(2).

[92] One commentator observes that "[t]his feature may be the reason that so few Latin American countries have signed BITs, since international arbitration conflicts with the Calvo doctrine, an important element in the legal systems of most countries in the region". Salacuse, *supra* note 54 at 673.

[93] Note, however, that the main focus of this part of this thesis is multilateral regulation, rather than regional regulation due to the relatively greater importance of the earlier to developing countries.

instruments dealing with FDI that existed since 1948.[94]

Year	Title	Setting	Level	Form	Status
1948	Havana Charter for an International Trade Organization	International Conference on Trade and Employment	Multilateral	Binding	Not ratified
1948	Draft Statutes of the Arbitral Tribunal for Foreign Investment and of the Foreign Investments Court International	Law Association	Non-governmental	Non-binding	Not adopted
1949	International Code of Fair Treatment for Foreign Investments	International Chamber of Commerce	Non-governmental	Non-binding	Adopted
1957	Treaty Establishing the European Economic Community	European Economic Community	Regional	Binding	Adopted
1957	Agreement on Arab Economic Unity	Agreement on Arab Economic Unity	Regional	Binding	Adopted
1958	Convention on the Recognition and Enforcement of Foreign Arbitral Awards	United Nations	Multilateral	Binding	Adopted
1961	Code of Liberalisation of Capital Movements	OECD	Regional	Binding	Adopted
1962	United Nations General Assembly Resolution 1803 (XVII): Permanent Sovereignty over Natural Resources	United Nations	Multilateral	Non-binding	Adopted
1963	Model Tax Convention on Income and on Capital	OECD	Regional	Non-binding	Adopted

[94] Note that:
a. Bilateral investment treaties and directives of the European Union are not included in the table.
b. Dates given relate to original ratification. Subsequent revisions of instruments are not included.
c. The OECD Declaration on International Investment and Multinational Enterprises is a political undertaking supported by legally-binding Decisions of the Council. The Guidelines on Multinational Enterprises are non-binding standards.
UNCTAD World Investment Report 1996, *supra* note 5 at 135-139.

1965	Common Convention on Investments in the States of the Customs and Economic Union of Central Africa	Customs and Economic Union of Central Africa	Regional	Binding	Adopted
1965	Convention on the Settlement of Investment Disputes between States and Nationals of other States	World Bank	Multilateral	Binding	Adopted
1967	Revised Recommendation of the Council Concerning Co-operation Between Member Countries on Anticompetitive Practices Affecting International Trade	OECD	Regional	Non-binding	Adopted
1967	Draft Convention on the Protection of Foreign Property	OECD	Regional	Non-Binding	Not open for signature
1969	Agreement on Andean Subregional Integration	Andean Common Market	Regional	Binding	Adopted
1970	Agreement on Investment and Free Movement of Arab Capital among Arab Countries	Arab Economic Unity	Regional	Binding	Adopted
1970	Decision No. 24 of the Commission of the Cartagena Agreement: Common Regulations Governing Foreign Capital Movement, Trade Marks, Patents, Licences and Royalties	Andean Subregional Integration Group	Regional	Binding	Supersed -ed
1971	Convention Establishing the Inter-Arab Investment Guarantee Corporation	Inter-Arab Investment Guarantee Corporation	Regional	Binding	Adopted
1972	Joint Convention on the Freedom of Movement of Persons and the Right of Establishment in the Central African Customs and Economic Union	Central African Customs and Economic Union	Regional	Binding	Adopted
1972	Guidelines for International Investment	International Chamber of Commerce	Non-Govern-mental	Non-binding	Adopted
1973	Agreement on the Harmonisation of Fiscal Incentives to Industry	Caribbean Common Market	Regional	Binding	Adopted

1973	Treaty Establishing the Caribbean Community	Caribbean Community	Regional	Binding	Adopted
1974	United Nations General Assembly Resolution 3201(S-VI): Declaration on the Establishment of a New International Economic Order and United Nations General Assembly Resolution 3202 (S-VI): Programme of Action on the Establishment of a New International Economic Order	United Nations	Multilateral	Non-binding	Adopted
1974	United Nations General Assembly Resolution 3281 (XXIX): Charter of Economic Rights and Duties of States	United Nations	Multilateral	Non-binding	Adopted
1975	The Multinational Companies Code in the UDEAC (Customs and Economic Union of Central Africa)	Customs and Economic Union of Central Africa	Regional	Binding	Adopted
1975	Charter of Trade Union Demands for the Legislative Control of Multinational Companies	International Confederation of Free Trade Unions	Non-governmental	Non-binding	Adopted
1975	International Chamber of Commerce Rules of Conciliation and Arbitration	International Chamber of Commerce	Non-governmental	Non-binding	Adopted
1976	Declaration on International Investment and Multinational Enterprises	OECD	Regional	Binding /non-binding	Adopted
1976	Arbitration Rules of the United Nations Commission on International Trade Law	United Nations	Multilateral	(Model)	Adopted
1977	ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy	International Labour Office	Multilateral	Non-binding	Adopted
1977	International Chamber of Commerce Recommendations to Combat Extortion and Bribery in Business Transactions	International Chamber of Commerce	Non-governmental	Non-binding	Adopted

1979	Draft International Agreement on Illicit Payments	United Nations	Multilateral	Binding	Not adopted
1979	United Nations Model Double Taxation Convention between Developed and Developing Countries	United Nations	Multilateral	(Model)	Adopted
1980	The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices	United Nations	Multilateral	Non-binding	Adopted
1980	Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data	OECD	Regional	Non-binding	Adopted
1980	Unified Agreement for the Investment of Arab Capital in the Arab States	League of Arab States	Regional	Binding	Adopted
1980	Treaty Establishing the Latin American Integration Association (LAIA)	LAIA	Regional	Binding	Adopted
1981	International Code of Marketing of Breast-milk Substitutes	World Health Organization	Multilateral	Non-binding	Adopted
1981	Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data	Council of Europe	Regional	Binding	Adopted
1981	Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organisation of the Islamic Conference	Islamic Conference	Regional	Binding	Adopted
1981	Treaty for the Establishment of the Preferential Trade Area for Eastern and Southern African States	Preferential Trade Area for Eastern and Southern African States	Regional	Binding	No longer in effect
1982	Community Investment Code of the Economic Community of the Great Lakes Countries (CEPGL)	CEPGL	Regional	Binding	Adopted
1983	Draft United Nations Code of Conduct on Transnational Corporations	United Nations	Multilateral	Non-binding	Not adopted

1983	Treaty for the Establishment of the Economic Community of Central African States	Economic Community of Central African States	Regional	Binding	Adopted
1985	Draft International Code of Conduct on the Transfer of Technology	United Nations	Multilateral	Non-binding	Adopted
1985	United Nations General Assembly Resolution 39/248: Guidelines for Consumer Protection	United Nations	Multilateral	Non-binding	Adopted
1985	Convention Establishing the Multilateral Investment Guarantee Agency	World Bank	Multilateral	Binding	Adopted
1985	Declaration on Transborder Data Flows	OECD	Regional	Non-binding	Adopted
1987	Agreement for the Establishment of a Regime for CARICOM Enterprises	Caribbean Common Market	Regional	Binding	Adopted
1987	Revised Basic Agreement on ASEAN Industrial Joint Ventures	ASEAN	Regional	Binding	Adopted
1987	An Agreement Among the Governments of Brunei Darussalam, the Republic of Indonesia, Malaysia, the Republic of the Philippines, the Republic of Singapore and the Kingdom of Thailand for the Promotion and Protection of Investments	Agreement mong the ASEAN countries	Regional	Binding	Adopted
1989	Fourth ACP-EEC Convention of Lomé	ACP-EU	Regional	Binding	Adopted
1990	Criteria for Sustainable Development Management: Towards Environmentally Sustainable Development	United Nations	Multilateral	Non-binding	Adopted
1990	Charter on a Regime of Multinational Industrial Enterprises in the Preferential Trade Area for Eastern and Southern African States	Preferential Trade Area for Eastern and Southern African States	Regional	Binding	Adopted

1991	Decision 291 of the Commission of the Cartagena Agreement: Common Code for the Treatment of Foreign Capital and on Trademarks, Patents, Licenses and Royalties	Andean Subregional Integration Group	Regional	Binding	Adopted
1991	Decision 292 of the Commission of the Cartagena Agreement. Uniform Code on Andean Multinational Enterprises	Andean Subregional Integration Group	Regional	Binding	Adopted
1991	The Business Charter for Sustainable Development: Principles for Environmental Management	International Chamber of Commerce	Non-governmental	Non-binding	Adopted
1992	Guidelines on the Treatment of Foreign Direct Investment	World Bank	Multilateral	Non-binding	Adopted
1992	Articles of Agreement of the Islamic Corporation for the Insurance of Investment and Export Credit	Islamic Conference	Regional	Binding	Adopted
1992	North American Free Trade Agreement	Canada, Mexico and the United States	Regional	Binding	Adopted
1992	The CERES Principles	CERES	Non-governmental	Non-binding	Adopted
1993	Permanent Court of Arbitration Optional Rules for Arbitrating Disputes between Two Parties of which only One is a State	Permanent Court of Arbitration	Multilateral	Binding	Adopted
1993	Treaty Establishing the Common Market for Eastern and Southern Africa	Common Market for Eastern and Southern Africa	Regional	Binding	Adopted
1994	Marrakesh Agreement Establishing the World Trade Organization. Annex 1A: Multilateral Agreements on Trade in Goods. Agreement on Trade-Related Investment Measures	World Trade Organization	Multilateral	Binding	Adopted

1994	Marrakesh Agreement Establishing the World Trade Organization. Annex 1B: General Agreement on Trade in Services and Ministerial Decisions Relating to the General Agreement on Trade in Services	World Trade Organization	Multilateral	Binding	Adopted
1994	Marrakesh Agreement Establishing the World Trade Organization. Annex 1C: Agreement on Trade-Related Aspects of Intellectual Property Rights	World Trade Organization	Multilateral	Binding	Adopted
1994	Protocol of Colonia for the Reciprocal Promotion and Protection of Investments in the MERCOSUR (Intra-zonal)	MERCOSUR	Regional	Binding	Adopted
1994	Recommendation of the Council on Bribery in International Business Transactions	OECD	Regional	Non-binding	Adopted
1994	Protocol on Promotion and Protection of Investments from States not Parties to MERCOSUR	MERCOSUR	Regional	Binding	Adopted
1994	APEC Non-Binding Investment Principles	APEC	Regional	Non-binding	Adopted
1994	Energy Charter Treaty	European Energy Charter Conference	Regional	Binding	Provisional application
1995	Consumer Charter for Global Business Consumers International		Non-governmental	Non-binding	Adopted
1995	Pacific Basin Charter on International Investments	Pacific Basin Economic Council	Non-governmental	Non-binding	Adopted

Despite this impressive number of international legal instruments, there is not, yet, a comprehensive international legal instrument regulating FDI on a multilateral level.[95] The

[95] See Burt, *supra* note 41 at 1015.

most comprehensive regulatory framework for FDI, still far from complete, can be found in some of the World Trade Organization (WTO) agreements, namely, the Agreement on Trade-Related Investment Measures (TRIMS Agreement),[96] the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement),[97] and the General Agreement on Trade in Services (GATS).[98] However, there have been efforts by developed countries, mainly in the Organization for Economic Cooperation and Development (OECD), to conclude a comprehensive multilateral agreement on investment.

The following part of this thesis analysis the FDI framework of the WTO. This is followed by an examination of the OECD multilateral agreement on investment.

1. The WTO FDI Regulatory Framework

1.1. Pre-Uruguay Round FDI Regulation

Prior to the Uruguay Round, the GATT framework barely contained any provisions regulating FDI. The General Agreement on Tariffs and Trade (GATT)[99] was a pure trade-oriented agreement that did not include any sort of FDI regulation. The Charter of the International Trade Organization (ITO),[100] however, included provisions regulating some

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[96] See *Agreement on Trade-Related Investment Measures*, 25 April 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Legal Instruments - Results of the Uruguay Round (1994) [hereinafter *TRIMS Agreement*].

[97] See *Agreement on Trade-Related Aspects of Intellectual Property Rights*, 15 April 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, Legal Instruments - Results of the Uruguay Round, vol. 31, 33 I.L.M. 1197 (1994) [hereinafter *TRIPS Agreement*].

[98] See *General Agreement on Trade in Services*, 15 April 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, Legal Instruments- Results of the Uruguay Round, 33 I.L.M. 1168 (1994) [hereinafter *GATS*].

[99] See *General Agreement on Tariffs and Trade*, 30 October 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter *GATT*].

[100] See *Charter for the International Trade Organization*, 24 March 1948, Final Act and Related Documents, U.N. Conf. on Trade and Employment, U.N. Doc. ICITO/1/4 (1948) [hereinafter *ITO Charter*].

aspects of FDI.[101] These provisions, however, were so rudimentary and were considered to be a codification of the existing international law at that time. Furthermore, since the ITO never came into existence, it can be correctly stated that prior to the Uruguay Round, the GATT framework did not include any investment regulation whatsoever.[102]

Due to the growing importance of FDI and its correlation with international trade, the GATT framework had to evolve to include some investment-oriented provisions. This need was clearly illustrated in the 1982 FIRA dispute between the US and Canada, which helped trigger the TRIMS Agreement.[103]

In the FIRA dispute, the US alleged that Canada's administration of its *Foreign Investment Review Act* (FIRA)[104] was inconsistent with GATT principles. The FIRA adopted a case-by-case approach in accepting FDI proposals. As a condition to entry, all FDI proposals had to be deemed of "significant benefit to Canada" in a review by the Canadian government.[105] It is worth noting that the FIRA did not include provisions imposing local content requirements or any other trade-related investment measures (TRIMS). It was through the negotiations

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[101] The main articles touching upon investment in the ITO Charter were Article 11, entitled "Means of Promoting Economic Development and Reconstruction" and Article 12, entitled "International Investment for Economic Development and Reconstruction". "The ITO investment provisions, however, were not demanding in their liberalization requirements. They required States to only "give due regard to the desirability of avoiding discrimination as between foreign investments". There was no obligation for national treatment or right of establishment in the ITO provisions, and the provisions did not cover investment incentives or performance requirements." Burt, *supra* note 41 at 1029.

[102] Some commentators believe that part of the reason behind the failure of the ITO was its investment provisions, which were considered to be too protective of MNEs by developing countries and too protective of host countries by developed countries. See *ibid.*

[103] See *Canada Administration of the Foreign Investment Review Act*, 7 February 1984, GATT B.I.S.D. (30th Supp.) at 140 (1984) [hereinafter *FIRA Dispute*].

[104] See *Act of Dec. 12, 1973, ch. 46, 1973-1974 S.C. 619 (Can.)*, as amended [hereinafter *FIRA*], repealed by *Investment Canada Act*, R.S.C., ch. 28, 46 (1st Supp. 1985), as amended.

[105] FIRA adopted general criteria to assist in determining the benefits of the investment for Canada. For example, Article 2(2)(a) included the following criteria: "The effect of the acquisition or establishment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on unemployment, on resource processing, on the utilization of parts, components and services produced in Canada, and on exports from Canada." *Ibid.*, art. 2(2)(a).

with the Canadian government, however, that foreign investors were pushed to accept performance requirements or undertakings, as the FIRA calls them. For example, when the American Apple Company wanted to invest in Canada, it was pressured to accept a number of undertakings. Thus, Apple undertook to purchase component parts of Canadian origin and to promote Canadian-made peripheral equipment to its dealers all around the world.[106]

The FIRA case panel reviewed the validity of two types of undertakings under the FIRA: (1) undertakings that require investors to purchase goods of certain origins (purchase undertakings), and (2) undertakings that require foreign investors to export a certain percentage of their production (export undertakings). Regarding purchase undertakings, the panel found such requirements to be inconsistent with GATT Article III:4, "National Treatment on Internal Taxation and Regulation". The panel concluded that "undertakings to purchase goods of Canadian origin without any qualification exclude the possibility of purchasing available imported products so that the latter are clearly treated less favourably than domestic products and that such requirements are therefore not consistent with Article III:4".[107] Nonetheless, in order to avoid applying GATT principles to FDI, the FIRA decision had to be based "on the discriminatory effects on those countries that would lose the opportunity to export goods to the investor" instead of "the discriminatory treatment to the foreign investor, *per se*".[108]

Although the US claimed that export undertakings infringe GATT Article XVII:1(c) because they deprive investors from operating on a commercial basis,[109] the panel did not find export

[106] See R.H. Edwards, "Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures" [Summer 1997] 33 Stan. J Int'l L. 169 at 189.
[107] *FIRA Dispute*, *supra* note 103 at 159.
[108] Burt, *supra* note 41 at 1030.
[109] Article XVII:1(a-c) provides that the Contracting Parties shall not prevent enterprises from acting in accordance with commercial considerations or in a manner consistent with the general principles of nondiscriminatory treatment set out in the GATT. See *GATT*, *supra* note 99, art. XVII:1(a-c). See also Edwards, *supra* note 106 at 190.

undertakings to be inconsistent with any of the GATT provisions.[110]

It should be noted that the findings of the panel do not necessarily apply in the case of developing countries. Since the FIRA dispute was between two developed countries, Argentina argued that "the provisions and arguments invoked against Canada were not necessarily those which could legitimately be invoked against developing countries, considering the protection which those countries have the right to grant under the General Agreement to their developing industries".[111] The panel confirmed this point and noted that "in disputes involving less-developed Contracting Parties full account should be taken of the special provisions in the General Agreement relating to these countries, such as Article XVIII:C".[112]

Some commentators argue, however, that a strict application of the GATT would lead to the prohibition of all performance requirements. Edwards asserts that:

> Although no single Article of GATT is applicable to all forms of [performance requirements], all [performance requirements] arguably violate one Article or another. Some [performance requirements] clearly run afoul of specific provisions while the case against other forms is weaker, given a strict construction of treaty obligations. Nonetheless, where obligations do not appear, on their face, to prohibit certain [performance requirements], the general intent and context of the GATT-MTN system should be considered. The system is intended to foster free trade, while [performance requirements] are protectionist measures. The presumption should, therefore, be against

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[110] It should be noted that some commentators consider this ruling problematic, "since binding export requirements are possibly the most trade-distorting of all TRIMS [trade-related investment measures]". Furthermore, export requirements "are one of the concerns high on the priority list of the industrialized countries, as these TRIMS may promote dumping in their home markets and disrupt trade flows to third country markets. This aspect of the FIRA Panel Report was therefore both troublesome and significant because it highlighted an important limitation of the GATT in addressing TRIMS." *Ibid.* at 191-192.

[111] *FIRA Dispute*, *supra* note 103 at 157.

[112] *Ibid.*, at 158. Although the panel asserted developing countries' right to have a different treatment than developed countries regarding trade-related investment measures (TRIMS), it did not elaborate on how this treatment would differ. See Edwards, *supra* note 106 at 191.

considering any [performance requirement] valid under GATT.[113]

Even though Edwards admits that this argument for broad applicability did not prevail in the Uruguay Round, he argues that "its reasoning should be used as a central guideline in the development of a new TRIMS Agreement".[114]

1.2. Post-Uruguay Round FDI Regulation

The Uruguay Round negotiations focused on the so-called "new issues", which included trade in services, trade-related investment measures, and intellectual property rights. The negotiations on these issues produced three agreements that regulate these matters respectively, the GATS, the TRIMS and the TRIPS Agreements. Although it might appear that the only investment-oriented agreement of the Uruguay Round is the TRIMS Agreement, the GATS and the TRIPS Agreement do regulate certain aspects of FDI.

1.2.1. The GATS

Due to the importance of trade in services in the world economy and to the large number of provisions relating to FDI in the GATS, many commentators believe that the GATS is the "true investment agreement of the Uruguay Round".[115] The following part analyses GATS rules as they relate to FDI.

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[113] *Ibid.*, at 190-191.

[114] *Ibid.*

[115] See OECD Trade Directorate, "Investment and the Final Act of the Uruguay Round: A Preliminary Stocktaking," OECD Doc. COM/TD/DAFFE/IME(94)56/REV 1 (1994) at 5 [hereinafter *OECD Uruguay Round Stocktaking*]. See also D.M. Price & P. Christy, III, "Agreement on Trade Related Investment Measures (TRIMS): Limitations and Prospects for the Future" in T.P. Stewart, ed., *The World Trade Organization: The Multilateral Trade Framework for the 21st Century and U.S. Implementing Legislation* (1996) 439 at 454.

