Why we need a MAID (a MAI for Development)

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Abstract

The paper examines whether new multilateral rules on foreign direct investment (FDI) are necessary, and –if this is the case- whether such rules should be the result of a Multilateral Agreement on Investment (MAI) within the next WTO Round. The first part describes the evolution, and present status, of national and international FDI rules. It is shown that the system emerged from the pervasive changes of the 1980s and 1990s is fragile, since the liberalisation of FDI policies has mostly come unilaterally. The second part analyses why international co-operation leading to multilateral rules may lead to a rise in world welfare. The third part depicts four potential scenarios on how international FDI rules might evolve and the position of different countries. I argue that we need a multilateral negotiation on FDI which should take into account development needs (what I call a MAI for Development, or MAID). The essential features of a MAID are discussed.

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1. Introduction

The spectacular growth of foreign direct investments (FDI) by multinational companies (MNEs) represents the most distinctive feature of the present phase of globalisation of the world economy. The increased importance of FDI is not only due to their rapid rise but also to the fact that FDI are tightly – and increasingly - linked to the development and international transfer of technology and have become the single most important component of private capital flows to developing countries (UNCTAD-DTCI, 1999).

Notwithstanding the significance of this phenomenon, differently from what has happened in the trade and in international monetary fields, no coherent framework of multilateral rules has yet emerged. So, in the last few years, a lively debate has taken place on whether to launch a negotiation dealing specifically with FDI, i.e. a Multilateral Agreement on Investment (MAI), and on whether such a MAI should be part of the next WTO Round.

The main issues to be addressed in a MAI are (UNCTAD, 1999b):

- standards of treatment for the foreign investors;
- market distortions created by host governments' policies (entry restrictions, performance requirements, FDI incentives);
- market distortions created by investing firms (restrictive business practices);
- investment protection (and mechanisms for the settlement of disputes).

Some of these issues imply obligations for host countries, while others for the investing firms. The main difficulty of agreeing on a set of multilateral rules on FDI rests on the contrast between the objectives of MNEs (consequently of home countries) and the objectives of host countries. MNEs maximise profits on a global scale, therefore press for market access and common regulatory standards. Instead, host countries have national objectives, and thus try to preserve their ability to manage independently their national economy, subjecting to controls some forms of firms' behaviour.

The paper is structured as follows. Sect. 2 describes the evolution and present status of FDI rules at both national and international level. Sect. 3 analyses the welfare implications of multilateral FDI rules. Sect. 4 depicts four scenarios on how international FDI rules might evolve. The main conclusions are presented in Sect. 5.

2. Evolution and present status of FDI rules at both national and international level.

In this section I will briefly discuss the key features of the evolution of national FDI policy and international FDI rules since the end of WWII. It is possible to identify three major phases (Sauvant and Aranda, 1994; Tolentino, 1999; Brewer and Young, 1998):

2. 1 The mid-1940s - late 1960s: the beginning of bilateralism

In the second post-war period a complex architecture of rules was created, designed to allow an orderly development of international economic transactions. Initially FDI were meant to be part of this project. The Havana Charter of 1948, designed to establish the International Trade Organisation (ITO), was an attempt to deal with FDI issues at the multilateral level and in a comprehensive way (Table 1). The Charter included articles on trade, FDI (articles 11 and 12) and competition (chapter v). The attempt failed since the USA and some other countries did not ratify the Charter, holding that rules on investment protection were too weak, while the ITO powers to regulate restrictive business practises were too wide.

After the failure of the Havana Charter, further attempts to create international rule on FDI had a narrower scope. There was a shift from multilateralism to bilateralism and from a comprehensive set of problems to specific issues. The most important feature of this period became therefore the signing of bilateral agreements on investment (BITs) between developed and developing countries, dealing with investment protection and with the settlement of disputes.

