In this chapter and chapter 7 we return to some of the specific issues raised by the MAI, issues that remain relevant even in the wake of the negotiations’ failure. This chapter examines certain of these issues from the perspective of developing countries. This discussion does not center on whether or not globalization itself or foreign direct investment is in the interests of these countries. Chapters 4 and 5 have already dealt with such issues as how FDI affects growth, wages, and environmental conditions in the developing world. Rather, this chapter focuses on whether new multilateral rules on direct investment are something that developing countries might support and, if so, in what form.

Chapter 1 noted a main reason that the MAI was negotiated at the Organization for Economic Cooperation and Development rather than at the World Trade Organization. It was that the industrialized countries feared that, had the latter venue been chosen, a blocking coalition of developing countries would have prevented a high-standards agreement from being implemented. The expected leaders of such a coalition were India, Egypt, and the ASEAN nations led by Malaysia. By no means all developing countries would have joined this coalition; a number of important countries might actually have sought implementation of an effective agreement in the WTO. Indeed, while the MAI negotiations were being pursued, some developing countries, mostly in Latin America, indicated an interest in participating in the finished agreement. However, the pro-MAI developing countries were a minority, and enough countries would have joined, or would have at least been sympathetic to, the blocking coalition to have prevented a WTO negotiation from reaching consensus on an
effective agreement. Or at least that was the view of officials of most of the OECD countries in 1995 when the talks were launched.

This chapter examines the major potential differences between the developing and the developed countries over what might be contained in a multilateral investment agreement. Such an examination is greatly complicated by the fact that, since no negotiations involving developing countries took place, it is difficult even to guess what would have been the developing countries’ position on specific provisions. In any case, the developing countries do not hold uniform views on what an investment agreement should contain, or even agree that such an agreement is desirable.

Therefore, this chapter instead takes a normative approach, attempting to identify what the position of most developing countries on these issues “should” be. Needless to say, the result will be largely judgmental and will not necessarily reflect the actual position of any developing-country government, much less any consensus view among such governments. It will, however, be based in large part on interviews with officials of a number of developing countries, most of whom spoke on condition that they not be cited. (At these conferences, officials often speak in a “personal capacity,” meaning that they do not necessarily reflect official views.) In addition, the author has attended a number of conferences at which officials from developing countries have spoken on this issue, again, in most instances, on condition of anonymity. Finally, this section draws on the official statements of a number of developing countries on the issue of trade and investment. These were submitted to the WTO as background documents before the 1999 WTO ministerial meeting in Seattle. But in the end, the views expressed here are judgment calls with respect to what should be, rather than what is.

What is perhaps surprising is that, when the issues are examined normatively, most of the features of an agreement on investment that would be “friendly” to developing countries do not diverge markedly from the actual provisions of the April 1998 MAI text. The positions of developing and developed countries on investment rules would seem to be much closer than were, say, the initial negotiating positions of the United States and most developing countries over the substance of the Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights. That

1. These include conferences sponsored by the Overseas Development Council (in Washington, 7 October 1997), the Asia Pacific Economic Cooperation forum (Hong Kong, 28-30 October 1997), the United Nations Conference on Trade and Development (Glion, Switzerland, 8-9 June 1998; Geneva, Switzerland, 21-22 September 1998; Kingston, Jamaica, 28-29 September 1998; and Caracas, Venezuela, 6-7 December 1999), and the Inter-American Development Bank (Barbados, 25-26 October 1999). The author has particularly benefited from exchanges with A. V. Ganesan, former Commerce Secretary of India, at several of these conferences.

2. National statements are available at [http://www.wto.org/seattle/english/state_e/state_e.htm](http://www.wto.org/seattle/english/state_e/state_e.htm)
agreement was one, of course, on which consensus among developing and developed countries was eventually achieved. Agreement on an MAI would therefore, at first blush, seem easier. This is not to say that there are no significant differences between developing and developed countries on investment issues, but rather that these do not seem so intractable that the only imaginable outcome is a complete impasse. Although some of these differences have the potential to create major stumbling blocks, they do not appear to be wholly irreconcilable.