1.2.1.1. Scope of Application

The GATS's scope of application as defined in Article I(1) extends to measures by member States that affect trade in services. Paragraph (2) of Article I defines trade in services as encompassing the supply of a service:

(a) from the territory of one Member into the territory of any other Member;

(b) in the territory of one Member to the service consumer of any other Member;

(c) by a service supplier of one Member, through commercial presence in the territory of any other Member;

(d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.[116]

Thus, although the GATS does not use the term FDI or even investment, its coverage of FDI is clearly derived from subparagraph (c), which extends to the supply of service through the establishment of a commercial presence in the territory of another GATS member.[117] Article XXVIII(2)(d) defines commercial presence as "any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service".[118]

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[116] *GATS*, *supra* note 98, art. I.

[117] "Negotiators chose the term "commercial presence" over "commercial establishment" because developing countries sought to avoid the possible interpretation of the commercial presence mode of delivery as constituting an absolute right of establishment." Burt, *supra* note 41 at 1031.

[118] *GATS*, *supra* note 98, art XXVIII(2)(d). It should be noted, however, that the definition of investment in the GATS is narrower than the asset based definition of investment in the Organization for Economic Cooperation and Development (OECD) multilateral agreement on investment (MAI). See *infra*, page 71 of this thesis. However, several commentators believe that the GATS still covers FDI. See *OECD Uruguay Round Stocktaking*, *supra* note 115 at 5.

1.2.1.2. Conditions for Entry

As with most developing countries' BITs, the GATS does not grant an absolute right of entry to foreign investors of other contracting States. In fact, the GATS does not grant any right of entry, but rather leaves the issue of market entry, to a large extent, to States' prudence. According to GATS Article XVI, States have full discretion to decide if they want to enter into market access obligations or not; and if they decide to enter into such commitments, they can specify, in their national schedules, the service sectors in which these obligations will be undertaken and the terms, limitations and conditions which will apply to the commitments. In other words, the GATS takes a positive list approach with respect to market access obligations and leaves the determination of this list to States' discretion.

Once market access commitments are, however, undertaken regarding certain sectors, Article XVI (2) provides a list of measures that member States are forbidden to maintain or adopt on the basis of either a regional subdivision or its entire territory. These measures are:

(a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;

(b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;

(c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;[119]

(d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;

(e) measures which restrict or require specific types of legal entity or joint

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[119] "Subparagraph 2(c) does not cover measures of a Member which limit inputs for the supply of services." *GATS, ibid.*, art. XVI(2), footnote.

venture through which a service supplier may supply a service; and

(f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.[120]

Obviously, these measures are not obligatory for States even with regard to service sectors in which States undertake market access commitments as the wording of Article XVI(2) clearly allows States to deviate from these measures by specifying so in their national schedules. However, the GATS subjects the regulation of market entry to the principle of MFN treatment.[121] Article XVI, entitled Market Access, provides that: "With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its national schedule."[122]

1.2.1.3. Treatment

The main treatment commitments under the GATS are the MFN treatment,[123] national treatment,[124] and transparency.[125]

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[120] *Ibid.*

[121] See J. Simser, "GATS and Financial Services: Redefining Borders" [Summer 1996] 3 Buff. J. Int'l L. 33 at 53, which notes that "Article XVI reaffirms MFN treatment to scheduled commitments".

[122] The GATS notes:

> If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(a) of Article I and if the cross-border movement of capital is an essential part of the service itself, that Member is thereby committed to allow such movement of capital. If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(c) of Article I, it is thereby committed to allow related transfers of capital into its territory.

GATS, supra note 98, art. XVI, footnote.

[123] GATS Article II(1) states that "[w]ith respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country". *Ibid.*, art. II(1).

[124] GATS Article XVII defines national treatment as treatment no less favourable than that which a State accords to its own like services and service suppliers. Paragraphs 2 and 3 of Article XVII

The GATS employs different approaches regarding the application of these obligations. While MFN treatment and transparency are considered to be general obligations that are imposed on all members in all service sectors, national treatment obligations are regarded as specific commitments that are limited to the sectors and modes of supply a State choses to record in its national schedule.

The GATS adopts a negative list approach regarding the MFN treatment principle; Article II(2) permits member States to maintain measures inconsistent with their MFN treatment obligations provided that such measures are "listed in, and [meet] the conditions of, the Annex on Article II Exemptions".[126] This means that the MFN treatment commitment is obligatory for all members and in all sectors, except for cases where a State files an exemption. As for national treatment commitments, the opposite approach is employed;[127] GATS Article XVII(1) adopts a positive list approach with regard to national treatment obligations and leaves the determination of this list to States' discretion. Accordingly, a State is obliged to respect the national treatment principle only for the sectors it chooses to include in its national schedule and subject to any conditions and limitations it wishes to apply thereto.

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elaborate that:

> [A] Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers. 3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

Ibid., art. XVII.

[125] The transparency obligation under GATS Article III consists of the publication of or making publicly available all State measures that affect trade in services including international agreements to which the member is a signatory. See *ibid.*, art. III.

[126] Furthermore, Article II(3) allows members to confer or accord "advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed". *Ibid.*, art. II(3)

[127] See Simser, *supra* note 121 at 47.

Beside the country specific exemptions, the GATS includes general and security exceptions. Members are exempted from their GATS obligations, in regard to measures adopted to, *inter alia*, preserve public order and human, animal and plant well-being, provided that such measures are applied in a nondiscriminatory fashion and do not constitute a disguised restriction on trade in services.[128]

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[128] Article XIV states:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:
(a) necessary to protect public morals or to maintain public order;
(b) necessary to protect human, animal or plant life or health;
(c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:
(i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;
(ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;
(iii) safety;
(d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members;
(e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound.

Article XIV*bis* reads:

1. Nothing in this Agreement shall be construed:
(a) to require any Member to furnish any information, the disclosure of which it considers contrary to its essential security interests; or
(b) to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests:
(i) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;
(ii) relating to fissionable and fusionable materials or the materials from which they are derived;
(iii) taken in time of war or other emergency in international relations; or
(c) to prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.
2. The Council for Trade in Services shall be informed to the fullest extent possible of measures taken under paragraphs 1(b) and (c) and of their termination.

GATS, *supra* note 98, arts. XIV & XIV*bis*.

The approaches that the GATS employs regarding its entry and treatment obligations, along with its general exceptions, considerably limit its extent of liberalization.[129] Although this limited liberalization might appear to be in line with the interests of developing countries only, the GATS contains a very reasonable balance of interests that accommodates the interests of both developed and developing countries. Indeed, although the GATS adopts this limited liberalization, it clearly states that its objective is to progressively achieve higher levels of liberalization through its progressive liberalization mechanism. Thus, the narrow liberalization of the GATS is balanced by its progressive liberalization mechanism,[130] which requires member States to enter into successive and periodical rounds of negotiations with the intention to achieve progressively higher levels of liberalization.[131] These negotiations, which should "take place with a view to promoting the interests of all participants on a mutually advantageous basis", must "be directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access".[132] Furthermore, Article XIX "seeks greater liberalization by requiring a review of the agreement by the year 2000 with the intention of broadening its scope".[133]

[129] Burt asserts that "[w]ith the national schedules of commitments qualifying most of the obligations of the Agreement, FDI liberalization through the GATS Agreement, in effect, is limited to the extent that members choose to enter upon specific liberalization commitments. The overall effect of GATS on the liberalization of FDI in services is, therefore, very limited." Burt, *supra* note 41 at 1033.

[130] Furthermore, the GATS grants developing countries preferential treatment in certain aspects, allowing flexible application of its rules to achieve a better balance of interests. For example, Article IV appeals to members to facilitate developing countries' access to their technology, information and distribution networks and to liberalize market access in sectors with developing countries' export potentials. *GATS*, *supra* note 98, art. IV.

[131] "Article XIX, however, qualifies the liberalization expectations for developing countries by stating that subsequent liberalization shall give due respect to national policy objectives and development levels. Further, it accepts the likelihood that developing country members will undertake liberalization commitments only commensurate with their level of development." Burt, *supra* note 40 at 1033. See also *GATS*, *ibid.*, art. XIX.

[132] *GATS*, *ibid.*, art. XIX.

[133] Burt, *supra* note 41 at 1033.

1.2.1.4. Monetary Transfers

As a general rule, the GATS guarantees the right of service providers to unrestricted international monetary transfers and payments.[134] However, as in most BITs with developing countries, the GATS includes an exception that allows countries to deviate from this obligation in cases of "serious [balance-of-payments] and external financial difficulties".[135] Nonetheless, this exception is not without limitations. Article XII(2) states that restrictions adopted under this exception on monetary transfers and payments:

> (a) shall not discriminate among Members;
> (b) shall be consistent with the Articles of Agreement of the International Monetary Fund;
> (c) shall avoid unnecessary damage to the commercial, economic and financial interests of any other Member;
> (d) shall not exceed those necessary to deal with the circumstances described in paragraph 1;
> (e) shall be temporary and be phased out progressively as the situation specified in paragraph 1 improves.[136]

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[134] Article XI(1) provides that "a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments". Paragraph (2) of Article XI, however, provides that nothing in the GATS

> shall affect the rights and obligations of the members of the International Monetary Fund under the Articles of Agreement of the Fund, including the use of exchange actions which are in conformity with the Articles of Agreement, provided that a Member shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions, except under Article XII or at the request of the Fund.

GATS, *supra* note 98, art. XI(1-2).

[135] Article XII(1) reads:

> In the event of serious balance of payments and external financial difficulties or threat thereof, a Member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments, including on payments or transfers for transactions related to such commitments. It is recognized that particular pressures on the balance of payments of a Member in the process of economic development or economic transition may necessitate the use of restrictions to ensure, *inter alia*, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development or economic transition.

Ibid., art. XII(1).

[136] *Ibid.*, art. XII(2).

Paragraph (3) of Article XII allows Members, in determining the incidence of such restrictions, to "give priority to the supply of services which are more essential to their economic or development programmes".[137] However, paragraph (3) prohibits such restrictions to "be adopted or maintained for the purpose of protecting a particular service sector".[138]

Furthermore, paragraph (4) of Article XII obliges States to promptly notify the General Council of the adoption or maintenance of such restrictions.[139] Members are also required to promptly consult with the Committee on Balance of Payments Restrictions regarding restrictions adopted under Article XII.[140] Paragraph 5 (b) of Article XII gives the Ministerial Conference the jurisdiction to "establish procedures[141] for periodic consultations with the objective of enabling such recommendations to be made to the Member concerned as it may deem appropriate".[142]

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[137] *Ibid.*, art. XII(3).

[138] *Ibid.*

[139] See *ibid.*, art. XII(4).

[140] See *ibid.*, art. XII(5)(a).

[141] For the procedures under this paragraph, the GATS incorporates the same procedures of the GATT 1994. See *ibid.*, art. XII, footnote.

[142] Article XII(5)(c-e) regulates the consultations as follows:

(c) Such consultations shall assess the balance of payment situation of the Member concerned and the restrictions adopted or maintained under this Article, taking into account, *inter alia*, such factors as:

(i) the nature and extent of the balance of payments and the external financial difficulties;

(ii) the external economic and trading environment of the consulting Member;

(iii) alternative corrective measures which may be available.

(d) The consultations shall address the compliance of any restrictions with paragraph 2, in particular the progressive phaseout of restrictions in accordance with paragraph 2(e).

(e) In such consultations, all findings of statistical and other facts presented by the International Monetary Fund relating to foreign exchange, monetary reserves and balance of payments, shall be accepted and conclusions shall be based on the assessment by the Fund of the balance of payments and the external financial situation of the consulting Member.

As for GATS members that are not members of the International Monetary Fund, Article XII(6) gives the Ministerial Conference the jurisdiction to "establish a review procedure and any other procedures necessary" for such cases. *Ibid.*, art. XII(5-6).

1.2.1.5. Settlement of Disputes

The GATS only regulates State-State disputes. Thus, the GATS dispute settlement mechanism can be employed whenever a member claims that another member's failure to fulfill its GATS obligations results in the nullification or impairment of a benefit (or even just a reasonable expectation of a benefit)[143] accruing to it under the GATS.

GATS Articles XXII and XXIII incorporate the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).[144] According to GATS Article XXII, consultations is the first approach to solving disputes between members. Paragraph (1) of Article XXII provides that member States "shall accord sympathetic consideration to, and shall afford adequate opportunity for, consultation regarding such representations as may be made by any other Member with respect to any matter affecting the operation of [the GATS]".[145] The paragraph then states that the "Dispute Settlement Understanding (DSU) shall apply to such consultations".[146] According to the DSU, the member requesting

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[143] GATS Article XXIII(3) provides that:

> If any Member considers that any benefit it could reasonably have expected to accrue to it under a specific commitment of another Member under Part III of this Agreement is being nullified or impaired as a result of the application of any measure which does not conflict with the provisions of this Agreement, it may have recourse to the DSU [Dispute Settlement Understanding]. If the measure is determined by the DSB [Dispute Settlement Body] to have nullified or impaired such a benefit, the Member affected shall be entitled to a mutually satisfactory adjustment on the basis of paragraph 2 of Article XXI, which may include the modification or withdrawal of the measure. In the event an agreement cannot be reached between the Members concerned, Article 22 of the DSU shall apply.

Ibid., art. XXIII(3).

[144] See *General Agreement on Tariffs and Trade-Multilateral Trade Negotiations (the Uruguay Round): Understanding on Rules and Procedures Governing the Settlement of Disputes*, 15 December 1993, 33 I.L.M. 112 [hereinafter *DSU*]. The DSU is incorporated into the GATS and GATT through the same numbered Articles XXII and XXIII. See *GATS*, *ibid.*, arts. XXII & XXIII; *GATT*, *supra* note 99, arts. XXII & XXIII.

[145] *GATS*, *ibid.*, art. XXII(1). Article XXII(2) gives the Council for Trade in Services or the Dispute Settlement Body (DSB) to, upon the request of a Member, "consult with any Member or Members in respect of any matter for which it has not been possible to find a satisfactory solution through consultation under paragraph 1". *Ibid.*, art. XXII(2).

[146] *Ibid.*

consultation should make a written request to the other member in dispute, to which the latter should reply within 10 days after the date of its receipt and should "enter into consultations in good faith within a period of no more than 30 days after the date of receipt of the request, with a view to reaching a mutually satisfactory solution".[147] If the consultations, however, prove unsuccessful within 60 days after the date of receipt of the request for consultations, the member seeking consultations may request the establishment of a dispute settlement panel.[148]

Upon the request of the complaining party, the Dispute Settlement Body (DSB) must establish such a panel in a very short period of time ("at the latest at the DSB meeting following that at which the request first appears as an item on the DSB's agenda"),[149] in order to "examine, in the light of the relevant provisions..., the matter referred to the DSB by [the complaining party] and to make such findings as will assist the DSB in making the recommendations...".[150]

After the establishment of the panel, the dispute is subjected to a fast and effective process and deadlines; the panel should conduct its examination of the dispute and circulate its final

[147] "If the Member does not respond within 10 days after the date of receipt of the request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, after the date of receipt of the request, then the Member that requested the holding of consultations may proceed directly to request the establishment of a panel." *DSU*, *supra* note 144, art. 4(3).

[148] Furthermore, the complaining party "may request a panel during the 60-day period if the consulting parties jointly consider that consultations have failed to settle the dispute". *Ibid.*, art. 4(7). Article 5 of the DSU Permits the contracting parties to have recourse to "Good offices, conciliation and mediation". According to paragraph (3) of Article 5, "Good offices, conciliation or mediation may be requested at any time by any party to a dispute [and]... may be terminated at any time. Once procedures for good offices, conciliation or mediation are terminated, a complaining party may then proceed with a request for the establishment of a panel." *Ibid.*, art. 5.

[149] *Ibid.*, art. 6(1). Note that Article XXIII(2) of the GATS empowers the DSB to "authorize a Member or Members to suspend the application to any other Member or Members of obligations and specific commitments in accordance with Article 22 of the DSU", if it deems the circumstances "serious enough to justify such action". *GATS*, *supra* note 98, art. XXIII(2).

[150] *DSU*, *supra* note 144, art 7(1).

report to the disputing parties within 6 months from the date of its composition;[151] and the report of the panel should be adopted by the DSB within 60 days after its circulation to the members in dispute, "unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report".[152] In this case, a standing Appellate Body should be established by the DSB to view the appeal.[153] The Appellant Body should submit its final report to the DSB for adoption within "60 days from the date a party to the dispute formally notifies its decision to appeal to the date the Appellate Body circulates its report".[154] In any case, a dispute settlement decision should be rendered by the DSB within a maximum of 9 months (or 12 months where the report is appealed) from the date of the establishment of the panel.[155]

1.2.2. The TRIMS Agreement

The Uruguay Round negotiations leading to the conclusion of the TRIMS Agreement demonstrated the inherent conflict between developed and developing countries regarding FDI regulation. Developed countries, led by the US, were of the opinion that TRIMS are a

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[151] However, "[i]n cases of urgency, including those relating to perishable goods, the panel shall aim to issue its report to the parties to the dispute within three months". *Ibid*, art. 12(8). Furthermore, [w]hen the panel considers that it cannot issue its report within six months, or within three months in cases of urgency, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will issue its report. In no case should the period from the establishment of the panel to the circulation of the report to the Members exceed nine months." *Ibid.*, art. 12(9).

[152] *Ibid.*, art. 16(4).

[153] *Ibid.*, art. 17(1). Paragraph (6) of Article 17 limits an appeal "to issues of law covered in the panel report and legal interpretations developed by the panel". *Ibid.*, art. 17(6).

[154] However, "[w]hen the Appellate Body considers that it cannot provide its report within 60 days, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. In no case shall the proceedings exceed 90 days." *Ibid.*, art. 17(5).

[155] "Where either the panel or the Appellate Body has acted, pursuant to paragraph 9 of Article 12 or paragraph 5 of Article 17, to extend the time for providing its report, the additional time taken shall be added to the above periods." *Ibid.*, art. 20.

barrier to a liberal trade regime.[156] Their initial negotiation agenda aimed at establishing a "GATT for investment".[157] Developing countries, on the other hand, asserted that the use of TRIMS is justified as a means to encounter abusive MNEs practices,[158] and to channel FDI towards their development objectives.[159] Accordingly, developing countries aimed at limiting the scope of TRIMS negotiations to measures "with direct and significantly adverse trade effects" only.[160] An examination of the TRIMS Agreement reveals developing countries' success in narrowing its scope.

The scope of application of the TRIMS Agreement is defined in its Article 1 which states that it "applies to investment measures related to trade in goods only".[161] TRIMS are basically investment restrictions imposed by host countries that directly affect trade flows by either restricting imports or exports or requiring imports or exports.[162] Thus, by definition, the

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[156] The US proposed a comprehensive list of TRIMS that it considered to be trade-distorting. The list included:

> local content requirements, export performance requirements, trade balancing requirements, product mandating requirements, domestic sales restrictions, foreign exchange and remittance restrictions, local equity requirements, technology transfer and licensing requirements, and investment incentives. The European Union supported the United States in all but technology transfer requirements and local equity restrictions. Japan supported all but local equity restrictions.

Burt, *supra* note 41 at 1034.

[157] P. Low & A. Subramanian, "Beyond TRIMS: A Case for Multilateral Action on Investment Rules and Competition Policy?" in W. Martin & L.A. Winters, eds., *The Uruguay Round and the Developing Countries* (New York: Cambridge University, 1996) 380-408 at 380.

[158] For the definition of restrictive business practices, see *supra* note 34.

[159] Developing countries' opinion was that:

> If an agreement were to prohibit TRIMS without addressing the trade-distorting practices of MNEs, it would result in an inequitable, one-sided agreement. They argued, therefore, that GATT should consider an agreement subjecting trade-distorting restrictive business practices to GATT principles to accompany any agreement that subjected TRIMS to GATT principles.

Burt, *supra* note 41 at 1034.

[160] *Ibid.*

[161] *TRIMS Agreement*, *supra* note 96, art. 1.

[162] Low and Subramanian define TRIMS as "measures employed usually, but not exclusively, by developing countries to compel or induce multinational enterprises to meet certain yardsticks of performance. They tend to be concentrated in specific industries: automotive, chemical and petrochemical, and computer/informatics." Low & Subramanian, *supra* note 157 at 380-381.

TRIMS Agreement has a very narrow scope; first, according to its Article 1, the TRIMS Agreement applies only to investment measures, leaving several other important aspects of FDI unregulated; the TRIMS Agreement does not, for example, cover FDI screening, establishment rights, profit repatriation, expropriation and compensation issues.[163] Furthermore, the TRIMS Agreement does not even cover all investment measures: the TRIMS Agreement only deals with trade-related investment measures. These include "local content requirements, trade balancing requirements, general import restrictions, trade balancing restrictions, foreign exchange balancing restrictions on imports, domestic sales requirements (export restrictions)".[164] Investment measures that are not trade-related and thus not covered by the TRIMS Agreement include: "local equity requirements, technology transfer and licensing requirements, local manufacturing requirements, personnel entry restrictions, local employment requirements, remittance restrictions, and export performance requirements, among others".[165]

TRIMS are dealt with in the TRIMS Agreement by simply applying the existing GATT Articles to them.[166] Article 2(1) of the TRIMS Agreement proscribes trade-distorting

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[163] See Burt, *supra* note 41 at 1038.