2.2 The 1970s: the phase of conflict

In the 1970s national FDI policies became more protectionist. Several restrictions on entry and operations were introduced by both developed and developing countries. This is the most tense phase in the relationship between host governments and MNEs. At the international level, most efforts to formulate rules on FDI were devoted to create obligations for MNEs. The failed attempt to approve a Code of Conduct for MNEs within the UN is the key feature of the period (Tab 1).

2.3 The 1980s and 1990s: unilateral FDI liberalisation and promotion

These two decades assisted to the liberalisation of FDI policy in both industrialised and developing countries, and thus to the convergence of national policies initially amongst developed countries and then in the North-South context. Another major development in this period is the intensification of policy competition amongst countries for attracting inward FDI, leading to incentive wars (Oman, 2000).

The unilateral liberalisation of national FDI policy was the result of two interrelated trends: on one hand the emergence of a new free-market policy orientation, on the other the acceleration of technological progress and the characteristics of the new technologies. The acceleration in technological change began in the mid-1970s (when measured in terms of R&D expenditures). As Petit and Sanna-Randaccio (1998, 2000) have demonstrated, innovation and multinationalization are interrelated phenomena, which are mutually reinforcing. Thus higher R&D spending stimulated firms to increase their production abroad and vice versa. In such a context governments increasingly focused their attention on technology as a crucial determinant of economic performance. Meanwhile, it became increasingly difficult to obtain and absorb advanced technological know-how through arm's length transactions, such as licences, due to the increasing complexity of the new technologies. Therefore, due mainly to the role of MNEs in the creation and international diffusion of technology, governments began to change their polices on FDI, opening up national markets to foreign investors. In turn, FDI liberalisation created further incentive for multinational expansion and technological innovation. Therefore technological change – multinational expansion – policy liberalisation interacted and reinforced each other, and these feedback mechanisms help explaining the acceleration in the pace of economic change in the recent past.

Globalisation therefore is not policy induced, as some authors maintain (e.g. Khor, 2000), but has its more profound roots in the acceleration of technological progress (and in its recent characteristics) and in the new ideological climate. A clear understanding of the causes of globalisation is of key importance in order to define correctly which is the best strategy for a country with regard to the creation of multilateral rules on FDI.

The 1990s saw a remarkable acceleration in international FDI rule making, especially at the bilateral and regional level (Tab. 1). The priority is not anymore to create obligations for MNEs: efforts are now directed to open markets to foreign investments and to define obligations for host governments.

At the bilateral level, a rapid increase in the number of agreements took place. In 1998 there were 1726 BITs, 80% of which concluded in the 1990s. These agreements were not only North-South but also South-South.

Several regional agreements containing specific rules on FDI were concluded. The most extensive treatment of FDI was in NAFTA. Chapter 11 of the NAFTA agreement grants to firms from other NAFTA countries national treatment and most favoured nation status in the pre- and post-entry phases; it prohibits most performance requirements and allows investment protection and settlement mechanism for State-State and for investor-State disputes. However no provisions are included on investment incentives, and on anti-competitive behaviour of MNEs (Graham, 1996, 2000).

At the multilateral level, two agreements dealing with FDI were reached as result of the Uruguay Round: the agreement on Trade Related Investment Measures (TRIMs) and the General Agreement on Trade in Services (GATS). These two agreements extended WTO competence to FDI matters. Although the convergence of national FDI policies had created the possibility of a comprehensive approach, FDI issue continued to be dealt with in a fragmented way, with the adoption of an issue- or sector-specific approach.

The TRIMs Agreement deals only with the post-entry treatment of FDI. It prohibits some forms of performance requirements, such as the local content requirement (the obligation that a given percentage of the volume of production of a foreign-owned subsidiary is locally made). Such measure had been widely adopted by developing countries, particularly in the automobile sector.