The Changing Position of Developing Countries on Foreign Direct Investment

That the potential seems to exist to reach an agreement on investment between developing and developed countries reflects, in large part, a considerable evolution in attitudes toward direct investment in developing countries during the past twenty years or so. As noted in previous chapters, during the early 1980s there was considerable negative sentiment within these countries toward multinational firms, and official policies tended to reflect this sentiment. To a very large extent, this sentiment has been replaced by an appreciation that multinational firms can bring to developing countries a large bundle of benefits.

The emerging view among experts in many developing countries that FDI can play a powerful and significant role in development is underscored in the 1999 issue of World Investment Report, an annual publication of the United Nations Conference on Trade and Development (UNCTAD). That organization has itself been a focal point for criticism of multinational firms by developing countries in the past. The 1999 report contains an extensive discussion of FDI and development, written by a team of experts under the direction of Sanjaya Lall of Oxford University, an often-cited expert on multinationals and development. That discussion stresses the role of FDI and multinationals in increasing the financial resources available to developing countries, to enhance their technological capabilities, boost their export competitiveness, and generate employment. The discussion is not wholly about benefits; some of the disadvantages of FDI are also discussed. But overall the emphasis is on the positive aspects.

Such a positive view would not have been common among experts on developing countries 25 or even 15 years ago. Lall himself, although not known as a critic of multinational corporations (MNCs), had argued in the 1970s, on the basis of empirical studies of various authors, that developing-country subsidiaries of multinational firms tended to increase those countries’ current account deficits substantially.3 Until well into the

1980s, developing-country experts often tended to view multinational firms as exploiters, transferring wealth from developing to developed countries while creating little of value in return.\(^4\) Furthermore, these firms were typically perceived as vehicles that their home-country governments used to project their own power. ("Neoimperialism" was a recurring term in the 1970s discourse about multinational firms and their roles in developing countries.)

This perception was in large measure a legacy of quite a long history of FDI and multinational operations in the raw materials-producing sectors of what we now call the developing countries. Earlier in the 20th century, large raw materials-based multinational firms were often successful in striking deals in resource-rich developing countries on terms that greatly favored the firms. Not uncommonly, these deals were backed by what amounted to gunboat diplomacy on the part of the firms’ home-country governments.\(^5\) Before World War II, of course, much of what is today the developing world was under the colonial domination of the industrial powers. But even in those developing countries that were independent, it was not uncommon in the early 1900s for powerful industrial countries to regularly intervene in these countries’ affairs. Some went so far as to topple governments to ensure that the commercial interests of the home country were safeguarded.

Most of the colonies of the industrial powers acquired their independence in the years following World War II. This period also saw the end of the most overt forms of gunboat diplomacy, although some such incidents continued, and some aspects of the earlier era survived well into the postwar period. During the height of the Cold War, for example, efforts by the US government to protect the interests of US investors in some developing countries became closely intertwined with efforts to prevent governments from coming into power in those countries that might be sympathetic to the Soviet Union. In particular, because leaders in developing countries who sought to renegotiate raw materials contracts were often leftist in political orientation, the US government tended to view them with suspicion, as potential Soviet sympathizers. Although history is likely to judge the efforts of the United States to promote US foreign policy interests as legitimate overall, in the process it became associated with efforts to resist renegotiation of what often were truly lopsided raw materials contracts. At times, the element of gunboat diplomacy in such efforts was all but unmistakable, at least in the eyes of the intelligentsia of the developing countries. Did the United States, for example, back the violent overthrow of democratically elected governments in Guatemala in 1954,

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4. Stewart (1981) provided a thoughtful and sympathetic examination of the developing world’s case against multinational firms as it was articulated during the 1970s, and of the changes in the international economic order that spokespersons for the developing world sought in this regard.

5. For example, see Moran (1976) on US direct investment in the copper industry of Chile.
and Chile in 1973, primarily because these governments represented real security threats, or because they had expropriated or threatened to expropriate local subsidiaries of US-based firms? It is doubtful that historians will ever reach a unanimous verdict on this issue.