[164] *Ibid.*, at 1037.

[165] It should be noted that several commentators criticized the lack of provisions dealing with export performance requirements in particular. Burt considers that "[t]he absence of a prohibition on export performance requirements, in particular, is a substantial failure of the agreement because export subsidies, which are closely related, are prohibited under the international trading system". Burt, *supra* note 41 at 1038. P. Low and A. Subramanian argue that the "most serious failure of the TRIMS Agreement lies in not addressing export-performance requirements". They consider "[a]llowing export-performance requirements, while prohibiting their close cousins, export subsidies (in manufacturing), [as] an unjustifiable anomaly in GATT's legal framework". It should be noted, however, that not all developing countries were strictly resisting export performance requirements; as Low and Subramanian explain, large developing countries, such as India, "resisted attempts to prohibit them because of a continuing desire to extract export performance from foreign enterprises in return for the carrot of entry into their large, protected markets. Smaller, more open developing countries, cognizant of the ability of large countries to divert investment away from them, were correspondingly more willing to eliminate export-performance requirements." Low & Subramanian, *supra* note 157 at 388.

[166] Some commentators consider the approach of regulating TRIMS in this manner, *i.e.*, prohibiting TRIMS that are inconsistent with some GATT's principles, to further limit the scope of the TRIMS Agreement. "Although the Agreement specifies that certain TRIMS are prohibited, it does so only in

investment measures that are inconsistent with GATT Articles III (national treatment) and XI (prohibition on quantitative restrictions).[167] The Annex to the TRIMS Agreement provides an illustrative list of such measures.[168] According to the Annex, investment measures which are inconsistent with the GATT's national treatment obligation and the GATT's obligation of general elimination of quantitative restrictions "include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage". Investment measures which are violative of GATT's national treatment obligation include those that require:

(a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or

(b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.[169]

TRIMS inconsistent with the GATT's obligation of general elimination of quantitative restrictions include those which restrict:

(a) the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;

(b) the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related

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the context of existing GATT articles. Thus, other trade-distorting TRIMS that arguably violate the intent and spirit of the GATT are still permitted." Edwards, *supra* note 106 at 196.

[167] Article 2(1) states: "Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994." *TRIMS Agreement*, *supra* note 96, art. 2(1).

[168] Article 2(2) states: "An illustrative list of TRIMS that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in the Annex to this Agreement." *Ibid.*, art. 2(2).

[169] *Ibid.*, ann.

to the foreign exchange inflows attributable to the enterprise; or

(c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.[170]

The extent of liberalization of the TRIMS Agreement is further narrowed by the important exceptions it introduces. First of all, Article 3 explicitly provides that all exceptions under GATT 1994 are applied, as appropriate, to the provisions of the TRIMS Agreement.[171] Furthermore, Article 4 grants developing countries the right to deviate from their obligations under Article 2 of the TRIMS Agreement in cases of balance-of-payments difficulties, in accordance with GATT Article XVIII.[172] Moreover, Article 5(2) gives countries a transition period before eliminating all TRIMS inconsistent with the TRIMS Agreement. This period is two years for developed countries, five years for developing countries, and seven years for the least-developed countries.[173]

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[170] *Ibid.* It should be noted that the transparency article of the TRIMS Agreement obliges members to notify the WTO Secretariat of existing TRIMS and to provide additional information to member States in that regard upon request. *Ibid.*, art 6.

[171] See *ibid.*, art. 3.

[172] Article 4 states:

> A developing country Member shall be free to deviate temporarily from the provisions of Article 2 to the extent and in such a manner as Article XVIII of GATT 1994, the Understanding on the Balance of Payments Provisions of GATT 1994, and the Declaration on Trade Measures Taken for Balance of Payments Purposes adopted on 28 November 1979 (BISD 26S/205-209) permit the Member to deviate from the provisions of Articles III and XI of GATT 1994.

Ibid., art. 4.

[173] Article 5(2) states: "Each Member shall eliminate all TRIMS which are notified under paragraph 1 within two years of the date of entry into force of the WTO Agreement in the case of a developed country Member, within five years in the case of a developing country Member, and within seven years in the case of a least-developed country Member." It should be noted, however, that the TRIMS Agreement, unlike the GATS, does not permit selective liberalization through a country's national schedule of commitments, but rather the TRIMS Agreement's prohibitions apply universally after the expiration of a phase-in period. *Ibid.*, art. 5.

Nonetheless, Article 9 requires a review of the TRIMS Agreement at the turn of the century by the Council for Trade in Goods.[174] After reviewing the operation of the TRIMS Agreement, the Council for Trade in Goods must make proposals for textual amendments to the Ministerial Conference. The review by the Council for Trade in Goods must consider the need to complement the TRIMS Agreement "with provisions on investment policy and competition policy".[175]

As for the settlement of disputes, the TRIMS Agreement takes a similar approach to that of the GATS; the TRIMS Agreement incorporates the GATT settlement of dispute mechanism and the DSU. Article 8 of the TRIMS Agreement clearly states that "[t]he provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding, shall apply to consultations and the settlement of disputes under [the TRIMS Agreement]".[176]

1.2.3. The TRIPS Agreement

The TRIPS Agreement complements the WTO framework regarding FDI regulation. The TRIPS Agreement provides the necessary protection for the transfer of technology through FDI operations. Article 7 of the TRIPS Agreement clearly states that the objective of the Agreement is to facilitate and provide adequate protection for technology transfers.[177]

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[174] See *ibid.*, art. 9.

[175] Article 9 states:

> Not later than five years after the date of entry into force of the WTO Agreement, the Council for Trade in Goods shall review the operation of this Agreement and, as appropriate, propose to the Ministerial Conference amendments to its text. In the course of this review, the Council for Trade in Goods shall consider whether the Agreement should be complemented with provisions on investment policy and competition policy.

Ibid.

[176] *Ibid.*, art. 8.

[177] Article 7 states:"The protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations." *TRIPS Agreement, supra* note 97, art. 7.

This is believed to be advantageous for both MNEs and host developing countries[178] as it provides crucial protection for FDI by MNEs with intellectual property as their core competence and, at the same time, gives incentives for MNEs to undertake technological transfers to host countries.[179]

Although it is generally believed that there is a positive relation between the level of protection in a country's intellectual property rights laws and its attractiveness to FDI as an investment site, some commentators believe that "the magnitude of the impact of weak protection on FDI decisions is debatable".[180] One commentator argues the following:

> First, evidence based on surveys of foreign investors that identify IPRs [intellectual property rights] as a relevant variable for FDI decisions tend also to point out that other considerations --in essence, the overall investment climate of the country-- are more

[178] See Burt, *supra* note 41 at 1039.

[179] However, some commentators believe that the TRIPS Agreement favours developed countries and that developing countries accepted this as a trade off for the other advantages they obtained in the Uruguay Round, especially those relating to market access. Hertz asserts that:

> [G]uaranteed access to the world's most significant markets ... was a key consideration for developing countries seeking to attract foreign investment and to increase their exports to rich markets in developed countries. However, the developing countries weie generally cool to IPRs which were seen to favour some developed countries as net exporters of technology and copyright product. Without the tempting carrot of market access, there would have been very little to induce developing countries to accept both the substantive TRIPS standards and the accompanying WTO dispute settlement procedures. In other words, going to Marrakesh to sign the Uruguay Round Final Act, a great many States knew they were swallowing the bitter pill of IPRs with effective dispute settlement in return for access to a range of benefits in trade in goods...the TRIPS Agreement consequently provide[s] Parties with a very strong incentive to fulfil their IP obligations, since they know that failure to perform may lead to suspension of valuable trade concessions because of an adverse panel finding.

A.Z. Hertz, "Proceedings of the Canada-united States Law Institute Conference: NAFTA Revisited: Shaping the Trident: Intellectual Property Under NAFTA, Investment Protection Agreements and At the World Trade Organization" (1997) 23 Can.-U.S. L.J. 261 at 280. For an elaborated assessment of the impact of the TRIPS Agreement on developing countries, see C.A. Primo Braga, "Trade-related Intellectual Property Issues: The Uruguay Round Agreement and its Economic Impact", in W. Martin & L.A. Winters, eds., *The Uruguay Round and the Developing Countries* (New York: Cambridge University, 1996) at 341-379. See also *U.N. Conference on Trade & Dev., The TRIPS Agreement and Developing Countries* (U.N. Sales No. E.96.II.D.10) (1996); F.M. Abbott, "The WTO TRIPS Agreement and Global Economic Development" (1996) 72 Chi-Kent L. Rev. 385 at 387-389.

[180] See Primo Braga, *supra* note 179 at 362.

important (Frischtak 1989). Second, ... FDI may replace trade flows as firms try to maintain control of proprietary information in countries with weak IPR protection. In this case, the impact of TRIPS would be to diminish the incentives of R&D-intensive industries for FDI at the margin (Maskus and Konan 1994).[181]

Nonetheless, the fact that the extent of intellectual property rights (IPRs) protection on the location decision of FDI is limited does not render IPRs protection unrelated to FDI regulation. On the contrary, any complete regulation of FDI should address the matter of IPRs protection since IPRs policies certainly affect FDI operations.

Like the GATT, the GATS and the TRIMS Agreement, the TRIPS Agreement is based on the foundations of the MFN treatment, national treatment and transparency principles.[182] Article 3 stipulates that a member "shall accord to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection[183] of intellectual property[184]".[185]

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[181] *Ibid.*

[182] However, the TRIPS Agreement includes several other detailed and substantive obligations regarding the standards concerning the availability, scope, use, enforcement, acquisition and maintenance of intellectual property rights. See *TRIPS Agreement, supra* note 97, parts II-IV.

[183] For the purposes of Articles 3 and 4, the term "protection" includes "matters affecting the availability, acquisition, scope, maintenance and enforcement of intellectual property rights as well as those matters affecting the use of intellectual property rights specifically addressed in [the TRIPS Agreement]". *Ibid.*, art. 3.

[184] Article 1(2) acknowledges that "the term "intellectual property" refers to all categories of intellectual property that are the subject of Sections 1 through 7 of Part II". These categories, according to Part three, are: 1. Copyright and Related Rights. 2. Trademarks. 3.Geographical Indications. 4. Industrial Designs. 5. Patents. 6. Layout-Designs (Topographies) of Integrated Circuits. 7. Protection of Undisclosed Information. 8.Control of Anti-Competitive Practices in Contractual Licences. *Ibid.*, art. 1(2).

[185] The TRIPS Agreement establishes a number of exemption regarding these principles. The national treatment principle, as Article 3 states, is subject to

> the exceptions already provided in, respectively, the Paris Convention (1967), the Berne Convention (1971), the Rome Convention or the Treaty on Intellectual Property in Respect of Integrated Circuits. In respect of performers, producers of phonograms and broadcasting organizations, this obligation only applies in respect of the rights provided under this Agreement. Any Member availing itself of the possibilities provided in Article 6 of the Berne Convention (1971) or paragraph 1(b) of Article 16 of the Rome Convention shall make a notification as foreseen in those provisions to the Council for TRIPS.

Article 4 provides that "any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members".[186] The transparency principle, introduced in Article 63(1), obliges member States to publish their laws and regulations, along with any final judicial decisions and administrative rulings related to the TRIPS Agreement.[187]

Developing and least-developed countries get a slightly more favourable treatment than developed countries under the TRIPS Agreement. Article 65 grants developing countries an extra four-year delay in applying the TRIPS Agreement, except for Articles 3 and 4 (national

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Furthermore, paragraph (2) of Article 3 provides:

> Members may avail themselves of the exceptions permitted under paragraph 1 in relation to judicial and administrative procedures, including the designation of an address for service or the appointment of an agent within the jurisdiction of a Member, only where such exceptions are necessary to secure compliance with laws and regulations which are not inconsistent with the provisions of this Agreement and where such practices are not applied in a manner which would constitute a disguised restriction on trade.

As for MFN exemptions, they are:

> any advantage, favour, privilege or immunity accorded by a Member:
> (a) deriving from international agreements on judicial assistance or law enforcement of a general nature and not particularly confined to the protection of intellectual property;
> (b) granted in accordance with the provisions of the Berne Convention (1971) or the Rome Convention authorizing that the treatment accorded be a function not of national treatment but of the treatment accorded in another country;
> (c) in respect of the rights of performers, producers of phonograms and broadcasting organizations not provided under this Agreement;
> (d) deriving from international agreements related to the protection of intellectual property which entered into force prior to the entry into force of the WTO Agreement, provided that such agreements are notified to the Council for TRIPS and do not constitute an arbitrary or unjustifiable discrimination against nationals of other Members.

Ibid., arts. 3 & 4.

[186] *Ibid.*, art. 4.

[187] Article 63(1) states:

> Laws and regulations, and final judicial decisions and administrative rulings of general application, made effective by a Member pertaining to the subject matter of this Agreement (the availability, scope, acquisition, enforcement and prevention of the abuse of intellectual property rights) shall be published, or where such publication is not practicable made publicly available, in a national language, in such a manner as to enable governments and right holders to become acquainted with them. Agreements concerning the subject matter of this Agreement which are in force between the government or a governmental agency of a Member and the government or a governmental agency of another Member shall also be published.

Ibid., art. 63(1).

treatment and MFN treatment);[188] and Article 66 relieves least-developed country members of applying the provisions of the TRIPS Agreement, other than Articles 3, 4 and 5, for a period of 10 years from the date of its application.[189] Moreover, Article 66 allows the Council for TRIPS to extend this period for least-developed member countries upon their request.[190] Furthermore, paragraph (2) of Article 66 calls on developed member countries to "provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least-developed country Members in order to enable them to create a sound and viable technological base".[191]

As for the settlement of disputes, the TRIPS Agreement takes the same approach as that of the TRIMS Agreement; it incorporates the GATT's dispute settlement mechanism and the DSU. As stated in Article 64(1), the "provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding ... apply to consultations and the settlement of disputes under [the TRIPS Agreement] except as otherwise specifically provided [in it]".[192]

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[188] *Ibid.*, art. 65. However, Paragraph (5) obliges a member that avails itself of a transitional period under Paragraphs 1, 2, 3 or 4 to "ensure that any changes in its laws, regulations and practice made during that period do not result in a lesser degree of consistency with the provisions of this Agreement". *Ibid.*, art. 65(5).

[189] See *ibid.*, art. 66.

[190] See *ibid.*

[191] *Ibid.* Moreover, Article 67, entitled Technical Cooperation, provides that:

> [D]eveloped country Members shall provide, on request and on mutually agreed terms and conditions, technical and financial cooperation in favour of developing and least-developed country Members. Such cooperation shall include assistance in the preparation of laws and regulations on the protection and enforcement of intellectual property rights as well as on the prevention of their abuse, and shall include support regarding the establishment or reinforcement of domestic offices and agencies relevant to these matters, including the training of personnel.

Ibid., art. 67.

[192] Paragraphs 2 and 3 of Article 64 read as follows:

> 2. Subparagraphs 1(b) and 1(c) of Article XXIII of GATT 1994 shall not apply to the settlement of disputes under this Agreement for a period of five years from the date of entry into force of the WTO Agreement.
>
> 3. During the time period referred to in paragraph 2, the Council for TRIPS shall examine the scope and modalities for complaints of the type provided for under subparagraphs 1(b) and 1(c) of Article XXIII of GATT 1994 made pursuant to this Agreement, and submit its

1.2.4. Conclusion

Developing countries consider regulating investment policies a sovereign right necessitated by national economic considerations. Their opposition in the WTO has lead to a moderately restricted and narrow regulation of FDI. An examination of the WTO framework for regulating FDI reveals the developing countries' success in limiting its degree of liberalization and narrowing its scope.

Just as the TRIPS Agreement is limited to trade-related aspects of intellectual property rights, the GATS is also by definition limited to investments related to trade in services and, furthermore, allows several general and country specific exceptions to deviate from the obligations it imposes. The TRIMS Agreement, moreover, is also limited in scope; it deals only with investment measures, leaving other important aspects of FDI unregulated, such as FDI screening, establishment rights, profit repatriation, expropriation and compensation issues. Additionally, the TRIMS Agreement does not even cover all investment measures as it only deals with trade-related investment measures and, further, gives space to important exceptions to the application of its provisions.

Although most developing countries regard the balance of interests of the WTO FDI framework considerably fair, developed countries view it as only a moderate first step towards a more comprehensive and liberal FDI regulation. Thus, the battle between developed and developing countries over regulating FDI in the WTO perpetuated after the Uruguay Round and is still alive to date.

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recommendations to the Ministerial Conference for approval. Any decision of the Ministerial Conference to approve such recommendations or to extend the period in paragraph 2 shall be made only by consensus, and approved recommendations shall be effective for all Members without further formal acceptance process.

Ibid., art. 64(2-3).

Before the WTO Singapore Ministerial Conference, a number of developing countries met in New Delhi, India in September 1996 and formed a coalition to coordinate their oppositions to the expansion of the TRIMS Agreement.[193] The 13 developing countries (Bangladesh, Cuba, Egypt, Ghana, India, Indonesia, Kenya, Malaysia, Mauritius, Tanzania, Thailand, Venezuela, and Zimbabwe, supported also by Pakistan and Sri Lanka) clearly expressed their rejection of expanding investment negotiations in the WTO on the basis of the WTO's incompetence in the field of investment.[194] Although several countries left the coalition leaving only Egypt, India, Indonesia, Malaysia, Pakistan, and Tanzania in it, the coalition did not fall apart.[195]

At the Singapore Ministerial Conference, the coalition of developing countries opposed including FDI in the framework of the WTO.[196] Developed countries, on the other hand, considered investment as a top priority issue for the WTO that would benefit developed and

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[193] Note that UNCTAD also organized two events in New Delhi on 15/17 July to discuss the matter of "international investment arrangements and their implications for developing countries/development dimension".

> The first event was a 2-day symposium for civil servants from Asian countries organised in association with the Government of India. Few NGOs and research institutions were also invited. The second event was a half-day panel discussion with NGOs and media in India organised in association with the CUTS Centre for International Trade, Economics and Environment and the Rajiv Gandhi Institute for Contemporary Studies.

The consensus that emerged from the symposium was that developing countries "should examine their national priorities when allowing FDI into the country". P.S. Mehta, "POV: The Pervasive MAI Mantra!" 21 August 1998, Press Release from Friends of the Earth International re: MAI and Human Rights, http://www.islandnet.com/~ncfs/maisite/pov-mai2.htm (date accessed: 28 December 1998).

[194] See "Developing Nations Oppose Investment Pact" *Times of India* (1 October 1996) at 15.

[195] See F. Williams, "WTO Push for Investment Rules Pact: Developing Countries Divided Despite Ruggiero's Assertion of a Compelling Case" *Financial Times* (17 October 1996) 4; F. Williams, "US May Block WTO Draft" *Financial Times* (4 November 1996) 6.

[196] See, for example, the Statements of India, Indonesia and Malaysia at the 1996 WTO Ministerial Conference, *World Trade Organization Secretariat, India: Statement by Dr. B.B. Ramaiah, Minister of Commerce*, WT/MIN(96)/ST/27 (Ministerial Conference, 9 December 1996). See also *World Trade Organization Secretariat, Indonesia: Statement by H.E. Mr. Tungky Ariwibowo, Minister of Industry and Trade*, WT/MIN(96)/ST/22 (Ministerial Conference, 9 December 1996); *World Trade Organization Secretariat, Malaysia: Statement by the Honorable Dato' Seri Rafidah Aziz, Minister of International Trade and Industry*, WT/MIN(96)/ST/64 (Ministerial Conference, 11 December 1996).

developing countries alike.[197] The compromise at the Singapore Ministerial Conference between the coalition of developing and developed countries was to establish a WTO working group on direct investment.[198] Upon the insistence of the coalition of developing countries, however, the working group's authority was limited to only examining the possible broadening "of the TRIMS Agreement, which the Agreement itself mandates".[199] The Singapore Declaration explicitly acknowledged that the establishment of the working group on investment "shall not prejudge whether negotiations will be initiated in the future" and that such negotiations will only commence after an "explicit consensus decision" of member States.[200]

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[197] See, for example, the Statement of the E.U. at the 1996 WTO Ministerial Conference, *World Trade Organization Secretariat, European Communities, Commission of the European Communities: Statement by Sir Leon Brittan Q.C., Vice-President of the European Commission*, WT/MIN(96)/ST/2 (Ministerial Conference, 9 December 1996).