GATS deals with entry and post-entry treatment of FDI in the service sector. The right of entry is granted according to the so-called method of the *positive list*, which implies that each member State must present a list of sectors to be liberalised and has then the obligation of allowing the entry of foreign firms only in the sectors explicitly indicated in such list. The agreement represents a mechanism for gradual liberalisation. It provides that a new round of negotiations to enlarge the coverage of GATS will take place every five years. The adoption of the positive list method has facilitated the participation of LDCs, since it has allowed for a gradual liberalisation compatible with the strategy of economic development pursued by each country (article XIX:2). Furthermore GATS also provides for several forms of technical assistance, meant to strengthen the competitiveness of local firms, and thus to increase the positive spillovers on the host economy.

2.4 Elements of fragility of the present system

The system that has emerged from the radical transformations of the 1980s and 1990s is fragile since the liberalisation of FDI policy has mainly taken place unilaterally and no comprehensive set of rules, able to mediate the interests of different countries, has emerged. Furthermore, we have had a rapid proliferation of international FDI agreements at different levels (bilateral, regional, multilateral) leading to what has been defined as an *inefficient patchwork* of FDI rules (Brewer e Young, 1998). Four elements of fragility of the present system can thus be identified:

- *Lack of credibility of unilateral commitments*. The fact that FDI liberalisation has taken place mainly unilaterally makes policy reversals easier. This fact creates uncertainty and increases the risks associated with FDI.
- *Absence of enforcement mechanisms*. Existing international FDI agreements have no effective mechanism to enforce obligations. The WTO at present has enforcement powers, but only for State-State disputes.
- *High transaction costs*. The variety of existing rules on FDI, the multiplicity of levels at which they operate (national, bilateral, regional, multilateral) and the consequent lack of transparency enhance the transaction costs faced by firms operating in several markets. The present situation results in an increase of the fixed cost associated with foreign operations, and thus in a lower volume of world FDI. In particular it penalises smaller producers, and thus discriminates against firms from emerging countries attempting to establish production abroad.
- *Unbalanced agenda*. If FDI liberalisation takes place unilaterally or due to bilateral agreements, it is not possible to tackle problems such as incentive wars or anti-competitive practices by MNEs, which can be solved only at the multilateral level.

3. Welfare implications of multilateral rules on FDI

3.1 The welfare impact of FDI

FDI take place mainly in oligopolistic industries. Therefore, at the theoretical level, is not possible to reach a general conclusion on the welfare implications of FDI. However, theoretical analysis helps to define in which settings an inward FDI: i) has a positive impact on the host country, and ii) leads to an increase in productivity of the recipient sector (and of local producers), and thus has a positive effect on growth (Sanna-Randaccio, 2000b). In the last few years, the theoretical literature has emphasised the mechanisms via which an inward FDI enhances the host country welfare. The channels through which an FDI exercises its effects are several: product market competition, technological effects, employment effects. Models show that the likelihood that inward FDI will enhance the host country welfare increases with the R&D intensity of the sector in which the potential investor operates, with the intensity of spillovers, with the linkages that the MNE forms with local producers (Sanna-Randaccio, 2000a). Finally, it has been established that the technological competitiveness of local firms has a key role : it has a positive influence on the absorption capacity of such firms and on the amount of technology transferred from the mother company to the local subsidiary, a phenomenon of key importance in a North-South context.

The results of empirical analyses indicate that in general FDI have a positive impact on the host country. Several studies show that –when compared to local firms- foreign-owned subsidiaries have a higher productivity, pay higher wages and have a higher propensity to export. In addition it results that inward FDI have a positive and significant impact on the growth of host countries both in the case of developed and developing countries. In the latter case, the effect is positive if the stock of human capital in the country is above a given threshold.

Therefore, one may conclude that on the whole FDI have a positive welfare impact on host countries, also in the case of developing nations. Most countries share this premise, as indicated by the intense competition taking place internationally to attract inward FDI frequently via costly incentives.

3.2 The welfare impact of multilateral rules on FDI: the literature

In this section I will illustrate the position of those in favour of a MAI by discussing Drabek (1998), and the positions of those sceptical on the need of launching a MAI by presenting the results of Hoekman and Saggi (1999).

