Investment liberalization: the next great boost to the world economy

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The liberalization of foreign direct investment worldwide could be the next great boost to the world economy. To make this a reality, worldwide cooperation is needed to tear down existing obstacles to investment and prevent new hurdles being thrown up. The time is ripe for such an initiative—investment is no longer seen as a threat but as a scarce resource that no country can afford to drive away. Developing countries are now the dominant hosts of foreign direct investment. Their contribution to this process of liberalization will be essential.

Introduction

It was not by accident that the issue of liberalizing worldwide flows of foreign direct investment (FDI) was chosen as the theme for the European Commission's first policy initiative in a speech in Washington, D.C., on 31 January 1995 (Brittan, 1995)[1], following the ratification of the World Trade Organization (WTO) agreement and the beginning of the post-Uruguay Round era. Of all the so-called "new issues" mooted for the post-Round agenda, the liberalization of FDI is the most significant. Alone among the issues so far tabled, it offers the prospect of a deal that could unleash enormous new opportunities for growth and prosperity in developing and developed countries alike.

Since January 1995, the Commission has backed up the themes laid out in the January speech with two documents: a policy analysis and a strat-

* Vice-President, European Commission. The article is based on a speech given at the Royal Institute of International Affairs, London, 17 March 1995.

[1] Sir Leon Brittan, "Smoothing the path for investment worldwide". Address delivered to the European-American Chamber of Commerce, Washington, D.C., 31 January 1995, mimeograph.

egy paper now being discussed in the Council of Ministers (European Commission, 1994 and 1995)[2]. It is against this background that this article should be seen.

The benefits of foreign direct investment

Because the developed countries share a commitment to the pursuit of prosperity in open markets, they share a conviction that the free flow of worldwide investment is a good thing. Foreign direct investment matters for a number of reasons:

- For the business people, FDI breaks down barriers. It can overcome border barriers to market access. It can secure access to raw materials. As technological advance reduces the size of production units and allows greater flexibility to meet local demand, investment remains essential to overcoming barriers to success, such as distance from markets and ignorance of local tastes.
- For the host economy, investment was for too long regarded with suspicion. Developing countries feared economic colonization. Foreign investment in Europe was regarded as an unwelcome challenge. This earlier ambivalent attitude has substantially changed in the vast majority of countries around the world.

The issue of foreign investment has been largely divested of the ideological overtones of the 1960s. Investment is recognized for what it is: a source of extra capital, a contribution to a healthy external balance, a basis for increased productivity, additional employment, effective competition, rational production, technology transfer, and a source of managerial know-how. Investment is no longer a threat, transplants are no longer Trojan horses. On the contrary, capital is recognized as a scarce resource that no country can afford to drive away.

Unsurprisingly, perhaps, as host countries have increasingly welcomed inward FDI, there has been a growth of popular fear in Europe, the United States and Japan that outward FDI cannot be as good for the home country as it is for the host country. Fortunately, however, the populist view that outward FDI is a self-wounding search for cheap labour is very far from reality.

[2] European Commission, Directorate General for External Economic Relations, "Trade and investment. Discussion paper" (Brussels, European Commission, December 1994), mimeograph, and "Commission communication to the Council: a level playing-field for direct investment worldwide" (Brussels: European Commission, 1995), mimeograph.

In most industries, labour costs account only for 5 to 10 per cent of overall production outlays, as against 25 per cent as recently as the 1970s. Foreign direct investment tends not to occur in industries with a high labour content.

Nor are wage costs a determining factor in investment-location decisions. The quality of labour, the quality of infrastructure and the level of local demand for a product are much more important. Very often, outward investment generates additional demand for exports of capital equipment, technology and sub-assemblies from the home country. Research into the subject very rarely suggests any adverse effect of outward investment on activity or employment levels. In short, investment is not a zero-sum game: there is no sucking sound, whether across the Rio Grande, across the borders of Europe or across the North-South divide.

Growth of foreign direct investment

The facts and figures suggest that the benefits of investment have been long understood by business, although not always by politicians. During the 1980s, world FDI increased at around 30 per cent annually, more than three times the rate of world exports and four times as fast as world GDP. Investment is spreading as well as growing. It is no longer only large North American, European and Japanese transnational corporations (TNCs) that are driving these impressive investment figures:

- Large TNCs no longer have a monopoly of FDI. Small and medium-sized enterprises now account for one in ten of international investments made.