[198] See *World Trade Organization Secretariat, Singapore Ministerial Declaration*, para. 20, WT/MIN(96)/DEC (adopted on 13 December 1996), reprinted in "Singapore Ministerial Declaration (World Trade Organization, Geneva, Switzerland)" [January 1997] World Focus 7 at 10 [hereinafter *Singapore Declaration*].

[199] "India, in particular, insists that it will resist any multilateral agreement on direct investment in the WTO." Burt, *supra* note 41 at 1017.

[200] *Singapore Declaration, supra* note 198. Burt asserts:

> India stands as perhaps the primary obstacle to the commencement of negotiations on direct investment. Although India eventually agreed to the establishment of a working group on investment, bowing to pressure from developed countries and the isolation created by the collapse of the developing country coalition, it maintains that it will resist the start of any new negotiations on direct investment in the WTO. It views further restrictions on investment measures and policies as an unacceptable encroachment on host country sovereignty. India points to the "explicit consensus" principle attached to the investment language in the Declaration and interprets this principle as requiring the unanimous vote of all WTO member countries before beginning any new negotiations on investment issues. India accepted the Declaration's reference to investment, it claims, only because the TRIMS Agreement requires review before the year 2000. India suggests that the working group will, therefore, only have the authority to examine the TRIMS Agreement.

Burt, *supra* note 41 at 1052. See also, P. R. Dash, "India Will Not Compromise on WTO Investment Pact" *Times of India* (12 December 1996) 13; "India Softens its Stand; Agrees to Include Labor, TRIMS in Final Pact" *Times of India* (13 Dec. 1996) 13; P.R. Dash, "India Poses Immigration to Offset Investment Pact" *Times of India* (13 December 1996) 13.

This does not mean that developed countries have given up on establishing a comprehensive FDI agreement in the WTO. Indeed, most of them emphasize the importance of such an agreement and their willingness to put pressure on developing countries to accept negotiations on a comprehensive investment agreement.[201] Developed countries will use the "built-in authority" for reviewing both the GATS and the TRIMS Agreement before the year 2000,[202] "along with the conclusions of the investment working group to seek the beginning of negotiations on direct investment as early as 1999".[203]

2. The Multilateral Agreement on Investment

In light of the lack of a comprehensive multilateral FDI instrument, OECD members[204] started negotiations in 1995 with the aim to reach a Multilateral Agreement on Investment (MAI).[205] The MAI, which was intended to be open to accession by OECD and non-OECD countries, is an ambitious effort to conclude the most comprehensive far-reaching multilateral agreement on FDI ever. The MAI promises to streamline the existing

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[201] See Burt, *ibid.*, at 1051.

[202] See *GATS*, *supra* note 98, art. XIX. See also *TRIMS Agreement*, *supra* note 96, art. 9.

[203] Several commentators believe that developed countries will succeed in putting pressure on developing countries to accept the commencement of FDI negotiations in the WTO. Burt, for instance, acknowledges:

> Realistically, the ability of developed country trade ministers to achieve their agenda through political manoeuvring and a linkage of concessions will likely enable the developed countries to set a course for negotiations on direct investment. The limiting language in the Singapore Declaration will not have its current effect in a few years. Developed countries will determine the areas where developing countries will accept concessions in return for allowing the start of direct investment negotiations. The TRIMS Agreement, to which many developing countries were opposed, was hammered out in a similar fashion.

Burt, *supra* note 41 at 1053.

[204] The OECD is considered to be an organization of rich countries. The member countries are Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Norway, New Zealand, the Netherlands, Poland, Portugal, Republic of Korea, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

[205] See A. Jackson, "The MAI. What Is It?" in A. Jackson & M. Sanger, eds., *Dismantling Democracy. The Multilateral Agreement on Investment (MAI) and Its Impact* (Ottawa: Canadian Centre for Policy Alternatives, 1998) at 7 [hereinafter "The MAI. What is it?"].

multilateral FDI framework and to unify and replace the current bilateral and unilateral FDI regulations.[206] The idea, in short, is to establish a legally-binding international body of rules for investment, much as the GATT and GATS have done for trade in goods and services.[207] The MAI, basically, promises to reduce barriers and discriminatory treatment to FDI and increase legal security for international investors by applying the principles of national treatment and MFN treatment and securing their application through a strong dispute settlement mechanism that allows both States and private persons to take recourse against violations.

The MAI was expected to be completed and submitted for ratification at the May 1997 OECD Ministerial Council meeting. However, due to some considerable technical and political obstacles, the MAI has not been signed yet.[208] The May 1997 deadline for concluding the MAI was first postponed until May 1998. Then, the April 1998 OECD Ministerial meeting failed again to complete the Agreement.[209] Faced with mounting disagreements among themselves and opposition from citizen, labour and environmental groups, the negotiating countries postponed the deadline for six months.[210] Before the October OECD meeting, the MAI faced yet another blow when France declared its

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[206] See W.H. Witherell, "The OECD Multilateral Agreement on Investment" (1995) 4 Transnat'l Corporations 2.

[207] See "Why We Need the MAI?" *The Washington Times* (25 December 1997).

[208] See "The MAI. What Is It?", *supra* note 205 at 6.

[209] "OECD negotiators have agreed to a six-month period of "assessment and consultation", during which, critics believe, supporters of the MAI will try to sell the deal at home and negotiators may hold more private talks aimed at reducing the number of exemptions – health care, education, culture – that countries such as Canada have requested." "MAI Update: Dead Deal Walking", http://www. Canadians. org/mainotdead.html (date accessed: 27 July 1998) [hereinafter "Dead Deal Walking"].

[210] At the OECD meeting in April 1998,

> each of the 29 member countries committed to consult with their own citizens about the MAI. Many did nothing and a few (like Canada) went through a cursory consultation process more like a PR campaign. The French government was the only one that engaged in consultations in any depth, so it's no surprise that they withdrew from negotiations! Most citizens oppose the agreement when they understand the clauses and implications of the MAI.

Ibid.

withdrawal from the negotiations.[211] France believed that the MAI, in its present form, would be a threat to its culture and sovereignty,[212] and criticized the exclusion of developing countries, which it considered to be against its interests.[213] A month later, Australia dropped out of the talks for the same reasons.[214] Commentators considered the French and Australian withdrawal to be "a death blow to the MAI, which was already on shaky ground after ministers last April [April 1998] suspended negotiations for six months".[215] The failure series of the MAI continued at the October 1998 OECD meeting when the negotiating countries failed to resolve their disagreements, or make any meaningful progress.[216] Several commentators considered this failure as an indicator of the collapse of the MAI. Indeed,

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[211] See *Report on the Multilateral Agreement on Investment (MAI) Interim Report* - September 1998, http://www.Canadians.org/maifrancesposition.html (date accessed: 30 October 1998) [hereinafter *French Report*]. The French original of this document is published by France's Ministry of the Economy, Finance, and Industry and is available on the Ministry's Internet site at: http://www.finances.gouv.fr/pole_ecofin/international/ami0998/ami0998.htm

[212] The French position was that: "1. The opposition has taken on new forms. 2. The opposition concerns the very structure of the agreement. 3. The OECD's organization of the negotiations was very inappropriate. 4. While the results of the consultation show a certain divergence of opinion, but support for the MAI in its current form is limited and, where it exists, conditional." Accordingly, France declared its intention to avoid: "1. Allowing negotiations to resume on the existing bases. 2. Amending the existing text without changing its structure. 3. Giving up on any international investment agreement." *Ibid.*

[213] France contended that it "should emphasize its interest in the effective participation of emerging nations...[and that it is] not proposing this as a condition to continuing the negotiations, but rather making final signing of the agreement conditional on a sufficient number of those countries coming on board as parties to the agreement". *Ibid.*

[214] See M. Selinger, "Nations Drop Efforts on Global Investment Deal" *The Washington Times* (5 December 1998) C1. Australia announced in November that "it would not support the treaty unless it was granted exemptions from key areas - a position already adopted by a number of other countries...[and that it] no longer list[s] the MAI as a treaty Australia was working on or considering signing". "Foreign Investment Treaty Effectively Dead-inquiry Told" *AAP Newsfeed* (21 December 1998).

[215] See "OECD MAI Negotiations" 20 October 1998, http://www.islandnet.com/~ncfs/maisite/MAI-up1.htm. (date accessed: 30 November 1998) [hereinafter *OECD MAI Negotiations*].

[216] A press release following the October meeting stated:

> Agreement on an OECD-broked treaty setting new rules for global investment appeared slimmer than ever on Wednesday after a consultative meeting failed to make progress, or even set a firm date for more bargaining. Officials told a news conference at the Paris-based Organization for Economic Cooperation and Development there was general agreement that a framework governing international investment was needed, but did not endorse the MAI itself.

Ibid.

although the MAI negotiating group was scheduled to meet again before the end of 1998 (mid to end December 1998) to continue discussions,[217] this meeting never took place. Instead, an informal OECD consultation among senior officials responsible for investment policy was held on 3 December 1998. The meeting, which might be the last episode of the MAI failure series, announced that the MAI negotiations were indefinitely suspended. An OECD press release following this meeting declared: "Negotiations on the MAI are no longer taking place."[218]

Although it appears unlikely that the MAI be concluded at the OECD, at least in its present form, the MAI, or at least its spirit, is not dead yet.[219] Indeed, although the OECD officials at the 3 December consultation acknowledged that further analytical work and inter-governmental co-operation are needed regarding a number of important issues, they explicitly "reaffirmed the desirability of international rules for investment [and] agreed on the importance of multidisciplinary work on investment at OECD".[220]

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[217] "While officials at the meeting said they would return to Paris before the end of the year, the effective result of the session was that discussions on the so-called Multilateral Agreement on Investment (MAI) were downgraded to consultations from negotiations." *Ibid.*

[218] "This meeting followed an earlier consultation on 20 October and a discussion of investment matters at the OECD's Executive Committee in Special Session (ECSS) on 22 October." "Informal Consultations on International Investment" *Press Release* (3 December 1998), http://www.oecd.org //daf/cmis/MAI/maindex.htm (date accessed: 15 January 1999) [hereinafter "3 December OECD Press Release"].

[219] Donald Johnston, the OECD's secretary-general, restated the importance of a multilateral agreement on investment, yet emphasized the unlikeliness of concluding the MAI in its present form at the OECD. He stated that: "There is a general recognition of the importance of some agreement. I don't think you are going to see something emerge called MAI. I do think it's in everyone's interest, including France's, that there be some investment framework." Selinger, *supra* note 214. Similar statements were made after the October MAI meeting; at the press conference following the meeting, the delegations to the MAI negotiation did not show optimism about concluding the present MAI text in the OECD, yet they refused to declare the MAI dead. When asked by reporters if the current MAI text will serve as the basis for a deal, Robert Madelin, the European Commission's representative to the OECD MAI negotiations, acknowledged that: "The MAI text remains one of the key points of reference for our discussions". The U.S. Assistant Secretary for Economic and Business Affairs, Alan Larson, stated: "Now is not a good time to rule in or rule out specific options". He said: "More time is needed to assess what the position of France and other countries will be." *OECD MAI Negotiations*, *supra* note 215.

[220] "3 December OECD Press Release", *supra* note 218.

Despite the doubts about the feasibility of concluding the MAI in the OECD, the study of the MAI remains important. First of all, even if the MAI failed at the OECD, negotiating countries seem determined to bring about some sort of a multilateral agreement on investment.[221] Thus, in case of the failure to conclude the MAI at the OECD, there seems to be wide support in the OECD to export the work already done on the MAI to the WTO.[222] By all means, the MAI will be the benchmark against which all other multilateral investment agreements and efforts will be measured.[223] Indeed, the results of the MAI negotiations provide insight about the feasibility and content of any future efforts to regulate FDI multilaterally. Since the OECD is a developed-countries organization, the MAI embraces the optimal degree of liberalization ever possible. This implies two things: on the one hand, if the MAI ever came into being, the fact that developing countries would find its level of liberalization unaffordable would make it highly unlikely that the MAI be accepted by them. On the other hand, the failure of the MAI would mean automatic failure of any attempt to reach the same level of multilateral FDI liberalization within the frameworks of

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[221] Willard A. Workman, international vice president for the U.S. Chamber of Commerce, for example, stated: "There's still a need out there to have agreed-upon rules governing investment overseas." Furthermore, "Business groups expressed disappointment with the MAI's demise and pledged to keep pushing for international investment rules in some form." Selinger, *supra* note 214.

[222] "The European Commission is already on record, stating that once the OECD MAI is done, it should be taken to the WTO so that it is subject to its dispute settlement machinery. The US officials appeared to have threatened that if the MAI cannot be achieved at the OECD, they will vigorously pursue investment liberalization agenda at the WTO, the Free Trade Agreement of the Americas etc." Mehta, *supra* note 193. More recently, Japan and the European Union revealed their intention to jointly propose creating a set of rules aimed at protecting FDI at the next WTO round of trade liberalization talks. According to Japanese government sources, "Japan and the EU will put forward their proposal in the course of a next round of global trade and investment liberalization talks to start in 2000 under the auspices of the World Trade Organization". "Japan, EU to Propose Rules Protecting Investment at WTO" *Japan Economic Newswire*, (7 January 1999) [hereinafter Japan, EU to Propose FDI at WTO]. Furthermore, "France and Canada had said the proper place for investment talks was not the OECD but the World Trade Organization". Selinger, *supra* note 214. See also "World Trading Powers Seek New Home for MAI Negotiations" *Globe & Mail (Toronto) - Metro Edition* (22 October 1998) B4.

[223] See *OECD MAI Negotiations*, *supra* note 215, which quotes Robert Madelin, the European Commission's representative to the OECD MAI negotiations, acknowledging that the MAI text will still serve as a basis for a deal on a multilateral agreement on investment and "one of the key points of reference for [future] discussions".

organizations involving developing countries as well, such as the WTO.[224] Accordingly, the next part of this thesis analyzes the provisions of the draft text of the MAI and highlights the main controversial issues in its negotiation.[225]

2.1. Scope of Application

The MAI's scope of application is divided to substantive and geographical scope. The substantive scope of application of the MAI is determined through the definition of investment and investor. The geographical scope is regulated in a separate article by defining the territories of the contracting parties in which the MAI applies.[226]

2.1.1. Substantive Scope of Application

2.1.1.1. Investments

The definition of investment has been the subject of lengthy debate. The results, so far, are to establish the broadest coverage through a comprehensive asset-based definition of investment which encompasses all stages of the investment, including the pre-investment stage.[227] The draft MAI text, thus, states that investment means every kind of asset owned

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[224] "U.S. and OECD officials have said that if a treaty agreement could not be reached at the OECD, with only 29 members and several nonmembers involved in the talks, it would not be reached at the WTO, which has more than 100." Selinger, *supra* note 214.

[225] See *MAI Negotiating Text*, as of 24 April 1998, available in PDF formate on http://www.oecd.org/daf/cmis/MAI/negtext.htm (date accessed: 22 September 1998) [hereinafter *MAI Negotiating Text*]. The OECD acknowledges:

> This document consolidates the text of the agreement considered in the course of the MAI negotiations so far. The texts reproduced here result mainly from the work of expert groups and have not yet been adopted by the MAI Negotiating Group. They are presented with footnotes and proposals that are still under consideration. The final text will be accompanied by country specific exceptions which will form an integral part of the agreement.

[226] It should be noted that a number of delegations were of the opinion that instead of a an article on geographical scope, "an article should define the "territory" or "area" of a Contracting Party to which the MAI would be applicable and in that case, it could be included in a general definitions part of the agreement. Some delegations had serious misgivings about the feasibility of embarking on this approach." *Ibid.* part II. *Geographical Scope of Application* at 12, footnote.

[227] See Witherell, *supra* note 206. See also "The MAI. What is it?," *supra* note 205 at 12.

or controlled by an investor. The text then provides the following open-ended list of the assets that are considered to be investment:

(i) an enterprise (being a legal person or any other entity constituted or organised under the applicable law of the Contracting Party, whether or not for profit, and whether private or government owned or controlled, and includes a corporation, trust, partnership, sole proprietorship, branch, joint venture, association or organisation);
(ii) shares, stocks or other forms of equity participation in an enterprise, and rights derived therefrom;
(iii) bonds, debentures, loans to and other form of debt; and rights derived therefrom;
(iv) rights under contracts, including turnkey, construction, management, production or revenue sharing contracts;
(v) claims to money and claims to performance;
(vi) intellectual property rights;
(vii) rights conferred pursuant to law or contract such as concessions, licenses, authorisations, and permits.
(viii) any other tangible and intangible, movable and immovable property, and any related property rights, such as leases, mortgages, liens and pledges.[228]

2.1.1.2. Investor

As in most BITs, the definition of investor under the MAI encompasses both natural and legal persons. The MAI applies to natural persons insofar as they have the nationality of or permanently reside in a contracting State in accordance with the applicable laws. As for legal persons, the MAI applies to any legal person or any other entity provided that the legal person be either organized or constituted under the applicable law of a contracting State.[229] The MAI clearly states that it applies to both government and privately-owned and controlled entities, regardless of whether or not they are for profit, such as corporations, trusts, joint

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[228] *MAI Negotiating Text*, *supra* note 225, part II. *Definitions*, para. 2 at 11.

[229] The MAI states that investor means:

(i) a natural person having the nationality of, or who is permanently residing in, a Contracting Party in accordance with its applicable law; or
(ii) a legal person or any other entity constituted or organised under the applicable law of a Contracting Party, whether or not for profit, and whether private or government owned or controlled, and includes a corporation, trust, partnership, sole proprietorship, joint venture, association or organisation.

Ibid., para. 1 at 11.

ventures, associations, organizations, partnerships and sole proprietorships. [230]

2.1.2. Geographical Scope of Application

The MAI applies in:

> (a) the land territory, internal waters, and the territorial sea of a Contracting Party, and, in the case of a Contracting Party which is an archipelagic State, its archipelagic waters; and
> (b) the maritime areas beyond the territorial sea with respect to which a Contracting Party exercises sovereign rights or jurisdiction in accordance with international law, as reflected particularly in the 1982 United Nations Convention on the Law of the Sea. [231]

2.2. Conditions for Entry

The objective of the MAI is to facilitate entry by MNEs to the markets of member countries. The MAI's approach, therefore, is to directly subject the issue of admission regulation to the principles of national treatment and MFN treatment. The national treatment principle of the MAI reads:

> Each Contracting Party shall accord to investors of another Contracting Party and to their investments, treatment no less favourable than the treatment it accords [in like circumstances] to its own investors and their investments with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposition of investments. [232]

The MFN treatment principle of the MAI states:

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[230] Some States took the position that branches should not be included in the definition of investor. France and the United States requested more time to verify that the deletion of branches does not pose problems for non-financial sectors. See "Growing Consensus on Ills of Globalization" http://www.idrc.sg/south/twn (date accessed: 24 October 1998), which states that the laws of most countries do not grant branches the legal capacity to independently act as investors.

[231] *MAI Negotiating Text, supra* note 225, part II, *Geographical Scope of Application* at 12.

[232] *Ibid.* part III, *National and Most Favoured Nation Treatment,* para. 1 at 13.

> Each Contracting Party shall accord to investors of another Contracting Party and to their investments, treatment no less favourable than the treatment it accords [in like circumstances] to investors of any other Contracting Party or of a non-Contracting Party, and to the investments of investors of any other Contracting Party or of a non-Contracting Party, with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposition of investments.[233]

These texts make it clear that the national treatment and MFN treatment obligations extend to both pre and post-establishment phases of FDI, including the admission of FDI, and would thus prohibit both *de facto* and *de jure* discrimination in that regard.[234] Although some exceptions might be applicable to these principles, they are limited, as will be observed when discussing these principles in the context of the treatment obligations of the MAI below.

The MAI, furthermore, regulates the issue of "temporary entry, stay and work of investors and key personnel". The MAI requires contracting States to grant temporary entry, stay and work authorization to natural persons of the other contracting countries who are:
(i) investors seeking "to establish, develop, administer or provide advice or essential technical services to the operation of an enterprise to which the investor has committed, or is in the process of committing, a substantial amount of capital,"[235] or
(ii) employees of an enterprise referred to in (i) above, or of an investor, "[who may be required to have been employed for a specified minimum period, for example one year]"[236]

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[233] *Ibid*. para. 2.

[234] See M. Khor, "The MAI and Developing Countries" in A. Jackson & M. Sanger, eds., "Dismantling Democracy. The Multilateral Agreement on Investment (MAI) and Its Impact" (Ottawa: Canadian Centre for Policy Alternatives, 1998) 276.

[235] See *MAI Negotiating Text*, *supra* note 225, part III *Temporary Entry, Stay and Work of Investors and Key Personnel*, para. 1(a) at 14.