Drabek (1998) begins by asking whether there is the need for a MAI, the agenda of which remains unspecified; only after replying to this question he examines the possible items to be discussed. The author lists some arguments in favour of a MAI: it would lead to greater transparency, predictability, legal security, it would decrease the risk of inconsistent rules, avoid policy competition for FDI and the marginalisation of poorer countries. Then he points to arguments against a MAI, in particular the high costs of negotiation associated to multilateral agreements, which are considerably higher than those of regional negotiations. The author concludes: *I am convinced that, on balance, the benefits from such an agreement could greatly exceed the costs*.

The issues highlighted by Drabek (1998) are rather interesting, but his work –which is in line with other studies in favour of launching a multilateral negotiation- can be criticised on several grounds. To begin with, it is not possible to assess the impact of a MAI without previously having specified its agenda. Thus one first has to define the agenda and then to assess the welfare implications of the agreement. The order in which problems should be examined is thus the reverse of that followed by Drabek. Furthermore, there is no attempt to measure the benefits and costs of a MAI, neither at the theoretical nor at the empirical level. Naturally it is very difficult to quantify the costs and benefits of a MAI. However, the studies conducted to evaluate the welfare implications of the Single Market completion, although not totally satisfactory, suggest the possibility to operate in a similar direction in the MAI case too.

The necessity to define in a more precise way the costs and benefits of a MAI and to attempt its measurement has been underlined by several authors. Graham (2000) argues that nowadays the priority should be assigned to a reasonable estimation of these costs and benefits. An interesting step in this direction has been made by Drabek and Payne (1999). The two authors, by using an index of transparency published by the Political Risk Services, undertake an econometric study, finding that on average an increase by one point of the transparency index leads to a rise by 40% of the inward FDI flow. They conclude that their results show that greater transparency in national policies would result in a powerful stimulus for FDI.

Hoekman and Saggi (1999) try to assess whether developing countries would benefit from a MAI within the WTO. By using imperfect competition models dealing with each issue in the agenda separately (entry, performance requirements, FDI incentives, etc.), the authors evaluate the welfare repercussions of each of these measures, and of its elimination, for the home and the host country. They indicate that, if the interaction between the two countries takes the form of a zero-sum game (a winner and a looser), there is no incentive to participate to a MAI meant to restrict the use of the measure considered, since it is not possible to increase the welfare of both players. If, on the contrary, the interaction between the countries takes the form of a prisoner's dilemma, there is an incentive to co-operate since a negotiation may have a positive impact on the welfare of all participants. The authors argue that several of the issues to be discussed represent zero-sum games, therefore with regard to several of the points to be included in the agenda there is no incentive to co-operate. Furthermore they maintain that incentive wars are not a phenomenon of great importance and suggest that the transaction costs due to the existing inefficient patchwork of rules are relatively modest and the lack of credibility of national policies has equally only a minor effect.

Their conclusion is that most of the benefits associated to a MAI can be obtained by exploiting the mechanisms present in existing agreements, such as the TRIMs agreement and GATS. In particular, (p. 2) "*priority should be given to expanding the coverage of the GATS, before seeking to negotiating general disciplines on investment policies*".

The elegant work of these two authors represents an important contribution in evaluating the welfare effects of a MAI. However their work can be criticised on three grounds. Firstly, the welfare implications of an agreement on FDI are evaluated by considering each issue separately. The core of a negotiation however is how to link different questions in order to allow the incentive to co-operate to emerge. The two authors mention the problem of issue-linkage, but state that in order to incentivate the participation of developing countries to a MAI some form of compensation must be found in the trade field. They argue that (p. 17) "*the quid pro quo for accepting to adopt national treatment, MFN, and the right of establishment as general multilateral disciplines should be sought outside the investment area*". In Sect. 3.3 I will briefly present a few suggestions of possible linkages between questions, some of primary interest for developed countries and other of primary interest for developing countries, but all connected with FDI, and consequently part of a MAI agenda.