- Nor do the companies of Europe, North America and Japan dominate as of old. Newly industrializing economies are becoming outward investors in their own right, albeit from a low base. Four out of ten of the largest investors in China are East Asian economies, for example. Nor are the tigers investing only in their own region. Indonesia will build its new regional passenger aircraft in the United Kingdom. Samsung recently announced a United Kingdom investment worth $700 million in consumer electronics. Indeed, the Republic of Korea is now the biggest foreign investor in Romania.

- Developing countries have become very attractive hosts to FDI. The share of investment going into OECD countries has been slashed in half during the past decade. Over half of world FDI now goes to developing countries, compared to less than one fifth as recently as 1989.

- The sectoral composition of FDI is changing, too. The shift from goods to services-related investment is even faster than the growth of the share of services in world trade, because many services require a commercial presence as a precondition of effective market access. In the United States, for example, services already account for over half of all FDI.

If investment is a desirable and desired thing, governments still sometimes find it threatening, because free FDI flows limit administrations' ability to control and shape their countries' economic destiny. This is a small price for allowing private sector decision makers to generate economic benefits worldwide. But it is a price that some governments in some sectors still find difficult to pay. That is a tragedy. Investment is good for us all. It is not merely of economic but also of overwhelming political benefit. To trade is one thing, but to invest in each others' economies implies a lasting political involvement, a stake that we take in our different societies. Investment relies on, and helps to create, stability and prosperity worldwide. It is a critical building block in lasting international friendships and is an important guarantee to the sustainability of trade flows themselves.

That is why I attach enormous importance to freeing further the scope for investment worldwide. That is why I welcome the long-standing commitment of companies of the developed countries to a better climate for investment. UNICE[3] put investment high on its agenda in its inauguration memorandum to President Santer, making clear that it wanted the investment regimes of Europe, as well as those of others, to be made as attractive as possible to worldwide investors.

Despite this support, the figures show that European companies are falling behind their main competitors in the race to take up the even greater opportunities for FDI in growing world markets, particularly in Asia. I hope that, with the help of European business, we will be able to negotiate better worldwide rules for investment in the years ahead, so that the path for European investors is made smoother. But only business people themselves can take advantage of both present and future opportunities.

To build those future opportunities, the time has come for governments, too, to make an effort in this area. Only with a sustained and coordinated push can we achieve a lasting and significant improvement in the climate for FDI worldwide, and secure for all our citizens the increased prosperity and well-being that would result.

[3] Union des Confédérations de l'Industrie et des Employeurs d'Europe.

Obstacles

What are the problems that investors face, and what can one do to resolve them?

The most obvious obstacle to would-be investors is lack of opportunity: an embargo on FDI, whether economy-wide or in a single industry. Such wholesale restrictions are increasingly rare, particularly now that the tide of communism has receded so far. Remaining investment bans, which exist even in developed countries, may relate to what are presented as overriding national security considerations, but are actually in some cases the unjustified and unjustifiable hangover from a *dirigiste* past. We need a major campaign for liberalization, but it will not be easy to achieve total success. Hence there are needs also to look at more specific and insidious obstacles to investment.

More widespread than a total ban and equally damaging is secrecy. Governments seem too often reluctant to set clear public guidelines as to who can invest and under what conditions. Would-be European investors in a number of countries, for example, know to whom to apply for an investment licence, and do so. But they have no means of knowing whether their application is being processed, what considerations are being applied by those examining it or when they might expect a reply. Clearly, in investment as in other areas where multilateral rules exist, transparency will be a minimum requirement.

The next requirement is non-discrimination. There must be no discrimination by host countries between foreign investors of different nationality. Once established, foreign investors as a whole should be treated no less favourably than national companies. In other words, we need a most-favoured national requirement and a national treatment obligation. Agreeing these rules may not be as easy as defining them.

In this context, we need to make clear that preferential regional investment arrangements can also be acceptable. The Commission is of the view that new investment rules—like all the rules that already exist for agriculture, goods, intellectual property and services—should allow members of regional groupings such as the European Union to open up more rapidly among themselves than externally, if the multilateral pace of investment liberalization is not adequate. This rule is not a tool of protectionism in investment any more than elsewhere. Nor need it be used extensively. Indeed, because the European Union has an open policy on establishment and treats all companies alike, the regional integration clause is not a threat at all. But it is a necessary guarantee of our future freedom, and I hope our partners will recognize this.