[236] *Ibid.*, footnote:

> The phrase [*who may be required to have been employed for a specified minimum period, for example one* year] reproduces an amendment proposed by one delegation. It is generally agreed, however, that legally speaking, it is not necessary to clarify in the text that specific minimum periods, for example one year, are allowed by the chapeau of paragraph 1. Some delegations consider, however, the retention of this language to be a political necessity.

in the capacity of executive, manager or specialist and who is essential to the enterprise.[237]

The MAI further obliges contracting parties to grant temporary entry and stay to the spouse and minor children of natural persons who have been granted temporary entry, stay and authorization to work. In fact, the MAI even encourages contracting States to grant work authorization to the spouses of persons who have been granted temporary entry, stay, and authorisation to work.[238]

Moreover, the MAI prohibits contracting parties from denying entry, stay and authorization to work "for reasons relating to labour market or other economic needs tests or numerical restrictions in national laws, regulations, and procedures".[239] The MAI also forbids contracting parties from requiring its enterprises, which constitute an investment of an investor of another Contracting Party, to "appoint as executives, managers and members of boards of directors individuals of any particular nationality".[240] Finally, the MAI obliges contracting parties to grant investors and investments of other contracting parties freedom in employing any natural person regardless of nationality and citizenship. The only conditions are that such a person hold "a valid permit of sejour and work delivered by the

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[237] The MAI defines natural persons, executives, and managers, as follows:
Natural person of another Contracting Party: "a natural person having the nationality of [or who is permanently residing in] another Contracting Party in accordance with its applicable law."
Executive: "a natural person who primarily directs the management of an enterprise or establishes goals and policies for the enterprise or a major component or function of the enterprise, exercises wide latitude in decision-making and receives only general supervision or direction from higher-level executives, the board of directors, or stockholders of the enterprise".
Manager: "a natural person who directs the management of an enterprise, or department, or subdivision of the enterprise, supervises and controls the work of other supervisory, professional or managerial employees, has the authority to hire and fire or recommend hiring, firing, or other personnel actions and exercises discretionary authority over day-to-day operations at a senior level".
Specialist: "a natural person who possesses knowledge at an advanced level of expertise and who may be required to possess specific or proprietary knowledge of the enterprise's product, service, research equipment, techniques, or management". *Ibid.*, para. 3 at 15.

[238] *Ibid.*,para. 1(b).

[239] *Ibid.*, para. 2.

[240] *Ibid.*, part III, *Nationality Requirements for Executives, Managers and Members of Boards of Directors* at 16.

competent authorities of the former Contracting Party and that the employment concerned conforms to the terms, conditions and time limits of the permission granted to such person".[241]

2.3. Treatment

The principle of nondiscrimination is the backbone of the MAI's treatment provisions. This principle is enforced, as in the WTO framework, through the obligations of national treatment and MFN treatment. The MFN and national treatment principles of the MAI are, however, broader than those of the WTO agreements as they extend the scope of national treatment and MFN treatment principles to "the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposition of investment".[242] As mentioned earlier, these provisions cover all phases of FDI (pre and post-establishment) and assure the abolishment of *de facto* and *de jure* discrimination.[243] In fact, the nondiscrimination principle of the MAI even explicitly obliges the contracting parties to accord to investors of other contracting counties the better of either national or MFN treatment, whichever is more favourable to foreign investors of other contracting States.[244] This means that "while foreign investors cannot be treated less favourably than local investors, they can be treated better".[245]

Exceptions to MFN and national treatment have undergone a prolonged debate and remain as the main stumbling block in the way of concluding the MAI. So far, contracting States may lodge country specific exceptions to national treatment and MFN treatment

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[241] *Ibid., Employment Requirement* at 17.
[242] *Ibid.* part III, *National and Most Favoured Nation Treatment*, paras. 1 & 2 at 13.
[243] See Khor, *supra* note 234 at 276.
[244] *MAI Negotiating Text*, *supra* note 225, part III, *National and Most Favoured Nation Treatment*, paras. 1 & 2 at 13.
[245] Khor, *supra* note 234 at 276.

obligations[246] in their national schedules regarding any existing nonconforming measures,[247] and any amendments to such nonconforming measures, provided that the amendments do not "increase the conformity of the measure, as it existed immediately before the amendment," with the principles of national treatment and MFN treatment.[248]

Accordingly, while country specific exceptions are allowed, they are subject to a standstill obligation, *i.e.*, no new restrictions are permitted once the MAI has taken effect for a country.[249] The question remains whether these exceptions would be subject to a rollback obligation or not.[250] If so, reservations made by contracting States would be subject to future negotiations and eventual removal. The delegations have not reached an agreement regarding this point, although the draft text does not include such an obligation.

Furthermore, MFN and national treatment obligations are subject to the general exceptions of the MAI. These general exceptions are narrow as they only allow contracting States to deviate from the agreement for purposes of essential security interests, public order, and compliance with a country's obligations under the United Nations Charter for the maintenance of international peace and security.[251]

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[246] The delegates had different views with respect to"the disciplines against which reservations should be permitted. While some favoured an open list, others argued for a limited closed list of disciplines comprising National Treatment, MFN and new disciplines (special topics)." Thus, "it was suggested that the disciplines listed in the chapeau text of parts A and B should remain incomplete for the time being pending political decisions by the Negotiating Group". *MAI Negotiating Text, supra* note 225, part IX, *Lodging of Country Specific Exceptions* at 90.

[247] The only condition for lodging such a nonconforming measure is that the measure be maintained, continued or promptly renewed in legal system of the lodging contracting State. See *ibid.*

[248] For a list of reservations for the MAI that the negotiating States filed as of 22 April 1997, see http://www.Canadians.org/reservations.html (date accessed: 22 September 1998). The site acknowledges that while 22 April 1997 "may seem like a while ago, it is the most comprehensive list that we have been able to track down so far from confidential sources".

[249] See Engering, *supra* note 79 at 151.

[250] See "The MAI. What is it?", *supra* note 205 at 15.

[251] *MAI Negotiating Text, supra* note 225, part VI, *General Exceptions* at 77.

However, negotiating countries remained divided on a number of important issues which have contributed to the indefinite suspension of the MAI;

> France, Canada and others wanted to exempt film and other cultural material from the MAI. European countries have criticized US trade sanctions laws like the Helms-Burton Act against companies investing in Cuba (investors in Iran and Libya are also targeted by US legislation). The US is critical of an EU proposal to allow EU countries to treat investors from other EU member countries more favourably than others. Other disputes include ones about wording relating to the environment and labour standards, and a long list of reservations setting out areas to which the MAI won't apply.[252]

The transparency principle of the MAI obliges contracting States to promptly publish or make publicly available their "laws, regulations, procedures and administrative rulings and judicial decisions of general application as well as international agreements which may affect the operation of the Agreement"[253] and all "policies which are not expressed in laws or regulations or by other means listed in this paragraph but which may affect the operation of the Agreement".[254]

Nonetheless, the MAI relieves contracting parties of furnishing or allowing access to:

> a) information related to the financial affairs and accounts of individual customers of particular investors or investments, or
> b) any confidential or proprietary information, including information concerning particular investors or investments, the disclosure of which would impede law enforcement or be contrary to its laws protecting confidentiality or prejudice legitimate commercial interests of particular enterprises.[255]

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[252] "MAI Update and Urgent Action Alert", http://www.islandnet.com/~/maisite (date accessed: 17 September 1998) [hereinafter "MAI Update"].

[253] *MAI Negotiating Text, supra* note 225, part III, *Transparency*, para. 1 at 13.

[254] *Ibid.* The MAI further requires contracting States to "promptly respond to specific questions and provide, upon request, information to other Contracting Parties on matters referred to in Article 2.1." *Ibid.*, para. 2.

[255] *Ibid.*, para. 3. In this regard, the MAI also allows contracting States to require routine information concerning their investments, or the investments of other contracting States, solely for information or statistical purposes. See *ibid.*

Unlike the TRIMS Agreement, the MAI does not just deal with trade-related investment measures and does not only subject them to the general obligations of national treatment, MFN treatment and prohibitions on quantitative restrictions. Rather, the MAI encompasses specific rules to deal with performance requirements and investment incentives. The performance requirements section of the MAI forbids contracting parties, with regard to the "establishment, acquisition, expansion, management, operation or conduct of an investment in its territory of an investor of a Contracting Party or of a non-Contracting Party",[256] to "impose, enforce or maintain" certain performance requirements, commitments or undertakings.[257] The MAI, thus, takes a one-list approach in establishing the prohibited investment requirements. These requirements, as listed in paragraph 1 of the Performance Requirements Article of the MAI, are:

> (a) to export a given level or percentage of goods or services;
> (b) to achieve a given level or percentage of domestic content;
> (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
> (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
> (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales to the volume or value of its exports or foreign exchange earnings;
> (f) to transfer technology, a production process or other proprietary knowledge to a

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[256] Note that this list of investment activities includes more activities than the national and MFN treatment provisions. The following activities are included in this provision, but do not appear in the national and MFN treatment Articles: "maintenance, use, enjoyment, sale or other disposition of investments". The MAI Negotiating Text elaborates:

> A large majority of delegations consider that the enumeration of activities in the chapeau should closely follow the list of activities in the National Treatment/MFN articles to avoid any confusion over the meaning of any differences in the lists. They consider furthermore that there are no substantive grounds for the deletion of the terms"maintenance, use, enjoyment" since the implications for intellectual property rights are taken care of by the proposed carve-out in paragraph 1(f) and the consequences of keeping them as regards land assets are immaterial. It is noted that these are also arguments for not mentioning these terms in the chapeau. One delegation favours the deletion of these terms. Two delegations question the relevancy of the terms"sale or other disposition".

Ibid, part III, *Performance Requirements*, para. 1, footnote at 19.

[257] *Ibid.*, para. 1.

natural or legal person in its territory, except when the requirement
– is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws, or
-- concerns the transfer of intellectual property and is undertaken in a manner not inconsistent with the TRIPS Agreement;[258]
(g) to locate its headquarters for a specific region or the world market in the territory of that Contracting Party;
(h) to supply one or more of the goods that it produces or the services that it provides to a specific region or the world market exclusively from the territory of that Contracting Party;
[(I) to achieve a given level or value of production, investment, sales, employment, or research and development in its territory;]
(j) to hire a given level of nationals;[259]
(k) to establish a joint venture with domestic participation;[260]or
(l) to achieve a minimum level of domestic equity participation other than nominal

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[258] *Ibid.*, footnote:

> [A] large number of delegations indicated that they can agree to a final version of this paragraph only if a clear exception is made for the possibility of enforcing competition laws and for the transfer of intellectual property rights, as long as the latter is not contrary to the TRIPS Agreement. The exact wording of this paragraph remains to be determined in consultation with competition and intellectual property experts, to reflect the comments made in paragraph 7 of the Report to the Negotiating Group on Intellectual Property. In this context, questions were raised concerning the meaning of "proprietary knowledge" and the reference to the relevant authorities.

[259] The MAI Negotiating Text notes:

> There is wide agreement to retain paragraph (j) with the inclusion of the following footnote with the same legal standing as the paragraph itself:
>
> "*Nothing in this paragraph shall be construed as interfering with programmes targeted at disadvantaged regions persons or other equally legitimate employment policy programmes. It is also understood that permanent residency requirements are not inconsistent with this paragraph.*"
>
> It is confirmed that this provision will not overlap with the MAI article on Employment Requirements since it is meant to cover specific performance requirements expressed in terms of given numbers or percentages of employees while the Article on Employment Requirements addresses problems of discrimination among natural persons holding a valid permit of sejour and work in a given Contracting Party. Two delegations continue to favour the deletion of paragraph (j).

Ibid.

[260] The MAI Negotiating Text clearly elaborates, in a footnote, that Paragraph (k) forbids joint ventures requirements involving domestic participation. Thus, it allows, for example,"joint venture requirements, not involving a requirement of domestic participation, which may be motivated by an economic concern to spread risk". *Ibid.*

qualifying shares for directors or incorporators of corporations.[261]

Paragraphs 2-5 of the same Article qualify and elaborate the prohibitions of paragraph 1. Paragraph 2 explains that paragraph 1 does not preclude a contracting State from "conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of a Contracting Party or of a non-Contracting Party, on compliance with any of the requirements, commitments or undertakings set forth in paragraphs 1(f) through 1(I)".[262]

Paragraph 3 provides that paragraphs 1(a), 1(b), 1(c), 1(d), and 1(e) shall not be construed as to prevent contracting parties from

> conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Contracting Party or of a non-Contracting Party, on compliance with a requirement, commitment or undertaking to locate production, provide particular services, train or employ personnel, construct or expand particular facilities, or carry out research and development in its territory.[263]

Paragraph 4, still between brackets,[264] provides that paragraphs 1(b) and 1(c) shall not be construed as to prevent contracting States from adopting or maintaining certain measures,

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[261] *Ibid.*

[262] *Ibid.*, para. 2 at 22.

[263] In the April 1998 MAI Negotiation Text, paragraph 3 was transformed into an interpretative footnote to paragraph 1 with the same legal standing. *Ibid.*, para. 3 at 22.

[264] *Ibid.*, para. 4 at 23. The delegations agreed to keep paragraph 4 between brackets as the majority considers it broad and sees no need for it. One delegation proposed the following text to be inserted as an interpretive note:

> Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on investment, nothing in paragraphs 1(b) and 1(c) shall be construed to prevent any Contracting Party from adopting or maintaining measures necessary to secure compliance with environmental laws and regulations [that are not otherwise inconsistent with the provisions of this Agreement and] that are necessary for the conservation of living or non-living resources, [or that are necessary to protect human, animal or plant life or health.]

A majority of delegations agreed to insert an interpretive note along the line of this proposed text, although some delegations doubted the need for even an interpretative note. See *ibid.*, footnote.

including environmental measures, which are:

(a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
(b) necessary to protect human, animal or plant life or health;
(c) necessary for the conservation of living or non-living exhaustible natural resources;[265]

provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on investment.

Paragraph 5 further imposes a number of qualifications; paragraph 5(a) provides that paragraphs 1(a), 1(b), and 1(c) "do not apply to qualification requirements for goods or services with respect to export promotion and foreign aid programmes;"[266] paragraph 5(b) restricts the application of paragraphs 1(b), 1(c), 1(f), and 1(h) to procurement by a contracting States or an entity owned or controlled by a contracting States;[267] and paragraph 5(c), between brackets, states that "paragraphs 1(b) and 1(c) do not apply to requirements imposed by an importing Party relating to the content of goods necessary to qualify for preferential tariffs or preferential quotas." [268]

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[265] The wide coverage of subparagraph (a) raised the concerns of several delegations. Thus, several delegations showed willingness to approve replacing paragraph 4 with an interpretative note proposed by one delegation. This notes reads:

> Nothing in paragraphs 1(b) and 1(c) shall be construed to prevent any Contracting Party from adopting or maintaining measures necessary to secure compliance with environmental [laws and regulations] that are not otherwise inconsistent with the provisions of this Agreement and that are necessary for the conservation of living or non-living exhaustible natural resources, or [that are necessary to protect human, animal or plant life or health.]

One delegation, however, was of the opinion that the phrase "that are not inconsistent with the provisions of this Agreement" did not fit properly in this proposal. *Ibid.*

[266] The delegates are considering the inclusion of paragraph (a *bis*) after paragraph (5)(a). The text of this paragraph, which is still between brackets, provides:
"[Paragraph 1(a), 1(b), and 1(c) do not apply to:
– [measures] [advantages] related to the production, processing and trade of agricultural and processed agricultural products
– advantages related to trade in services]." *Ibid.*, para. 5(a) at 24.

[267] See *ibid.*, para. 5(b) at 25.

[268] See *ibid.*, para. 5(c) at 25-26.

Investment incentives, on the other hand, were subject to more debate, leading the delegations to fail to agree on a text. They, thus, incorporated two alternatives to be further discussed. Alternative 1 reflects the opinion of the delegations that believed that no additional text is necessary because the current MAI Articles on National Treatment, MFN Treatment, and Transparency are sufficient to cover investment incentives, at least for the time being.[269] Alternative 2 encompasses the opinions of other delegations favouring specific provisions on investment incentives in the MAI. The latter delegations, however, had different views regarding the nature and scope of the incentives provisions. One alternative was a built-in agenda for future work regarding the matter at hand. The discussion focused on the following draft article which is considered as "a compromise text by those who would still prefer more far-reaching disciplines":[270]

> 1. The Contracting Parties confirm that Article XX (on NT and MFN) and Article XX (Transparency) applies to [the granting of] investment incentives.
>
> 2. [The Contracting Parties acknowledge that[, in certain circumstances,] even if applied on a non-discriminatory basis, investment incentives may have distorting effects on the flow of capital and investment decisions. [Any Contracting Party which considers that its investors or their investments are adversely affected by an investment incentive adopted by another Contracting Party and having a distorting effect, may request consultations with that Contracting Party.] [The former Contracting Party may also bring the incentive before the Parties Group for its consideration.]]
>
> 3. [In order to further avoid and minimise such distorting effects and to avoid undue competition between Contracting Parties in order to attract or retain investments, the Contracting Parties [shall] enter into negotiations with a view to establishing additional MAI disciplines [within three years] after the signature of this Agreement. These negotiations shall recognise the role of investment incentives with regard to the aims of policies, such as regional, structural, social, environmental or R&D policies of the Contracting Parties, and other work of a similar nature undertaken in other fora. These negotiations shall, in particular, address the issues of positive discrimination, [transparency], standstill and rollback.] [271]

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[269] *See ibid.*, part III, *Investment Incentives*, alternative 1 at 46.

[270] *Ibid.*, alternative 2 at 47.

[271] *Ibid.*

4. [For the purpose of this Article, an "investment incentive" means:
The grant of a specific advantage arising from public expenditure [a financial contribution] in connection with the establishment, acquisition, expansion, management, operation or conduct of an investment of a Contracting Party or a non-Contracting Party in its territory].[272]

2.4. Monetary Transfers

The MAI grants foreign investors a very liberal transfer of payments regime. The MAI obliges contracting parties to permit free and undelayed transfer in and out of their territories of all payments relating to an investment in their territories by investors of other contracting parties.[273] The MAI provides the following illustrative list of such transfers:

a) the initial capital and additional amounts to maintain or increase an investment;
b) returns;
c) payments made under a contract including a loan agreement;
d) proceeds from the sale or liquidation of all or any part of an investment;
e) payments of compensation under Articles 2 and 3;
f) payments arising out of the settlement of a dispute;
g) earnings and other remuneration of personnel engaged from abroad in connection with an investment.[274]

Furthermore, contracting countries must ensure that these transfers may be made in a freely convertible currency,[275] and "at the market rate of exchange prevailing on the date of transfer".[276]

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[272] *Ibid.*

[273] *Ibid.*, part IV, *Transfers*, para. 4.1. at 59.

[274] *Ibid.*, para. 4.2.

[275] *Ibid.*, para. 4.3. The delegations could not agree on the definition of "freely convertible currencies" and thus placed the following two definitions between brackets for further discussions:
[Freely convertible currency means a currency which is widely traded in international foreign exchange markets and widely used in international transactions.] or [Freely convertible currency means a currency which is, in fact, widely used to make payments for international transactions and is widely traded in the principal exchange markets].

[276] *Ibid.* Paragraph 4.4 , between brackets, provides that: "In the absence of a market for foreign exchange, the rate to be used shall be the most recent exchange rate for conversion of currencies into Special Drawing Rights." *Ibid.*, para. 4.4.

The right to free monetary transfer is not, however, absolute under the MAI. Paragraph 4.5 of the Transfers Article gives contracting States the right to "restrict the transfer of a return in kind in circumstances where the Contracting Party is permitted under the GATT 1994 to restrict or prohibit the exportation or the sale for export of the product constituting the return in kind".[277] This paragraph, however, obliges contracting parties to "ensure that transfers of returns in kind may be effected as authorised or specified in an investment agreement, investment authorization, or other written agreement between the Contracting Party and an investor or investment of another Contracting Party".[278]

Moreover, paragraph 4.6. gives contracting parties the right to delay or prevent a transfer through measures:

> (a) to protect the rights of creditors;
> (b) relating to or ensuring compliance with laws and regulations:
> (i) on the issuing, trading and dealing in securities, futures and derivatives,
> (ii) concerning reports or records of transfers, or
> (c) in connection with criminal offences and orders or judgements in administrative and adjudicatory proceedings;[279]

provided that such measures and their application are taken on an equitable, nondiscriminatory and good faith basis, and that they do not be used as a means to avoid other MAI obligations.[280]

Furthermore, as a temporary safeguard, the MAI allows contracting parties to adopt or maintain measures inconsistent with its transfers and national treatment obligations:

> (a) in the event of serious balance of payments and external financial difficulties or threat thereof; or
> (b) where, in exceptional circumstances, movements of capital cause, or threaten to cause, serious difficulties for macroeconomic management, in particular monetary and

[277] *Ibid.*, para. 4.5.
[278] *Ibid.*
[279] *Ibid.*, para. 4.6 at 60.
[280] *Ibid.*

exchange rate policies.[281]

The scope of the latter exception is, however, very limited since the MAI provides that the abovementioned measures:

"(a) shall be consistent with the Articles of Agreement of the International Monetary Fund;

(b) shall not exceed those necessary to deal with the circumstances described in paragraph 1

(c) shall be temporary and shall be eliminated as soon as conditions permit."[282]

Furthermore, these measure, and any changes therein, should be promptly notified to the Parties Group and the International Monetary Fund, where they would be subject to a review to determine their compliance with paragraph 2 of the Transfers Article.[283] This review, which would determine the approval or disapproval of these measures, should take place "within six months of their adoption and every six months thereafter until their elimination".[284]

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[281] *Ibid.*, part VI, *Temporary Safeguard*, para. 1 at 79.