Secondly, the analytical approach followed by Hoekman and Saggi (1999) represents only the first step of a more complex reasoning. These models allow us to evaluate the welfare repercussion on home and host countries. However, what we really need is to define the welfare impact on negotiating countries, and these frequently are at the same time origin and destination of FDI. Thirdly, some of the assertion on which the results of these authors rest seem to be in contrast with the findings of recent empirical research. They assert that the increased credibility of national policy and the lowering of transaction costs resulting from a MAI will have only a relatively minor impact on the volume of FDI, and thus on countries' welfare. Such statement however is contradicted by the finding of Drabek and Payne (1999). Furthermore, Oman (2000) shows the great empirical relevance of incentive wars.

3.3 The welfare impact of multilateral rules on FDI: an analytical framework

I will present here some initial ideas on how to evaluate the welfare impact of a MAI. I will distinguish between different types of multilateral rules. This analysis will then help to evaluate specific agendas (i.e. specific types of MAI).

3.3.1. Rules to <u>lock in</u> minimum standards prevailing at the international level

This is the case of rules negotiated within the WTO and meant to *lock in* the results of unilateral liberalisation of national FDI policy or to adopt standards prevailing in bilateral agreements. This category of rules include the right of entry, defined according to the *positive list* method –which allow the country to offer market-access only in the sectors explicitly indicated in a list - and agreements which incorporate at the multilateral level investment protection standards prevailing at the bilateral level.

Such type of rules will affect world welfare via three channels (Tab. 2):

- *Credibility*. By binding itself, a country will confer greater credibility to its policy. Commitment to lock-in rules will lower the risks associated with FDI, since it will prevent sudden reversals in national FDI policies.
- *Transaction costs*. Such rules will lead to a decline in the transaction costs which foreign investors must face due to the variety of existing FDI norms.
- *Enforcement*. Lock-in rules within the WTO will provide a mechanism for making obligations enforceable.

This type of multilateral rules will result in a more favourable environment for FDI, with a likely increase in firms' propensity to invest abroad. The overall volume of FDI will increase leading to a rise in world welfare. Furthermore, since some of the problems to be eliminated –and in particular transaction costs- penalise mainly the smaller producers and thus firms from emerging countries, such rules will stimulate the foreign expansion of new producers. Economic theory helps to analyse through which mechanisms *lock in* rules influence world welfare, however the intensity of these effects is an empirical question. Hoekman and Saggi (1999) suggest that these effects are relatively minor, without supporting their statement with empirical evidence. On the contrary, the analysis of the evolution and present status of FDI rules suggests that in the current context the three mechanisms just described might have a major influence on the world volume of FDI, since liberalisation has been mainly unilateral. The results of Drabek and Payne (1999) support such expectation.

3.3.2. Rules directed to eliminate market distortions created by host countries' policies

Hoekman and Saggi (1999) represents a useful starting point in order to assess the impact of different multilateral rules on the welfare of home and host countries. Such analysis will then help to assess the welfare implications of a MAI for developed and developing countries (i.e. for the main negotiating parties). The attention will be directed to two types of FDI policies at the centre of the debate: performance requirements and FDI incentives.

Performance requirements

Several restrictions on the operations of foreign-owned subsidiaries were imposed by host countries mainly during the 1970s, in order to increase their share of the benefits from inward FDI. The debate is focused on restrictions enacted by developing countries, thus the fact of identifying developing countries with the host economy and developed countries with the home economy is a reasonable approximation.

Some of these measures are welfare reducing not only for the home country but also for the country imposing it (Moran 1998). Therefore their elimination would lead to a rise in world welfare (Tab.2).