Beyond these key issues, foreign investors need to know that they can take the risk of investing in a given country free at least from unreasonable and uncompensated expropriation. They will invest only if they can have access to a fully convertible currency, can repatriate their profits at will and are free from unduly onerous performance requirements.

Companies, being in existence to make profits, will also want to have reasonable treatment from tax authorities: I do not denigrate the profit motive; but here the legitimate aim of restricting tax evasion must be set against the principle of non-discrimination.

Solutions to all these problems are conceivable, and precedents exist in the agreements already made on related issues in WTO. The most difficult question is a more general one: how to resolve disputes about the application of such rules to real life? Detailed rules on these matters will be worthless unless they are backed by expeditious, fair and effective dispute settlement procedures that bind the parties and provide clear penalties for non-compliance.

The experience of WTO shows that the world has come to accept the need for strong dispute settlement procedures. Should such dispute procedures in the investment field apply only between States or also between investors and host States? I am inclined to want to see both. Where a company's problems reflect a pattern of failure in the host State's system, WTO-style dispute settlement has a key role to play in ratcheting down the obstacles to investment flows. But it may not be the only solution. Where a country's investment culture is already on the right lines, investor State arbitration is enough to correct occasional departures from normally sound host State behaviour.

Current rules

Although this is a somewhat daunting list of issues, there are rules already in place that provide some answers to some of the problems. The most widespread and promising solutions to these problems are found in existing bilateral investment protection treaties. OECD countries as a whole have signed nearly 600 such agreements, mostly with non-OECD partners. European countries are particularly active. The geographical coverage of these treaties is uneven, but is growing. The problem now indeed is that there are just too many such treaties, that they differ one from another, and that they foster both a complex and uneven basis for investment operations.

Regional agreements have also addressed investment liberalization of late, but have yet to make much of an impact. The investment principles of Asia Pacific Economic Cooperation (APEC), for example, seem entirely laudable, at least as far as they go. But they are non-binding and are couched in best-endeavours language, allowing any exception provided for in current "domestic laws, regulations and policies".[4] This does not detract from their significance as a step in the right direction by a group of countries not all of which had made any moves at all before now. But APEC is still without binding rules and without any dispute settlement.

The same goes for the developed world's regional organization. The OECD national treatment instrument is similarly non-binding. Other OECD commitments relevant to investment also leave much to be desired, not least in their lack of effective enforcement procedures.

I should mention here the recently signed Energy Charter. This treaty, the result of a Community initiative, proves it is possible to agree on a set of core rules for investment with countries that are not members of OECD. For the first time, Eastern Europe, Russia and the countries of the Commonwealth of Independent States have signed up to high, multilateral standards of investment protection enforced by international arbitration. Fifty countries have signed so far. It is regrettable that the United States signature is still missing.

This survey of current rules needs to be rounded off with a brief description of what has been achieved in WTO. We have done better than any of us would have expected. Trade-related investment measures (TRIMs) barely scraped onto the Punta del Este agenda in 1986, and were treated as the poor relation of the talks. But the investment-related content of the Marrakesh package is none the less substantial.

To begin with, the TRIMs agreement itself has made a number of useful contributions. It incorporates specific investment disciplines in the multilateral system for the first time. It secures full transparency, with an obligation to notify existing TRIMs, an obligation that will extend automatically in the future as the list of prohibited investment measures is lengthened. For non-conforming TRIMs, the agreement sets a strong standard of liberaliza-

[4] "APEC non-binding investment principles" (Jakarta, Department of Foreign Affairs, November 1994), mimeo, p. 2.

tion by prohibiting the maintenance of those measures at the end of agreed transitional periods. All these requirements are backed by WTO dispute settlement. Most important of all, the agreement acknowledges that broader future work on investment will be needed in WTO. That work is to begin no later than the year 2000. But, in my view, it should begin this year. Developed countries, and particularly Quad partners, must give a lead.

On the investment protection front, the substantial safeguards secured for intellectual property rights mark a huge step-change in the climate for international investment in a range of knowledge-based industries.