[282] *Ibid.*, para. 2.

[283] *Ibid.*

[284] *Ibid.* Paragraph 3(c) and paragraphs 4-7 of the MAI incorporate the following procedural and substantive texts regarding this review:

(c) These reviews shall address the compliance of any measure with paragraph 2, in particular the elimination of measures in accordance with paragraph 2 (c).

4. Measures referred to in paragraph 1 and any changes therein that are approved by the International Monetary Fund in the exercise of its jurisdiction shall be considered as consistent with this Article.

5. With regard to measures referred to in paragraph 1, and any changes therein, not falling within paragraph 4:

(a) The Parties Group shall consider the implications of the measures adopted under this Article for the obligations of the Contracting Party concerned under this Agreement.

(b) The Parties Group shall request an assessment by the International Monetary Fund of the conditions mentioned under paragraph 1 and of the consistency of any measures with paragraph 2. Any such assessment by the International Monetary Fund shall be accepted by the Parties Group.

(c) Unless the International Monetary Fund determines that the measure is either consistent or inconsistent with the provisions of this Article, the Parties Group may either approve or disapprove the measure. The Parties Group shall establish procedures for this purpose.

6. The Contracting Parties shall seek agreement with the International Monetary Fund regarding the role of the International Monetary Fund in the review procedures established under this Article.

2.5. Protection Against Expropriation and Strife

The general treatment provisions of the MAI require contracting States to accord foreign investments of other contracting parties in their territories "fair and equitable treatment and full and constant protection and security", which, in no case, should be less favourable than that required by international law.[285] Furthermore, a contracting State is prohibited from impairing, by unreasonable and/or discriminatory measures "the operation, management, maintenance, use, enjoyment or disposal of investments in its territory of investors of another Contracting Party".[286]

As with most BITs, the MAI's approach towards expropriation reflects that of the Western view of international law. However, the definition of expropriation is very broad in the MAI and goes far beyond the "usual meaning of government takeover to include any government action that the investor might construe as damaging his investment-even tax increases".[287] As a general rule, the MAI forbids direct and indirect expropriation and nationalisation, or any measures that might have the equivalent effect, of investments in the territory of contracting States of investors of other contracting States. Expropriation is, however, allowed under the MAI in exceptional cases provided it is done:

a) for a purpose which is in the public interest,
b) on a non-discriminatory basis,
c) in accordance with due process of law, and
d) accompanied by payment of prompt, adequate and effective compensation in accordance with Articles 2.2 to 2.5 below.[288]

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7. Measures referred to in paragraph 1 and any changes therein that are approved by the International Monetary Fund in the exercise of its jurisdiction or determined to be consistent with this Article by the International Monetary Fund or the Parties Group cannot be subject to dispute settlement.

Ibid., paras. 3-7 at 79-80.

[285] *Ibid.*, part IV, *General Treatment*, para. 1.1.

[286] *Ibid.*, para. 1.2.

[287] Khor, *supra* note 234 at 281.

[288] *The MAI Negotiating Text*, *supra* note 225, part IV, *Expropriation and Compensation*, para. 2.1 at 57.

Articles 2.2 to 2.6 provide investors with a very liberal compensation formula. They state that investors shall be compensated, without delay, for an amount "equivalent to the fair market value of the expropriated investment immediately before the expropriation occurred".[289] For the purposes of evaluating the market value, "the fair market value shall not reflect any change in value occurring because the expropriation had become publicly known earlier".[290] In any case, compensation "shall be fully realisable and freely transferable".[291]

An investor claiming redress for expropriation is further empowered with the right to seek "prompt review of its case, including the valuation of its investment and the payment of compensation..., by a judicial authority or another competent and independent authority of the [contracting State where the damage took place]".[292]

Like in most BITs, the MAI grants investors of other contracting parties protection against strife. The MAI requires a contracting State in which investors of other contracting parties have suffered losses relating to their investment "due to war or to other armed conflict, state of emergency, revolution, insurrection, civil disturbance, or any other similar event" to accord, "as regards restitution, indemnification, compensation or any other settlement, treatment no less favourable than that which it accords to its own investors or to investors of any third State, whichever is most favourable to the investor".[293]

Nonetheless, if, in any of the situations referred to above, the losses suffered by an investor result from:

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[289] *Ibid.*, para. 2.3. The delegations failed to reach a final decision regarding the inclusion of interest in the compensation. The MAI Negotiating Text included the following provision between brackets subject to further discussion:"2.5. [Compensation shall include interest at a commercial rate established on a market basis for the currency of payment from the date of expropriation until the date of actual payment.]." *Ibid.*, para. 2.5.

[290] *Ibid.*, para. 2.3.

[291] *Ibid.*, para. 2.4.

[292] *Ibid.*, para. 2.6. at 58.

[293] *Ibid.*, *Protection From Strife*, para. 3.1. at 58.

(a) requisitioning of its investment or part thereof by the host contracting State's forces or authorities, or

(b) destruction of its investment or part thereof by the host contracting State's forces or authorities, which was not required by the necessity of the situation, the contracting State in which these losses occurred shall accord the investor prompt and adequate restitution or compensation in accordance with the MAI's compensation formula (paragraphs 2.1 to 2.5 above).[294]

2.6. Settlement of Disputes

Taking into account the importance of dispute settlement, the MAI delegations wanted to create a state-of-the-art dispute settlement mechanism. Thus, the MAI negotiating text included detailed and comprehensive procedural and substantive provisions regulating both State-State disputes and State-investor disputes. These provisions apply to all disputes regarding the interpretation and application of the MAI by default, unless the disputing parties agree otherwise.[295]

The State-State dispute settlement provisions introduce a wide range of alternative dispute resolution (ADR) mechanisms. Consultation is the first approach in settling disputes among contracting States regarding the interpretation or application of the Agreement. The consultation procedures are quite simple; a contracting party wishing to enter into consultation should submit a request in writing and the requested State should enter into consultation within thirty days of the receipt of the request.[296] The requesting State must provide the Parties Group with a copy of the request for consultation at the time it submits the request to the other contracting State in dispute.[297]

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[294] See *ibid.*, para. 3.2.

[295] See *ibid.*, part V, *State-State Procedures*, para. (A)(1) at 63.

[296] See *ibid.*, para. (B)(1)(a).

[297] See *ibid.* The MAI conditions initiating arbitration on requesting consultation by the State seeking arbitration. The latter State should afford the other contracting party "a consultation period of no less

The second step in settling disputes is multilateral consultations. Thus, if the abovementioned consultation process fails to resolve the dispute within sixty days, the parties in dispute may agree to submit a written request to the Parties Group to consider the matter.[298] In turn, the Parties Group will review the dispute and may formulate recommendations to the parties in dispute within sixty days from the date of receiving the request.[299]

Another approach for settling disputes under the MAI, which the parties can resort to in case consultations fail, is mediation or conciliation under any rules they agree upon.[300] The MAI emphasizes the confidentiality of proceedings involving mediation or conciliation and prohibits contracting parties from invoking statements made or positions taken by the other contracting States in the process of mediation, except for factual representations.[301]

Finally, disputing contracting States can resort to arbitration to resolve their disputes. The dispute can be submitted by any of the contracting States in dispute to an arbitral tribunal upon compliance with the consultations requirements under the MAI.[302] The party resorting to arbitration must submit to the counterpart State a request identifying the matters in dispute, notify the depositary of this, and deliver a copy of the arbitration request to the Parties Group.[303]

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than 60 days after the date of the receipt of the request". *Ibid.*, para. (B)(1)(b).

[298] See *ibid.*, para. (B)(2)(a-b) at 64.

[299] See *ibid.*, para. (B)(2)(c).

[300] See *ibid.*, para. (3).

[301] The MAI obliges parties to consultations, mediation, or conciliation to inform the Parties Group of any mutually agreed solution. See *ibid.*, para. (4).

[302] See *ibid.*, para. (C)(1)(a).

[303] It should be noted that a contracting State is not allowed to initiate proceedings "for a dispute which its investor has submitted, or consented to submit, to arbitration..., unless the other Contracting Party has failed to abide by and comply with the award rendered in that dispute or those proceedings have terminated without resolution by an arbitral tribunal of the investor's claim". *Ibid.*, para. (C)(1)(b) at 65.

The MAI then regulates in considerable details procedural and substantive aspects of the arbitration process. It includes provisions regarding: the formation of the arbitral tribunal, consolidation of arbitral cases, third parties interventions, scientific and technical expertise, proceedings of arbitration, arbitral awards, nullification of arbitral awards, and response to non-compliance.[304] Furthermore, the MAI incorporates the Permanent Court of Arbitration (PCA) Optional Rules for Arbitrating Disputes between Two States[305] as default rules to supplement the MAI's dispute settlement provisions.[306]

The MAI takes a similar approach regarding investor-State disputes. However, the MAI only regulates the investors' right to take legal recourse against contracting States, and not the States' right to take legal recourse against MNEs. Thus, the investor-State provisions apply to disputes between a contracting State and an investor of another contracting State related to an alleged breach of an obligation of the State under the MAI that causes loss or damage to the investor or its investment.[307]

Disputes between contracting States and investors of other contracting States should first be settled by negotiation or consultation. If this fails, the investor may choose to submit the dispute for resolution:

> a. to any competent courts or administrative tribunals of the Contracting Party to the dispute;

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[304] See *ibid.*, paras. (C)(2-9) at 64-69.
[305] See Permanent Court of Arbitration, *Optional Rules for Arbitrating Disputes between Two States*, effective 20 October 1992.
[306] See *MAI Negotiating Text, supra* note 225, para. (C)(8).
[307] See *ibid.*, para. (D)(1)(a) at 70. Investors of other contracting States are also empowered to submit to arbitration investment disputes regarding any other obligations that a contracting State enters into with respect to a specific investment of the investor through:
"i. An investment authorisation granted by its competent authorities specifically to the investor or investment.
ii. a written agreement granting rights with respect to [categories of subject matters] on which the investor has relied in establishing acquiring, or significantly expanding an investment." *Ibid.*, para. (D)(1)(b).

b. in accordance with any dispute settlement procedure agreed upon prior to the dispute arising; or
c. by arbitration in accordance with this Article under:
i. the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the "ICSID Convention"), if the ICSID Convention is available;
ii. the Additional Facility Rules of the Centre for Settlement of Investment Disputes ("ICSID Additional Facility"), if the ICSID Additional Facility is available;
iii. the Arbitration Rules of the United Nations Commission on International Trade Law ("UNCITRAL"); or
iv. the Rules of Arbitration of the International Chamber of Commerce ("ICC").[308]

By signing the MAI, contracting States give their "unconditional consent to the submission of a dispute to international arbitration".[309] Contracting States are, however, entitled to make reservations, by notification to the depository upon the deposition of their instrument of ratification or accession, that the abovementioned consent "only applies on the condition that the investor and the investment waive in writing the right to initiate any other dispute settlement procedure with respect to the same dispute and withdraw from any such procedure in progress before its conclusion".[310] The MAI further allows contracting States to reduce the scope of that limitation by notifying the depositary at anytime.[311]

The MAI, moreover, encompasses some substantive and procedural rules regulating the arbitration process. The coverage of these provisions includes: time periods and elements of notification by investors, appointments to arbitral tribunals, standing of the investment, consolidation of multiple proceedings, preliminary objections by States, indemnification, third party rights, scientific and technical expertise, the applicable law, interim measures of relief, final awards, confidential and proprietary information, place of arbitration and enforceability, and tribunal member fees.[312] Furthermore, the MAI gives the Parties Group

[308] *Ibid.*, para. (D)(2).
[309] *Ibid.*, para. (D)(3)(a) at 71.
[310] *Ibid.*, para. (D)(3)(b).
[311] See *ibid.*
[312] See *ibid.*, paras. (D)(3-19).

the jurisdiction to "adopt supplemental provisions to ensure the smooth functioning of these rules, in particular to clarify the inter-relationship between these rules and the rules of arbitration available [in the MAI]".[313]

2.7. Additional Disciplines of the MAI

Unlike the previously discussed investment instruments, the MAI is a comprehensive FDI agreement that covers a wide range of FDI issues. These include:[314]

2.7.1. Taxation

The MAI's application to taxation measures is limited. The general rule is that nothing in the MAI is applicable to taxation measures except where it expressly provide otherwise. Accordingly, the only MAI articles that are expressly applied to taxation measures are the Expropriation, Transparency and Dispute Settlement Articles.[315]

2.7.2. Privatization

The MAI does not impose any obligation on contracting parties to undertake privatization efforts. However, the MAI obliges contracting States to accord national treatment and MFN treatment to:

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[313] *Ibid.*, para. (D)(20) at 76.

[314] Besides the disciplines discussed in the following part of this thesis, the MAI includes provisions regarding Technology Transfers, R&D, Intellectual Property Rights, Public Debt, and Financial Services, among others.

[315] *Ibid.*, part VII, *Taxation* at 87-90. The MAI delegation made the following political declaration, attached as a footnote to the MAI Negotiating Text:

> Contracting Parties recognise the importance of the principle of non-discriminatory treatment in taxation for foreign investors and their investments. In this respect, they refer to their commitments under their agreements for the avoidance of double taxation. The Contracting Parties shall pursue their efforts to conclude agreements for the avoidance of double taxation, where appropriate, with Contracting Parties with which they have not yet entered into such agreements.

Ibid., footnote.

"a) all kinds of privatization, irrespective of the method of privatization (whether by public offering, direct sale or other method); and

b) subsequent transactions involving a privatized asset."[316]

2.7.3. Monopolies

The MAI clearly acknowledges that maintaining, designating[317] or eliminating monopolies[318] is the sovereign right of each country and that the MAI has no rules preventing States therefrom.[319] The MAI, however, obliges contracting States to [endeavour to][320] accord nondiscriminatory treatment[321] when designating any monopoly.[322] The MAI further obliges contracting States to ensure that any privately or publicly-owned monopoly that is maintained or designated by their nationals or their respective governments:

> a) provides non-discriminatory treatment to investments of investors of another Contracting Party in its supply of the monopoly good or service in the relevant market.
>
> b) provides non-discriminatory treatment to investments of investors of another Contracting Party in its purchase of the monopoly good or service in the relevant market. This paragraph does not apply to procurement by governmental agencies of goods or services for government purposes and not with a view to commercial resale

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[316] *Ibid.*, part III, *Privatization*, para. 1 at 27. Notwithstanding this paragraph, the MAI provides that "arrangements under which natural persons of a Contracting Party are granted exclusive rights as regards the initial privatization are acceptable as a method of privatization...provided that the exclusive right as regards the initial privatization is limited to natural persons only and provided that there is no restriction on subsequent sales". *Ibid.*, para. 2.

[317] Designate "means to establish or authorise, or to expand the scope of a monopoly". *Ibid.*, part III, *Definitions Related to Monopolies [and States Enterprises]*, para. (C)(2) at 38.

[318] The MAI Negotiating Text defines monopolies as"any person or entity designated by a [national [or subnational] government authority] [Contracting Party] as the sole supplier or buyer of a good or service in a relevant market in the territory of a Contracting Party. It does not include a person or entity that has an exclusive intellectual property right solely by reason of such right or the exercise of such right". *Ibid.*, para. (C)(3).

[319] See *ibid.*, *Monopolies*, para. (A)(1) at 32.

[320] "Delegations remain divided on the desirability of removing these brackets." *Ibid.*, *Definitions Related to Monopolies [and States Enterprises]*, para. (C)(2), footnote.

[321] Nondiscriminatory treatment is defined in the MAI as "the better of national treatment and most favoured nation treatment, as set out in the relevant provisions of [the MAI]". *Ibid.*, para. (C)(5) at 39.

[322] See *ibid.*, para. (C)(2).

or with a view to use in the production of goods or services for commercial sale;

c) does not abuse its monopoly position, in a non-monopolised market in its territory, to engage, either directly or indirectly, including through its dealing with its parent company, its subsidiary or other enterprise with common ownership, in anticompetitive practices that adversely affect [an investor or] an investment by an investor of another Contracting Party, including through the discriminatory provision of the monopoly good or service, cross-subsidisation or predatory conduct;[323]

[d) Except to comply with any terms of its designation that are not inconsistent with subparagraph (a) or (b), acts solely in accordance with commercial considerations in its purchase or sale of the monopoly good or service in the relevant market, including with regard to price, quality, availability, marketability, transportation and other terms and conditions of purchase or sale.]

[Nothing in Article A (Article on Monopolies) shall be construed to prevent a monopoly from charging different prices in different geographic markets, where such differences are based on normal commercial considerations, such as taking account of supply and demand conditions in those markets.

Article A (Article on Monopolies), paragraphs 3(c) and 3(d) differences in pricing between classes of customers, between affiliated and non-affiliated firms, and cross-subsidisation are not in themselves inconsistent with this provision; rather, they are subject to this subparagraph when they are used as instruments of anti-competitive behaviour by the monopoly firm].[324]

Furthermore, the MAI obliges contracting States to "notify to the Parties Group any existing designated monopoly within [60] days after the entry into force of the Agreement, any newly designated monopoly within [60] days after its creation, and any elimination of a designated monopoly [and related new reservation to the Agreement] within [60] days after its elimination".[325] Nonetheless, the MAI expressly permits contracting States to lodge

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[323] The delegations could not reach an agreement on the inclusion of this paragraph and thus kept it as one alternative. The other alternative is to delete this paragraph completely. See *ibid.*, para., *Monopolies*, (A)(1), footnote.

[324] *Ibid.*, para. (A)(3). "A large majority of delegations are in favour of the deletion of subparagraph (d) and the following two paragraphs. One delegation is prepared to accept the removal of subparagraph (d) provided that these two paragraphs are maintained as interpretative notes. Two delegations, which are proponents of subparagraph (d) in its entirety, wish to maintain their position for inclusion in the article." *Ibid.*, para. (A)(3), footnote.

[325] *Ibid.*, para. (A)(4-5) at 36.

reservations regarding "an activity previously monopolised at the moment of the elimination of the monopoly".[326]

2.8. Conclusion

The MAI, which is described as the charter of corporate rights, clearly offers a very liberal investment regime for MNEs. The primary objectives of the MAI are to facilitate the free movement of capital and assure the protection of foreign investors. To achieve these goals, the MAI extends its scope of application to a wide range of investments and imposes burdensome obligations on the contracting States. The principal obligation of contracting States is to offer nondiscriminatory treatment to investments and investors of other contracting parties (*i.e.*, the better of national treatment and MFN treatment). The MAI extends this obligation to all phases of FDI, including the admission, expansion and all other operations of FDI. The MAI, furthermore, prohibits a wide range of investment measures, thereby limiting host countries control over foreign investments in their territories. It, moreover, grants foreign investors of other contracting parties a considerably favourable monetary transfers regime and provides them with extensive protection against expropriation and strife damages. Although the MAI incorporates general exceptions to the application of its rules and gives space for country specific exceptions, these exceptions are narrow. Additionally, the country specific exceptions are subject to a standstill obligation and might also be subject to a rollback obligation. Finally, this liberal FDI regime is strengthened by a very powerful dispute settlement mechanism that allows both contracting States and their investors to have legal recourse against violations of the MAI's obligations.

The liberal regime of the MAI, which is the design of the rich developed countries of the OECD, clearly carries an unfair balance of interests. A joint NGO statement on the MAI, endorsed by 560 organizations in 67 countries, considered the draft MAI text to be completely unbalanced as it "elevates the rights of investors far above those of governments,

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[326] *Ibid.*

local communities, citizens, workers and the environment".[327] These NGOs criticized the MAI draft text on the basis that it:

1. Does not respect the rights of countries --"in particular countries in transition and developing countries-- including their need to democratically control investment into their economies".[328]

2. Does not contain an appropriate balance of interests as it fails to recognize the different needs of developed and developing countries.