However there are restrictions which represent an optimal policy (i.e. welfare increasing) for the country imposing it. Rodrik (1987) shows that, in markets characterised by imperfect competition, an export performance requirement may increase the host country welfare, since it leads to a profit shift from the foreign investor to the local firm. Moran (1998) reaches the same conclusion as to the role of export performance requirements. Since this type of measure is enacted only by developing countries, the interaction between two governments, deciding whether to eliminate this policy, represents a case of zero-sum game.

FDI incentives

In the last few years the phenomenon of *incentive wars* has become increasingly important (UNCTAD, 1996). While developed countries adopt more frequently financial incentives (such as government grants, the so-called “direct subsidy”), developing countries tend to privilege fiscal incentives as they lack the resources needed to supply financial incentives. Several surveys have shown that international executives value financial incentives on inward FDI as particularly effective. Although incentive wars take place mainly at the regional level, there are examples of inter-regional competition, and according to experts in the future more frequently emerging countries will compete with OECD countries in attracting FDI. The winner will be the one with the “deepest pockets”.

Incentive wars thus distort the allocation of world FDI, discriminating against developing countries. Furthermore, it can be shown (e.g. Haaland and Wooton, 1999) that this form of policy competition implies a transfer of income form the host countries to the investing firms.

Rules on FDI incentives –as the one operating in the EU - will increase developing countries’ welfare for several reasons: i) by reducing investment diversion; ii) by avoiding the transfer of income from host developing countries to MNEs; iii) by increasing transparency. The lack of transparency favours corruption, the costs of which are particularly high in developing countries (Oman, 2000). To evaluate the welfare implications for developed countries is more difficult since there are contrasting effects. Limits to FDI incentives may decrease developed countries’ welfare via two routes: i) by reducing investment diversion from developing countries; ii) by lowering the profits of national firms which invest abroad. However such rules may have a positive impact due to two other mechanisms. Such rules will reduce the transfer of income from the developed host country to the incoming MNEs and will lead to a decrease in corruption.

Several authors estimate that rules on FDI incentive will have a positive effect also on developed countries. If that were the case, incentive wars would represent a prisoner's dilemma for the world as a whole (instead of implying only losses for developing countries). The incentive to negotiate rules would thus be present. If on the contrary, the net welfare effect of FDI incentive were positive for developed countries, we would have a zero sum game, as in the case of some performance requirements. In other words, limits to FDI incentives would increase welfare in developing countries while lowering that of developed countries. Such possibility helps explaining why some developed countries, and in particular the USA, are opposed to the inclusion of investment incentive in the agenda of a negotiation on FDI.

A possible way to create an incentive to co-operate is by linking performance requirements and investment incentives. This issue linkage may result in higher welfare for both developed countries and developing countries. Although, when considering performance requirements and investment incentives in isolation, we have two zero-sum games and thus no incentive to negotiate, by enlarging the strategy space of the countries, and thus defining the agenda more broadly, it is possible to create a situation in which it is mutually convenient to create multilateral rules. This suggestion is in line with what discussed by Moran (1998).

3.3.3. Rules directed to eliminate market distortions created by foreign investors

The structure of the Havana Charter shows that since the second post-war period it had been clear that FDI and competition are tightly connected issues. In the TRIMs agreement too this link is recognised, since it includes a provision requiring a review (which was supposed to take place in 2000) which can be extended to include competition issues.

An efficient national antitrust authority is a prerequisite to deal with MNEs anti-competitive practices. Several developing countries are in fact moving in this direction. A national antitrust authority however represents a necessary but not sufficient condition. As pointed by Scherer (1994), since the market has a global dimension several of the anti-competitive behaviours which firms can enact should be dealt with at the international level, by creating for instance forms of international co-operation of antitrust authorities.

International competition rules will result in a transfer from MNEs to consumers. Consumer surplus will increase in both developed and developing countries. It is thus plausible that such rules will result in a welfare rise for developed countries too, although less pronounced than for developing countries (Tab. 2). Notwithstanding that some developed countries are against international competition rules. A possible explanation is offered by Markusen (1998, p.46) according to whom "we should note that often countries are acting as agents on behalf of domestic firms in international negotiations."