The General Agreement on Trade in Services (GATS) also has widespread implications for investment. Establishing a commercial presence through FDI is often essential to effective market access in the services field. The GATS fully recognizes this, and creates a positive liberalization dynamic for investment and commercial presence. But this is not a perfect solution, yet. For example, GATS does not guarantee the right to establish a commercial presence, although it does define categories of restrictions, for example, limitations on branching, that are generally prohibited. As with the TRIMs agreement, consultations and dispute settlement on services will be governed by the new tougher dispute settlement discipline of WTO. Both agreements provide members with the right to compensation if their benefits are damaged by breaches of these obligations.

Where next?

Without going further into detail, it is clear that there are already a lot of rules on investment. But they overlap and may contradict each other. They give less than complete coverage of the problems. They do not always have real bite. Their enforcement provisions are often lax.

What should happen next, to improve and strengthen current rules in a world in which the countries involved are ever more numerous, the companies involved ever smaller and the industries involved ever more complicated?

I take it for granted, first, that bilateral investment treaties will continue to play an important role for developed and developing countries. Nor, in Europe, should those who fear the ambitions of "Brussels" worry that the Commission is seeking to choke off European member countries' independent endeavours in this field: that is not my objective.

Alongside bilateral arrangements, regional arrangements will have their place. They must be subject to proper oversight. But I do not see why regional investment arrangements should not be allowed on the same sort of basis as preferential regional trade arrangements are allowed in WTO.

Neither regional nor bilateral action can match the need for broader efforts at investment liberalization.

The OECD for one has already done a lot of work on new investment rules. Negotiations in OECD could produce, perhaps within two years, a body of new rules to help investment worldwide. The organization should certainly be given a clear mandate at this year's Ministerial Meeting to pursue that objective. But it is only worth issuing such a mandate if we are all agreed ''up front'' that such rules would be more liberal and more binding than some past OECD rules, and would have fully effective enforcement and dispute settlement procedures.

Such a mandate would not detract from the ultimate need for worldwide investment rules. That is why the Commission is proposing that WTO be involved, starting now, in discussions of investment issues. We have no guarantee at this stage that our WTO partners will be ready to join us in writing binding WTO investment rules. But it would be perverse, in the first months of WTO's existence, to claim that truly multilateral rule-making in the investment field would somehow be less advantageous than multilateral rule-making in the many fields covered by the Marrakesh package. The great advantages of WTO rules in due course are twofold:

- First, they cover everyone, including the newly industrialized countries which played such an active part in the Uruguay Round rule-making and which are playing an ever more active part in worldwide investment.

- Second, WTO rules are real rules, binding for all members and subject to strict dispute settlement. Those are the sort of rules that business people recognize. They are of infinitely greater value than looser understandings binding narrower groups of countries.

I am not arguing for or against WTO or OECD to the exclusion of the other. My conviction is that we need both. If we are ready to negotiate binding rules in OECD, this should be done. But let us also launch now the work needed in WTO.

What I envisage is not a process of parallel negotiations in Geneva and Paris: that would be a waste of energy, nor is WTO ready to negotiate. But we owe a duty of transparency to our non-OECD partners in WTO: to tell them regularly what we are doing among ourselves, to overcome their fears that these initiatives are against their interests and to prepare the ground for decisions at the inaugural WTO Ministerial Meeting in autumn 1996, when OECD will be nearing the end of the planned two-year negotiations, and when WTO should be in a position to consider a complementary mandate to free investment flows worldwide.

Conclusions

If next year we have made the progress I hope for, both in OECD and more widely, it will be because the message is spreading that investment is good for our economies and good for our societies. It helps us to prosper in a cooperative way, and underlines the growing interdependence of all players in the world economy.

Investment should be the next great boost to the world economy, following the powerful impulse given by the removal of trade barriers in the Uruguay Round. To make this a reality, we need to tear down existing obstacles to investment and stop new hurdles being thrown up in its way. Nothing short of a comprehensive set of binding international rules will open up areas for investment that are currently closed and create a level playing field for international investors, which is so vital for the European economy.

How we construct that framework of rules is less important than getting the framework right. If we can construct the framework quickly enough and strongly enough with the broad participation that results only from a truly multilateral negotiation, this is highly desirable. I hope that all developed countries and developing countries will work hard towards this end, starting now.

We must launch negotiations in OECD. We must also start serious discussions with all our partners in WTO. In parallel, talks in the Quad and at the summit of the Group of 7 will also be needed. Time is short. Once we get the substance right, we will be better placed to convince the rest of the world to join us in what is a difficult but an urgent undertaking: the levelling of the worldwide playing-field for investors, in the interest of all our societies. ■