3. Contains a very strict withdrawal provision that "would effectively bind nations to one particular economic development model for fifteen years; prevent future governments from revising investment policy to reflect their own assessment of the wisest economic course; and force countries to continue to abide by the agreement even if there is strong evidence that its impact has been destructive."[329]

4. Does not contain obligations for MNEs' practises, especially with regard to "the environment, labour standards and anti-competitive behaviour", yet gives MNEs the right "to attack legitimate regulations designed to protect the environment, safeguard public health, uphold the rights of employees, and promote fair competition".[330]

5. Does not grant citizens, local governments and NGOs access to its dispute settlement system, thus depriving them from holding MNEs accountable to the communities that host

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[327] See *Joint NGO Statement on the Multilateral Agreement on Investment (MAI) to the Organization for Economic Cooperation and Development- Endorsed by 560 Organizations in 67 Countries*, http://www.Canadians.org/ngostatement.html (date accessed: 22 September 1998) [hereinafter *Joint NGO Statement*].

[328] *Ibid.*

[329] *Ibid.* MAI contracting States can only withdraw after five years from the date on which the MAI enters into force. Even after withdrawal, a country would remain bound by the MAI for 15 years after its notice of withdrawal for all investments that have exited before that date. See *MAI Negotiating Text*, *supra* note 225, part XII, *Withdrawal*, paras. 1-3 at 105.

[330] *Ibid.*

them, and even from commenting on cases where foreign MNEs take legal recourse against the host countries' governments.[331]

6. "Will be in conflict with many existing and future international, national and sub-national laws and regulations protecting the environment, natural resources, public health, culture, social welfare and employment laws; will cause many to be repealed; and will deter the adoption of new legislation, or the strengthening of existing ones."[332]

7. Facilitate cross-border capital movement "despite evidence that increased capital mobility disproportionately benefits multinational corporations at the expense of most of the world's peoples".[333]

Obviously, developing countries are likely to find the MAI's level of liberalization unaffordable. Indeed, if even major developed countries, such as France, Canada, and Australia, deemed the MAI's balance of interests inappropriate, weaker developing countries would certainly reject the MAI. In fact, some developing countries have already expressed their rejection of the MAI.[334]

Although the MAI talks were conducted in secret from the very beginning and developing countries and other non-OECD countries were not invited to the talks, the MAI was intended to be open to signature by all countries, developed and developing.[335] In fact, the OECD

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[331] *Ibid.*

[332] *Ibid.*

[333] *Ibid.*

[334] "The level of liberalization contained in the MAI has already been opposed as inappropriate by many developing countries. However, non-OECD countries are under increasing pressure to join." *Joint NGO Statement*, *supra* note 327. MAI's proposals "have drawn flak from some developing nations, which argued that such an accord would end up attaching excessive emphasis on the rights of multilateral corporations". "Japan, EU to Propose FDI at WTO", *supra* note 222.

[335] In an attempt to avoid an argument by developing countries to reject the MAI, the OECD countries invited a number of developing countries, including Argentina, Brazil, Chile and the Baltic States, as observers in its MAI negotiation group. These countries "will be used to say that "developing" countries are now being involved in MAI talks". "MAI Update", *supra* note 252. "To begin with the

countries considered the broadening of the MAI to include developing countries a prime objective.[336] As one commentator puts it:

> The main target of the MAI was and is the developing countries. Ostensibly this reflects from the old fear of businesses losing their investments to expropriation and nationalization. But, the rich nations decided cleverly to negotiate it among themselves and then put a gun on the heads of countries who they wanted into the framework, sign on or else! If they had wanted negotiations at the WTO, it could not have been done as fast as they planned at the smaller OECD.[337]

Nevertheless, bowing to pressure by critics of the MAI, and failing to stay unified, the OECD appears to have retreated from this approach. After the 3 December 1998 informal consultation, the OECD declared that further work on multilateral rules on investment "should be carried out in a *transparent manner* and should involve all OECD members *as well as interested non-member countries*, including those that participated as observers in the negotiations".[338]

This does not, however, put an end to developed countries' endeavours to regulate FDI multilaterally. Indeed, OECD officials explicitly reaffirmed the desirability of and need for multilateral FDI regulation. Furthermore, some OECD members reaffirmed their commitment to individually pursue their multilateral liberalization crusades and to continue to put pressure on developing countries to yield to their plans, either at the OECD, WTO or other organizations.

OECD roped in few key developing countries (Argentina, Chile, Hong Kong, Slovenia etc.) as observers in its MAI negotiating group, and targeted the rest through outreach workshops. These were mainly large developing countries such as China, India and Indonesia in Asia, and South Africa, Egypt and Nigeria in Africa." Metha, *supra* note 193.

[336] France, for example, conditioned its final signing of the MAI on the joining of a sufficient number of developing countries to the MAI. See *French Report*, *supra* note 211.

[337] Mehta, *supra* note 193.

[338] "3 December OECD Press Release", *supra* note 218 [emphasis added].

The developing countries' opposition to the MAI demonstrates that they are likely to find the liberalization level of any FDI agreements designed by developed countries, be it the MAI or any other agreement, unaffordable. Nonetheless, developing countries will face enormous pressure to join the MAI or other developed countries' proposals, whether concluded within the OECD, the WTO or elsewhere.

III. Conclusion

FDI is a mixed bag for developing host countries, MNEs and their home countries. As these parties try to maximise the advantages they can obtain from FDI, their interests conflict. The way to balance these conflicting interests is through the regulation of FDI, which can be done unilaterally, bilaterally, regionally and multilaterally.

All forms of FDI regulation tackle the economic factors of States' interests introduced in Chapter 1 of this thesis (*e.g.*, the effect of FDI on the balance-of-payments, resource-transfers, etc.). Thus, FDI regulation deals with a variety of issues, such as the conditions for entry, standards of treatment, monetary transfers, operational conditions, etc. This Chapter has introduced the various forms of FDI regulation and has analysed the balance of interests encompassed in some of these regulations.

Although the examination of the various forms of FDI regulation clearly demonstrates that the balance of interests vary from one regulation to another, the general formula that developing countries follow in regulating FDI is the same; developing countries balance between harnessing the most benefits from FDI through regulation and achieving certain liberalization levels in order to remain attractive to MNEs as a site for investment. Although FDI regulation is a sovereign matter, developing countries do not always attain such an advantageous balance. As will be explored in the next Chapter of this thesis, developing countries are often subject to external pressure and competition, which affect their approach towards FDI regulation.

Therefore, the next Chapter of this thesis highlights the global trend towards liberalization of FDI regulation and the case against this trend. It concludes by formulating general regulatory FDI guidelines for developing countries.

CHAPTER 3
LIBERALIZATION OF FDI

I. Introduction

FDI liberalization, or FDI deregulation, refers to the relaxation of FDI laws or the adoption of liberal laws that allow FDI to function on a free market basis rather than according to regulatory regimes. FDI liberalization "involves the reduction of barriers to entry and operations by foreign investors; the strengthening of standards for their treatment by host countries (with national treatment perhaps being the most important among them); and the strengthening of mechanisms that ensure the proper functioning of markets".[339] FDI liberalization is, thus, a sovereign matter that may be accomplished by States unilaterally, bilaterally, regionally and multilaterally.

The last decade has witnessed an increasing trend towards FDI liberalization. This liberalization phenomenon has taken place on unilateral, bilateral, regional and multilateral levels. The bulk of liberalization, however, has occurred at the unilateral level. In 1995 alone, 64 countries undertook 112 changes to their domestic FDI legislations. One hundred and six of these changes were in the direction of liberalization. This liberalization trend has also been very steady; throughout the period 1991-1995, 474 out of 485 changes in FDI regulation were in the direction of liberalization. The following table shows the changes in domestic FDI laws and the direction thereof during the period 1991-1995.[340]

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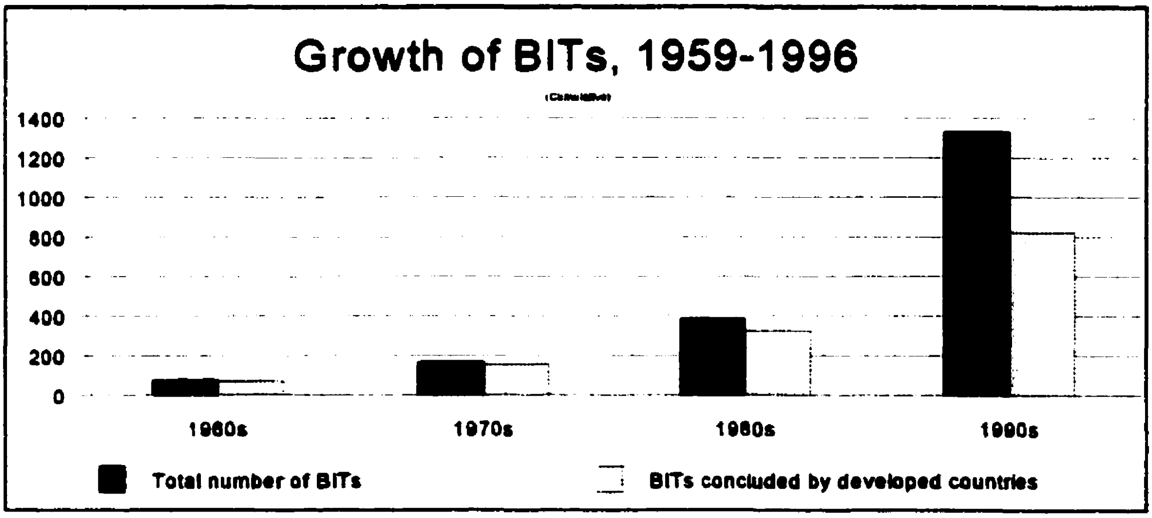
[339] Sauvant, *supra* note 60.

[340] See *UNCTAD World Investment Report 1997*, *supra* note 7 at 18.

Year	1991	1992	1993	1994	1995	1996
Number of countries that introduced changes in their investment regimes						
	35	43	57	49	64	65
Number of changes						
	82	79	102	110	112	114
Of which: In the direction of liberalization or promoting (a)						
	80	79	101	108	106	98
In the direction of control (b)						
	2	–	1	2	6	16

(a) Including measures aimed at strengthening market supervision, as well as incentives.
(b) Including measures aimed at reducing incentives.

The 1990s has also been a decade of bilateral liberalization. As illustrated in the following chart,[341] two-thirds of the 1,160 BITs that existed before June 1996 were concluded in the 1990s. Participation in these BITs included some 158 developed and developing countries. Although the majority of BITs were concluded between developed and developing countries, there has been an increase in the number of BITs concluded among developing counties.



[341] See *ibid.* at 19.

FDI liberalization has also extended to the regional and multilateral levels. As mentioned earlier, a number of regional agreements were concluded within the respective frameworks of regional organizations, such as ASEAN, the EU, NAFTA, APEC and MERCOSUR. These regional agreements entail a considerable degree of liberalization and are no longer considered only as "free trade agreements but more and more free investment agreements as well".[342] We have also examined a number of multilateral legal instruments aimed at the liberalization of FDI, such as the GATS, TRIPS and TRIMS Agreements. Although the existing agreements are of a "sectoral or issue-specific nature", there are efforts, mainly within the context of the OECD and the WTO, to realize full multilateral liberalization.

II. The Case Against FDI Liberalization

The advantages of FDI for host developing countries lie in the resource-transfer, employment, and balance-of-payments effects. If FDI was deregulated, these advantages would be eliminated or at least reduced to a minimum and could be more than offset by the disadvantages of FDI. If FDI was deregulated, first, the employment effect would be cut down in case the foreign MNE resorted to employing foreigners. Second, the resource-transfer could also be reduced. As previously explained, the positive effect of management skills transfer can be restricted when MNEs choose to limit their management and high-skilled positions to foreign employees. And the benefits of technology transfer can also be abolished if the investment takes the form of a wholly owned subsidiary. The benefits to the host county's balance-of-payments would further be reduced due to the lack of regulation; this would happen mainly in cases where MNE's goal of FDI is to serve the demand of the national market only. The result would, accordingly, be denying the host country of the advantage of exporting the goods that foreign MNEs produce domestically,[343] thus leaving the host country only with the benefits of capital-inflow to initiate the investment, which, by

[342] Sauvant, *supra* note 60.

[343] The balance-of-payments of the host country will still, however, benefit in this case from the reduction of importation of the goods that are produced domestically.

definition, has a one-time effect only.

FDI liberalization would not only result in the reduction of the benefits of FDI for host countries, but also in an increase in the costs of FDI to them. Under a deregulated environment, the potential negative impact on local competition in the host country would be greater as the local enterprises would be left without protection against the much larger foreign MNEs.[344] Furthermore, the negative consequences on a host country's balance-of-payments might be aggravated; the host country would have less or even no control over the level of increase in an MNE's repatriation of earnings and its importation of inputs for its production, potentially resulting in an increase in the host country's debt. Moreover, the risk of losing control over key economic decisions, by reducing oversight of the decisions made by MNEs, would be maximized.

However, advocators of liberalization argue that FDI liberalization is advantageous for developing countries. They assert that the advantages of FDI liberalization "would not only accrue at a micro-economic and at a national level but would also be more general and systemic".[345] They argue that FDI liberalization along with trade liberalization "would, in addition to generating more investment, lead to a better allocation of resources, greater economic efficiency and thereby faster economic growth at a global level".[346] Some economists even suggest that "a regime of free trade and capital movements (including FDI) will lead also to factor price equalization, that is, equality of real wages and profit rates world-wide".[347]

Nonetheless, the "empirical evidence provides no support for believing that there are unqualified systemic gains from a regime of free trade and capital movements. If anything,

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[344] See I.F.I. Shihata,"The Role of Law in Business Development" [June 1997] 20 Fordham Int'l L.J. 1577 at 1584.
[345] Yelpaala, *supra* note 45 at 250.
[346] *Ibid.*
[347] *Ibid.*

the evidence suggests that there have been systemic losses."[348] In fact, even if FDI liberalization resulted in an increase in world welfare, there is no guarantee that this increase would be distributed fairly. On the contrary, it is more likely that MNEs and their developed home countries would be the primary or only beneficiaries.

Generally speaking, therefore, FDI liberalization does not appear to be advantageous for developing host countries. If this is the case, and if, as noted earlier, regulation of FDI is the way for developing countries to manage and balance the advantages and disadvantages of FDI, it is legitimate to wonder why these countries would give up control over the regulation of FDI by liberalization.

Since FDI liberalization is done by States according to their sovereign will, the current FDI liberalization trend appears easily explainable.[349] As States try to increase the advantages and decrease the disadvantages of FDI through regulation, they also try to remain attractive to foreign MNEs as an investment site by achieving a certain degree of liberalization and flexibility in their FDI policies.[350] According to this formula, FDI deregulation seems only normal; developing host countries find a balance between liberalization and regulation that makes FDI advantageous for them while remaining attractive to foreign investment.

This does not mean, however, that developing countries can always achieve such an advantageous balance. Aside from the inability and lack of sufficient economic planning of some developing countries to sketch such a formula, developing countries encounter external

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[348] *Policy Brief for the South Foreign Direct Investment, Development and the New Global Economic Order* (Geneva: South Center, 1997) Chemin du Champ d'Anier 17, 1211, http://www.southcentre.org/publications/FDI/toc.htm [hereinafter *South Center Brief*]. See also Burt, *supra* note 41 at 1056.

[349] This is true for international liberalization (bilateral, regional and multilateral) just as much as it is true for unilateral liberalization. Although international liberalization might appear to conflict with States' sovereignty, it does not because States "may voluntarily constrain or qualify [their] sovereign ability to control FDI by participating in an international treaty that specifically limits the [States'] rights". Burt, *ibid.*, at 1027.

[350] See, *supra* note 45.

factors which contribute to their failure to achieve such a beneficial balance and thus explains the current liberalization trend.

First of all, developing countries are being pushed to participate in a destructive race to attract FDI through liberalization. Although FDI incentives are a minor factor in choosing a location for FDI, "the way the competitive game in incentives is being played by governments, no country can afford to refrain from offering investment incentives for fear of losing out to similarly placed countries".[351] Under such circumstances, developing countries are subject to pressure to accept a degree of liberalization where FDI is least advantageous or not advantageous at all for them. Indeed, "developing countries as a whole lose collectively from competition among themselves in offering ever greater incentive packages to attract FDI. Collectively and individually, developing countries would gain from cooperation rather than competition in this sphere."[352]

Furthermore, developing countries usually face pressure from developed countries to achieve certain levels of FDI protection and liberalization by amending their national FDI laws or joining international FDI instruments.[353] While this pressure has usually taken economic and political forms, it seems that it is developing to include even military pressure under the so-called new world order. The latest American strike against Iraq (Operation Desert Fox), which was done unilaterally by the US and Britain in violation of the UN Charter, is a clear example of this sort of pressure. President Clinton of the US bluntly stated in his speech justifying the military action that the strike was done to protect American interests in the region, including economic interests.[354] While the fact that the strike had other political and

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[351] *South Centre Brief*, *supra* note 348.
[352] *Ibid.* See also Low & Subramanian, *supra* note 157 at 391, which notes that "poorer countries are likely to be at a disadvantageous if investment location is determined primarily by the relative attractiveness of various nations' fiscal incentive packages".
[353] See Mehta, *supra* note 193.
[354] For the text of President Clinton's speech, see http://www.cnn.com (date accessed: 17 December 1998).

legal justifications mitigating the use of force for protecting mere economic interests, the strike has generated an enormous psychological pressure in some developing countries; mess with American economic interests and you will suffer the same severe consequences.[355]

A South Centre policy brief argues that FDI liberalization can be harmful to developing countries and that pushing developing countries to adopt "a global investment regime which [takes] away a developing country's ability to select among FDI projects, and to regulate inflows for macro-economic reasons, [can] hinder development and prejudice economic stability".[356]

The brief concludes that "all developing countries lose from competition among themselves to offer ever greater FDI incentives and hence a policy conclusion to be drawn is that, in addition to being selective in their acceptance of FDI, developing countries would benefit collectively from cooperation on the matter of investment incentives rather than competition in this sphere".[357]

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[355] See F. Alfanek,"The Effect of the American Strike on Jordan" [in Arabic] *Al Ra'i News Paper* (19 December 1998) 50.

[356] Accordingly, as will be discussed in greater details in the following part of this thesis, the South Centre brief suggests that the best approach "to limit the risks associated with FDI, avoid its undesirable effects, and increase the likelihood of it making a positive contribution to a country's socio-economic development efforts is to pursue a policy of":

•Selectivity with respect to the magnitude and timing of capital inflows including FDI.

•Selectivity with respect to specific projects, with preference for those with large technological spill-overs or other important socio-economic benefits.

•Prudence with respect to total FDI flows as well as FDI stock so as not to render the economy financially more fragile in the context of future economic shocks.

South Centre Brief, *supra* note 348.

[357] *Ibid.*

III. Regulatory FDI Guidelines for Developing Countries

A. The Form of FDI Regulation: Multilateralism Vs Unilateralism

It should be noted that even though the liberalization trend has involved the participation of developing countries on the unilateral and, to a lesser extent, the bilateral and regional levels, it did not involve any meaningful participation of developing countries on the multilateral level. This is due in part to the very nature of multilateral liberalization. Developing countries generally prefer unilateral regulation as it can more precisely adapt to their specific situations and individual needs. Each developing host country can best evaluate its unique conditions and regulate FDI accordingly. Furthermore, unilateral regulation is more flexible and can be amended more easily because it only involves the will of the host country. This has caused some commentators to question the need for a multilateral FDI instrument, especially since the flows of FDI have been steadily increasing and since this increase was also accompanied by a surge in unilateral and bilateral FDI liberalization.[358]

Nonetheless, some commentators argue that multilateral regulation is a more efficient form of regulation.[359] Indeed, the virtue of multilateralism lies in the extended degree of

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[358] See Mehta, *supra* note 193.

[359] One commentary lists the following advantages for a multilateral framework for FDI regulation:

> 1. Governments that have liberalized their investment regimes could use a multilateral framework of commitments to make the reversal of such liberalization more difficult.
> 2. In a world economy so often dominated by mercantilist sentiment, common ground rules and a common purpose may provide a fillip to liberalization.
> 3. A framework of international commitments with dispute settlement provisions would provide policy continuity and therefore more secure investment opportunities.
> 4. With regionally based agreements among countries continually springing up, an international framework might ensure that agreements do not operate in ways that would fragment the international economy.
> 5. The possibility of controlling destructive competition among national finance ministers [to attract FDI through offering investment incentives].

Low & Subramanian, *supra* note 157 at 391. See also *Joint NGO Statement*, *supra* note 327, which notes that "[t]here is an obvious need for multilateral regulation of investments in view of the scale of social and environmental disruption created by the increasing mobility of capital". The statement, however, rejects developed countries' unbalanced regulatory proposals, like the MAI, which aim at regulating governments rather than investors.

uniformity it introduces in FDI regulation. This uniformity results in predictability and clarity,[360] thus allowing long-term planning and transaction costs reduction.[361] Developed countries in favour of multilateral liberalization, moreover, argue that if FDI liberalization was applied globally, it would achieve a net gain in world welfare.[362] Developing countries, however, focus on potential welfare loss to their own economics.[363] They argue that while it might be generally true that multilateral FDI liberalization could result in an increase in world welfare, nothing guarantees a fair distribution of this increase, and that, on the contrary, only developed countries would benefit from such an increase.