4. Future scenarios

I will now present four scenarios on how international FDI rules might evolve, and the positions of different countries:

- MAI-OECD;
- MAID (MAI for Development);
- no-MAI/1 (review of GATS and/or review of the TRIMs agreement);
- no-MAI/2 (no new multilateral rule, thus Bilateralism and/or Regionalism).

4.1 MAI-OECD.

Initially, proposals for a MAI within the WTO were structured along the lines of the negotiation on FDI undertaken by OECD countries between 1995 and 1998 (date in which it was discontinued). Thus I will briefly describe some characteristics of the MAI-OECD.

The MAI-OECD adopted the *negative list* approach (or *top-down*) to entry. In other words, foreign firms were granted entry in all sectors except in those explicitly indicated in the list presented by each country. A wide range of performance requirements was prohibited (including export performance requirements). Dispute settlement mechanisms were contemplated, for both State-State and investor-State disputes (UNCTAD 1999a).

An agreement along these lines would have implied a rapid acceleration of FDI liberalisation in developing countries, without real compensation from developed countries (in fact neither FDI incentives nor issues connected with competition were included in the agenda). Thus it is not surprising that proposals for such an agreement within the WTO were opposed by most developing countries. However after the WTO meeting in December 1999 in Seattle, there is no possibility of launching a negotiation structured as the MAI-OECD.

4.2 MAID (MAI for Development).

An alternative scenario is a multilateral agreement taking into greater account the needs of developing countries and favouring gradual liberalisation. I have labelled such scenario as MAI for Development (MAID). It is not possible to enter into details, however a few major features of a MAID can be briefly discussed. The agenda should:

- include the right of entry according to the *positive list* (or *bottom up*) approach, as in GATS;
- consider in a comprehensive way market distortions connected with FDI (thus include not only performance requirements but also FDI incentives);
- adopt the investment protection standards prevailing at the bilateral level;
- link the FDI negotiation with forms of international co-operation on competition policy;
- provide technical assistance to developing countries, to enhances beneficial effects on these countries.

A MAID would allows countries to enjoy the welfare improvement deriving from the *lock in* of standards already prevailing internationally with regard to both entry and investment protection, and would also began a process of gradual elimination of the distortions now prevailing in both developed and developing countries.

The European Commission, initially in favour of a negotiation such as the MAI-OECD within the WTO, has recently presented proposals which are in line with what I have defined as a MAID. Several emerging countries too are likely to support such an agreement. This is for instance the case of Korea, Hong Kong and of the other developing countries which participated as "Observers" to the MAI negotiation within the OECD (Argentina, Brazil, Chile, Estonia, Lithuania, Slovakia).

4.3 No-MAI/1 (Review of GATS and/or of the TRIMs agreement).

Several authors (Hoekman e Saggi, 1998; Graham, 2000) suggest that the best way to strengthen international co-operation on FDI is to use the mechanism already existing within the WTO, such as the review of GATS and/or of the TRIMs agreement. According to some of these authors, a MAI will have a positive effect on world welfare, but at present it is not possible to launch such a negotiation due to the lack of political will in developed countries, in the USA in particular (Graham, 2000).

4.4 No-MAI/2 (No new multilateral rule, thus Bilateralism and/or Regionalism)

Finally, it is also possible that no new international rule on FDI is introduced. The USA, given the impossibility of an agreement structured along the MAI-OECD lines, favour this scenario. By means of bilateral agreements, the USA are able to promote standards of liberalisation which are more advanced than those which could be adopted at the multilateral level. In fact, the BITs recently signed by the USA instead of dealing exclusively with investment protection, contain also obligations on entry liberalisation and on performance requirements. The USA-Bolivia Treaty signed in 1998 is an example of such a trend. It establishes the right of entry according to the *negative list* approach, and it prohibits several performance requirements, such as export performance requirements.