Accordingly, although multilateral FDI regulation could have global systemic benefits, it would entail serious costs to developing countries. Developing countries should, thus, continue to reject multilateral FDI regulation if the disadvantages of such regulation outweighs its advantages for them. However, if the concerns of developing countries are adequately eased, there should be no reason for them to reject multilateralism in FDI regulation. In other words, the benefits of multilateral regulation lie in the stability and uniformity it introduces, which could eventually result in an increase in world welfare; only if a fair distribution of this increase is guaranteed, by easing the concerns of developing countries, should developing countries uphold multilateralism in FDI regulation. Therefore, the following part of this thesis discusses the guidelines on which a multilateral agreement on investment involving developing countries should be based.

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[360] See T. L. Brewer & S. Young, "The Multilateral Agenda for Foreign Direct Investment: Problems, Principles, and Priorities for Negotiations at the OECD and WTO" [June 1995] World Competition 79.

[361] See A.B. Zampetti & P. Sauve, "Onwards to Singapore: The International Contestability of Markets and the New Trade Agenda" (1996) 19 World Econ. 333 at 340-341, which notes that multilateral liberalization in the WTO would achieve increased transparency and thus a reduction in transaction costs.

[362] See Burt, *supra* note 41 at 1055. See also R. McCulloch, "Investment Policies in the GATT" (1990) 13 World Econ. 541 at 552; R. Ruggiero, "Foreign Direct Investment and the Multilateral Trading System" [April 1996] Transnat'l Corp. 1 at 7.

[363] Burt asserts that "[i]n an international system still dominated by political concerns, pure welfare maximization is not possible, and political concerns will prevent a welfare maximizing agreement on direct investment." Burt, *ibid.*, at 1055.

B. Principles of A Multilateral FDI Instrument Involving Developing Countries

In order for a multilateral FDI agreement to: 1) achieve the general advantages of multilateral liberalization and at the same time meet the concerns of developing countries, and, 2) achieve a better balance between the interests of MNEs and other interested parties, such as governments, citizens, and workers, it should be based on the following principles, echoed in international conventions as the Charter of the Human Rights[364] and the United Nations Charter on the Economic Rights and Duties of States:[365]

(1) Citizens' Rights:

A multilateral FDI agreement should respect the basic citizens' rights included in the Universal Declaration of Human Rights and other citizens' rights agreements. Accordingly, such an agreement should take into account the respect and even strengthening of, *inter alia*:

> Labour Rights such as the right to employment, fair wages, and basic labour standards like health and safety, freedom to organize unions and collective bargaining; Social Rights such as quality health care, public education, social assistance, unemployment insurance, retirement pensions and special services to meet the needs of women, children, seniors and people with disabilities; Environmental Rights such as the preservation of the natural resources, species and bio-diversity of the planet for future generations through measures designed to prevent the destruction of the air, waters, forests, fish, wildlife, and non-renewable resources; Cultural Rights such as the preservation and enhancement of peoples' distinct identity, language, values, customs and heritage.[366]

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[364] See *Universal Declaration of Human Rights*, G.A. Res. 217, U.N. GAOR, 3d Sess., U.N. Doc. A/810 (1948). Available on: http://www.hrweb.org/legal/undocs.html#UDHR.

[365] See *United Nations Charter of the Economic Rights and Duties of States*, G.A. Res. 3281 (XXIX), 29 UN GAOR Supp. (No. 31), UN Doc. A/9631 (1974) at 50. Available on: http://www. hrweb .org/ legal/undocs.html#UDHR.

[366] "Towards a Citizens' MAI: An Alternative Approach to Developing a Global Investment Treaty Based on Citizens' Rights and Democratic Control" (Discussion Paper prepared by the Polaris Institute, Canada, 1998), http://www.canadians.org/citizensmai.html (date accessed: 25 November 1998) [hereinafter "Citizens' MAI"].

(2) Social Obligation of Capital:

Any multilateral regulation of FDI should be based on the principle that capital has an obligation to society. This principle, which was recognized in the United Nations Charter on the Economic Rights and Duties of States, asserts that "capital has a social dimension because it is the product of present and previous generations of labour [and that] society through the State makes it possible for the accumulation and use of capital by providing economic [*e.g.*, roads, bridges etc.] and social [*e.g.*, education] infrastructure."[367]

The observation of this principle would determine certain obligations and rights on both States and MNEs. On the one hand, States have the right and obligation, through FDI regulation, to guarantee that FDI pays its social debt, rather than just being deployed for profit maximization. Accordingly, as stated in the United Nations Charter on the Economic Rights and Duties of States, States have the right and duty to intervene in the national economy to steer FDI in the direction of public interest and to guarantee the protection of basic citizens' rights.[368] On the other hand, while MNEs are entitled to deploy their capital for profit making and to be granted protection against damages happening to their investments, MNEs must recognize the social obligation on their capital. Particularly, they must "ensure that their investment is designed to serve the public interest, primarily the basic rights of citizens," by recognizing the States' right and obligation to impose regulations to guarantee the compliance with this obligation.[369]

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[367] *Ibid.*

[368] *Ibid.*:

> The United Nations' Charter on the Economic Rights and Duties of States established this cornerstone... [T]he Charter recognized among other things, the political sovereignty of nation States to protect the public interest by regulating foreign investment. It granted member nations the authority to supervise the operations of transnational corporations in their territories by establishing performance requirements to ensure that foreign investment served the economic, social and environmental priorities of national development. While granting nation States the powers to "nationalize, expropriate or transfer ownership of private property", the Charter also called for the payment of fair compensation for expropriation.

[369] *Ibid.*

C. Components of A Multilateral FDI Instrument Involving Developing Countries

Developing countries stress their entitlement to a "development-friendly" policy framework for FDI, which should at least include elements that:

> * allow countries to be selective with regard to the timing of FDI and to actual FDI projects, according to current development levels and needs;
>
> * legitimize "qualified" market access so that a potential host country could specify the degree to which it would give national access, in terms of percentage limit on foreign share holding, or the total value of individual or aggregate foreign investment;
>
> * prevent abuse of monopoly power by large transnationals, encouraging, as far as possible, level playing fields between large foreign investors and small domestic companies so that the latter can survive and flourish;
>
> * permit limitations to national treatment, giving governments scope to stipulate performance requirements and similar measures, TRIMS notwithstanding, in order to encourage foreign enterprises to contribute to development objectives, including a healthy [balance-of-payments]; and
>
> * establish rules of conduct for foreign investors to prevent bribery and corruption and tax avoidance through transfer-pricing among other things.
>
> To provide a credible and predictable environment for foreign investment, whether by the North or the South, ground rules would be needed to guarantee the protection of investment and provide an appropriate dispute settlement mechanism, suitably designed to take account of the circumstances of developing countries.[370]

Obviously, this framework introduces very narrow liberalization, making it unlikely to be accepted by developed countries. Therefore, it is no surprise to find the framework suggested by developed countries, like that proposed in the MAI, for example, to the extreme opposite of that demanded by developing countries.[371]

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[370] *South Centre Brief*, *supra* note 348.

[371] Burt, *supra* note 41 at 1055.

It is manifest that both sides have valid arguments and legitimate concerns with regard to the matter of multilateral FDI liberalization. While developed countries want to take advantage of the benefits of multilateral liberalization, developing countries have been rejecting multilateral liberalization efforts because of the unaffordable degree of liberalization they introduce.[372] In rejecting this level of liberalization, developing countries stress the importance of investment regulation in steering FDI in the direction of their national development. Developing countries assert that they "are not economically or politically prepared for the rapid liberalization and almost complete relinquishment of sovereign control over FDI" required in developed countries' proposals such as the MAI.[373] Developing countries buttress this point by observing the fact that "the now advanced industrial countries built up their present economic strength under a regime, of strict controls over inflows and outflows of capital, which lasted for several decades, relaxing them only gradually and, in some cases only relatively recently".[374] So, developing countries argue that they should be permitted, by the same token, to maintain a certain degree of FDI regulation.

This conflict of interests was clearly crystallized at the WTO Uruguay Round negotiations leading to the TRIMS Agreement, and will perpetuate in the WTO as FDI regulation has found its way on the WTO agenda. While developing countries managed to limit the extent of FDI liberalization in the WTO, developed countries did not give up on achieving a more liberal multilateral FDI regulation. Thus, their reaction to the narrow FDI liberalization of the WTO was to embark on establishing the liberal MAI among themselves in the OECD with the intention to either pressure developing countries to sign this agreement or

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[372] Developing countries "have resisted multilateral efforts to regulate direct investment because they view restrictive investment policy as a sovereign right and an element of national economic policy. They fear abuse by multinational enterprises and a loss of sovereign control over national development if investment policies are liberalized." Burt, *ibid.*, at 1016.The South Centre Brief argues that "such an erosion of government autonomy in decision-making with respect to FDI as implied by current North proposals can have serious economic and political consequences for developing countries". *South Centre Brief*, *supra* note 348.

[373] See Burt, *ibid.* at 1015.

[374] *South Centre Brief*, *supra* note 348.

incorporate it in the WTO framework. In light of the recent stall of the MAI, it seems certain that the MAI will be exported to the WTO. If and when this happens, the conflict between developed and developing countries is expected to reach its peak.

This conflict must be settled by following an approach based on a balancing of interests and a trade-off of benefits.[375] In any case, a multilateral agreement on investment involving developing countries should adequately address the concerns of developing countries without putting any pressure on them.[376]

For any multilateral FDI agreement to accommodate the demands of developing countries and simultaneously allow developed countries to achieve multilateral FDI liberalization, it should follow a flexible and gradual liberalization approach. This study suggests that a GATS-like progressive liberalization method be followed in reaching a compromise

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[375] Since the MAI is designed by developed countries to suit their needs, it is only normal then for a multilateral FDI instrument involving developing countries, either within the framework of the WTO or other organizations, to include a different balance of interests than that of the MAI. Burt asserts that since

> the MAI promises to be the most comprehensive and the most liberalizing multilateral investment agreement in existence, it will figure prominently in negotiations at the WTO. Although the provisions and principles of the MAI will significantly influence negotiations in the WTO framework, it is not practicable for WTO negotiators to simply impose the MAI on all WTO member countries. Developed countries are negotiating the MAI, and the MAI, consequently, accommodates developed country concerns. The MAI provisions represent the interests and desired liberalization levels of developed countries. Consequently, the MAI should only be used as a reference agreement. It is not a practical model for a multilateral agreement in the WTO.

Burt, *supra* note 41 at 1055. However, realistically, developing countries should not expect all their demands to be met. Although designing a multilateral FDI instrument to consolidate the diverse demands of developed and developing countries, is, indeed, not an easy task, developed and developing countries should work together to realize a solution based on balancing of interests and trade-off of benefits.

[376] "To achieve a meaningful multilateral investment agreement and to secure the active participation of developing countries, WTO negotiators should take a balanced approach, seeking to understand the positions of both developed and developing countries on the issue of direct investment." *Ibid.*, at 1058.

multilateral FDI agreement between developed and developing countries.[377] This approach, which has gained wide acceptance among developing and developed countries, is flexible enough to accommodate the needs of countries with different levels of development as it allows each country some discretion in choosing the level of liberalization that best suits its economic conditions.

Such a liberalization method would apply the MFN treatment principle universally to all sectors and States with regard to the admission of foreign investors, the treatment of foreign investments and TRIMS, except for sectors to which a State files exceptions. The more liberal and burdensome obligations of market access and national treatment could be considered specific commitments, like in the GATS. These obligations would thus apply to the sectors that a State chooses and be subject to any conditions and qualifications it specifies. Such narrow and flexible liberalization "would give each developing country the scope to determine its own pace and approach to the liberalization of FDI" and thus would ease the main concerns of developing countries regarding FDI liberalization and grant them discretion in steering FDI in the direction of their national development objectives.[378]

However, this narrow liberalization must be balanced by a progressive liberalization mechanism in order to accommodate the interests of developed countries in achieving greater liberalization. Such a progressive liberalization mechanism would require States to attend periodical negotiations aimed at achieving higher levels of liberalization. However, in order for such negotiations to realize a fair balance of interests, they should take into account the different development levels of member countries and the development

[377] It is beyond the scope of this thesis to design a detailed and complete regulatory FDI instrument involving developing countries. Thus, it will only give general guidelines in that regard.

[378] The South Centre brief suggests that should there be a multilateral regime for FDI, rather than the current bilateral and regional agreements, "an approach worth considering, is that based on a "positive" list approach to liberalization of FDI - whereby each country specifies the economic sectors and industry, if any, in which it is willing to open up to FDI and willing to assume treaty obligations. This would give each developing country the scope to determine its own pace and approach to the liberalization of FDI." *South Centre Brief, supra* note 348.

objectives of developing countries. Thus, developing countries should be granted leeway to achieve less liberalization than developed countries and to impose greater restrictions to guarantee that FDI meets and contributes to their development objectives.

However, in order for the progressive liberalization mechanism to meaningfully achieve greater liberalization, it must be supported by a machinery to bridge the development gap between developed and developing countries. Thus, a multilateral FDI agreement should not only recognize the difference between its members' development levels, but should also aim at establishing a level playing field between them. This could be done by encouraging or even obliging developed countries to contribute to the development objectives of developing countries; developed countries, for instance, could be required to facilitate the access of developing countries to their technology, information and distribution networks and to undertake market access liberalizations in sectors with developing countries' export potential.

Furthermore, for a multilateral FDI instrument to better accommodate the different needs of developed and developing countries generated by the gap between their economic conditions, it could allow the application of a different set of rules to developing countries. For example, developing countries could be exempted from certain obligations, granted longer transitional periods for the application of some or all their obligations under the agreement and/or granted preferential treatment in certain areas, such as monetary transfers.

The agreement, moreover, must directly address the balance of the conflicting interests of MNEs and States; the agreement should include regulations for MNEs' practises rather than regulations on States' practises only.[379] A multilateral FDI agreement should not eliminate

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[379] Since the WTO framework regulates only products, not actors, Burt notes that:

> An extension of the WTO's rules to cover MNEs would be a noteworthy development in the evolution of the WTO system. The GATT/WTO system regulates only products, not actors. Its obligations apply only to governments, not firms. The GATT, however, never dealt with investment issues; it only covered trade issues. The extension of the WTO system in the

"important development policy tools -investment measures- without remedying the underlying problem for which the tools are employed -restrictive MNE practices-".[380] Indeed, only such a balance would ensure a fair allocation of FDI benefits and guarantee the contribution of FDI to the development objectives of developing countries. In establishing rules for MNEs' practises, the contracting States could consult the work already accomplished in the United Nations Conference on Trade and Development (UNCTAD) and the OECD in that regard.[381]

Finally, the agreement must formulate a fair and balanced dispute settlement mechanism. The negotiating countries should decide on whether to regulate State-State disputes only, or to include regulations for investor-State disputes. In general, developing countries reject the inclusion of provisions granting MNEs the right to have legal recourse against States' violations of their treaty obligations. This matter in closely related to the inclusion of rules regarding MNEs' practises. If such rules were included in the agreement, the rejection of developing countries to investor-State regulation could be lessened. Developing countries' acceptance of State-investor disputes could be traded for the inclusion of provisions regulating MNEs' practises and granting States the right to have legal recourse against MNEs for the violations of their obligations under the agreement. If such a trade-off was made, the agreement could regulate both State-State and investor-State disputes.

> Uruguay Round to cover investment issues was, itself, a radical development because the economic effects of and political sensitivities to foreign direct investment in host countries are far greater than the effects of trade. If developed countries earnestly desire comprehensive investment rules in the WTO, then they must be prepared to discuss the chief impediment to an agreement on such rules - uncontrolled MNE practices.

Burt, *supra* note 41 at 1058.

[380] *Ibid.*

[381] See *ibid.* at 1059. Particularly, reference should be made to *The Set of Multilaterally Agreed Equitable Principles and the Rules for the Control of Restrictive Business Practices*, U.N. Doc. TD/RBP/CONF/10, U.N. Sales No. E.81.II.D.5 (1981), reprinted in 19 I.L.M. 813 (1980); U.N. Ctr. on Transnational Corp.: *UN Code of Conduct, supra* note 82; and *The OECD Guidelines for Multinational Enterprises* (Org. for Econ. Cooperation and Dev., The OECD Guidelines for Multinational Enterprises (1994)).

III. Conclusion

The past decade has experienced an increasing FDI liberalization phenomenon. Liberalization efforts have been concluded on the unilateral, bilateral, regional and multilateral levels.

Generally speaking, liberalization is disadvantageous for developing countries. Liberalization of FDI regulations would not only result in a reduction in the advantages a host country can expect from FDI, but also in an increase in the disadvantages of FDI for it. Motivated by attracting FDI, developing countries, nevertheless, have had their share of participation in the liberalization trend. This participation seems easily explainable as developing countries try to achieve a balance between liberalizing their FDI policies to remain attractive to MNEs as an investment site and regulating FDI to ensure that it is advantageous for them

However, developing countries do not always achieve such an advantageous balance. Destructive competition among developing countries to attract FDI along with the pressure imposed on them to achieve greater liberalization has caused many developing countries to commit to liberalization levels at which the advantages of FDI for them are minimal or even non-existent.

The best approach developing countries can adopt to avoid this destructive competition and harness the full advantages of FDI is to cooperate on the issue of investment incentives and to employ "development-friendly" regulatory policies based on selectivity.

This Chapter has concluded by formulating regulatory FDI guidelines for developing. It has evaluated unilateral and multilateral forms of FDI regulation from the perspective of developing countries and has suggested the principles and components upon which a multilateral FDI agreement involving developing countries should be based.

CONCLUSION

Along with international trade, FDI has been the engine driving the current economic globalization of the world economy. The growth rate of FDI, which exceeded that of international trade and world output throughout the 1990s, raises important questions regarding the value of FDI to developing countries as host countries and the role it can play in their development.

An examination of the advantages and disadvantages of FDI demonstrates that FDI is a mixed blessing for developing countries. Just as FDI can benefit developing countries and contribute to their development, FDI also entails many costs to developing countries. FDI's benefits for host developing countries include the transfer of resources, the creation of jobs and a number of positive effects on the national balance-of-payments. The costs of FDI to host developing countries, on the other hand, may involve hindering domestic competition, the degradation of national sovereignty and some negative effects on the national balance-of-payments.

The controlling factor in determining the value of FDI to developing countries is, thus, dependent on the manner in which FDI is regulated. FDI regulation, which is a sovereign matter undertaken by States, can take unilateral, bilateral, regional and multilateral forms. The analysis of these forms of FDI regulation reveals an inherent conflict of interests between developed and developing countries regarding the manner in which FDI should be regulated. Correspondingly, the balance of interests encompassed in the various forms of FDI regulation to settle this conflict of interests vary considerably.

The formula that developing countries follow in regulating FDI is, however, ~~the~~ similar. Developing countries endeavour to achieve a balance between liberalizing their FDI policies to remain attractive to MNEs as investment sites and regulating FDI to assure that it remains advantageous for them. Nonetheless, destructive competition among developing countries to attract FDI coupled with external pressure on them to liberalize their FDI policies has caused many developing countries to commit to liberalization levels at which the advantages of FDI are minimal or even non-existent for them.

The best approach developing countries can adopt to avoid this destructive competition and harness the full advantages of FDI is to cooperate on the issue of investment incentives and to adopt "development-friendly" regulatory policies based on selectivity. Unilateral regulation is the best form of regulation to allow developing countries to achieve such "development-friendly" regimes. Although multilateral regulation offers less flexibility to developing countries in FDI regulation, it carries the advantages of uniformity and stability, which could result in a surge in world welfare. Thus, developing countries should embrace multilateralism in FDI regulation only if a fair distribution of this increase is guaranteed by offering flexibility in multilateral regulation to meet their demands.

In any case, a multilateral FDI agreement involving developing countries should adequately address their concerns. Such an agreement should be based on the principles of the social obligations of capital and respect the basic rights of citizens. This study has suggested that a GATS-like progressive liberalization approach be followed in order for a multilateral FDI agreement to accommodate the demands of developing countries and at the same time allow developed countries to achieve their needs for multilateral FDI liberalization. Such a method should initially adopt narrow liberalization, yet should be supported by a progressive liberalization mechanism and a machinery to bridge the development gap between developed and developing countries. It should, furthermore, allow the application of a different set of rules on developing countries, include regulations for MNEs' practices and establish a balanced dispute settlement mechanism.

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