Also some developing countries, such as India, favour this scenario. Their position seems to be grounded in the idea that in this way they will be better able to govern in an independent fashion their economy. However, we have seen that the pressures to unilateral FDI liberalisation originate from the pace and characteristics of technological change in recent years. Since the pace of technological change is further accelerating, there is still a powerful incentive to unilateral liberalisation. Therefore, in the absence of international co-ordination in the FDI field, FDI liberalisation will continue in an unbalanced way as in the past, without restraining the type of market distortions created by the policies of developed countries and those created by MNEs. That would imply a loss of world welfare, the loss however will be particularly large for developing countries.

5. Conclusions

The main conclusions are the following.

Firstly, it is important that the creation of multilateral rules on FDI should not be identified with the kind of rules negotiated within the OECD. In other words, not necessarily a MAI must imply a fast acceleration in the opening of developing countries' markets with no real compensation from developed countries. It is clear that the welfare (and distributive) implications of a MAI depend on the agenda considered. However, it is the identification of a MAI with the MAI-OECD which is at the root of the vast opposition to deal with FDI within the next WTO Round.

Secondly, it is possible to define the agenda for a MAI –here labelled as the MAI for Development (or MAID)- which, by creating rules oriented to *lock in* minimum standards already prevailing internationally, would allow developing countries to increase inward FDI without having to implement costly attraction policy. The agreement, furthermore, would allow developing countries to face the removal of existing restrictions in a more balanced way, with the possibility of reaching compromises. Only within a multilateral framework it is possible to deal not only with issues of prevalent interest for developed countries (such as performance requirements) but also with issues of prevalent interest for developing countries (such as FDI incentives and international antitrust). I stressed that, if the different items in the agenda are treated separately, in several cases the interaction amongst governments takes the form of a zero-sum game, and thus there is no incentive to co-operate, i.e. to reach an agreement. However, by expanding the strategy space of the countries, thus linking the different issues, it is possible to unveil the prisoner's dilemma nature of the present situation. In other words, the issue-linkage previously recommended brings to the surface the incentive to co-operate on multilateral rules.

Finally, I stressed the risks associated with the choice of not negotiating any new multilateral rule on FDI (the no-MAI/2 scenario). Such scenario implies the strengthening of bilateralism, which have been favoured since many years by the USA. Such choice would lead to the elimination of the distortions enacted by the developing countries, but not of those adopted by industrial countries, with perverse distributive effects.

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Table 1: Rules on FDI: prevailing trends

	National Policies	**Bilateral Agreements**	**Regional Agreements**	**Multilateral Agreements**
Mid-1940s – End –960s	Contrasting trends	Beginning	___	(Havana Charter)
1970s	Restrictive Policies	Continuation	___	(UN Code of Conduct)
1980s –1990s	• Liberalisation • Promotion • Convergence of national policies	Fast acceleration	• EU • NAFTA • MERCOSUR • ASEAN	• TRIMs • GATS

Note: (   ) = Agreement not ratified or approved.

Table 2: Welfare implications of international co-ordination on FDI rules

1) Rules to *lock in* minimum standards prevailing internationally

- Credibility Effect
- Transaction Costs Effect
- Enforcement Effect

W_{LDCs} (+) W_{DCs} (+)

2) Rules to eliminate distortions created by government policies

Performance requirements

- Non-optimal policies for host countries W_{LDCs} (+) W_{DCs} (+)
- Optimal policies for host countries W_{LDCs} (-) W_{DCs} (+)

FDI incentives

- Prisoner's dilemma cases W_{LDCs} (+ +) W_{DCs} (+)
- Zero-sum games W_{LDCs} (+ +) W_{DCs} (-)

3) Rules to eliminate distortions created by firms

International co-operation of antitrust authorities

W_{LDCs} (+ +) W_{DCs} (+)

Note: (   ) = Welfare effect of the rule in the case considered.