The perception that FDI was bad for development also extended to certain manufacturing operations that multinationals established in some developing countries. Often these operations produced for local consumption goods that proved to be higher in cost (and/or lower in quality) than substitute goods that might have been imported. As noted in the previous chapter, these operations were in most cases the result of ill-advised import substitution policies, under which host-country governments sought to establish a local manufacturing industry almost irrespective of economic considerations. Such policies were largely homegrown in the developing countries, not imposed from without, and were eagerly pursued by governments seeking to reduce ties between their domestic economies and the world economy. To lure this investment, developing-country governments often used a number of incentives, including high levels of protection against imports and, all too often, the granting of local monopolies to multinational firms. Not surprisingly, the outcomes of such policies were for the most part unsatisfactory (we take a closer look at this issue later in this chapter). Nonetheless, it was typically the multinational investors rather than the misconceived local policies that were blamed for the poor performance, at least until governments in many developing countries much later began to reexamine their own policies and to implement reforms.

One irony is that, by the early 1970s, when antimultinational fervor in many developing nations reached its peak, the basis for this fervor was already being severely eroded. In the raw materials sectors, the Cold War notwithstanding, old deals were being renegotiated and new ones agreed on terms much more favorable to host countries. The reasons for this were many, but economic factors played a major role. For example, many natural resource industries saw considerable new entry by firms that had not participated in international markets during the years immediately following World War II. Consequently, as time passed, developing countries could increasingly pick and choose their business partners from a grow-

6. Interestingly, when the rightist government of Augusto Pinochet replaced the leftist government of Salvador Allende in Chile in 1973, there was no effort to undo the Allende government’s expropriation of properties of two large American copper firms. Nor did the Nixon administration in Washington issue any strong demand that this be done.

7. Even those authors who were favorably inclined toward multinationals tended to be critical of the political power that these firms exerted at that time. See, for example, Vernon (1971). Also, one of the most stridently anti-multinational-firm works in the literature on these issues (Barnett and Mueller 1974) came not from a developing country but from the United States. A counter to this book is Bergsten, Horst, and Moran (1978).
ing list of suitors. This effectively broke the quasi-monopoly power in these sectors once held by certain large firms or oligopolies.

Also, host-country governments began to realize that certain other economic realities played, over time, to local advantage even in the absence of new entry. Prime among these was the fact that development of natural resources typically requires that an investor sink considerable money into start-up costs. Investors accept these costs in the expectation that future returns will amortize them. It follows that, once this cost is sunk, but before the revenues begin to flow, the investor cannot easily walk away from the undertaking without suffering considerable losses. One implication is that, during the early stages of negotiation of a raw materials deal, before the sunk cost is incurred, the negotiating advantage tends to lie with the investor, which can always walk away from the deal if the terms are not to its liking. Also, because the start-up costs are so large, the host country might have few if any alternative means of moving the project forward. However, once the deal is consummated and the costs have been sunk, bargaining power shifts to the host country. At this stage, the investor is largely locked in and cannot afford to walk away from the venture. This is especially true if the deal as struck provides some form of economic rent to the investor (that is, returns in excess of those needed to induce the investor to make the investment in the first place). In that case the investor can typically be induced to accept new terms more favorable to local interests than negotiated originally. The ultimate weapon that the government holds in this regard is the threat to nationalize the undertaking.

Importantly, however, once both investors and governments fully grasp the implications of the “obsolescing bargain” generated by a large sunk investment, both have an incentive to strike a deal from the outset on terms that both can live with in the long run. On one hand, the investor recognizes that if the initial terms are too much in its favor, they can be undone once the investment is in place. On the other hand, governments quickly learn that playing the nationalization card to force renegotiation of a contract on terms unfavorable to the investor has long-term costs for the country. Most important, it can lead to the country’s being effectively blacklisted by other investors. Raw materials deals between international investors and developing countries thus represent one of a number of types of negotiating situations where experience and learning tend to drive the negotiating parties toward an optimal outcome.

Learning on the part of host-country governments also played a role in improving the performance of FDI in developing countries. For example, by the mid- to late 1970s, the governments of many developing countries had become much more sophisticated at evaluating investments in local production of manufactured goods. Officials of developing-country gov-

8. This dynamic was described by Vernon (1971), who termed it the “obsolescing bargain.”

ernments worldwide have, for example, learned to apply the techniques of cost-benefit analysis to this task, in part as a result of advice from experts from multilateral institutions such as the Investment Advisory Service of the United Nations and the Foreign Investment Advisory Service of the World Bank. These agencies have instructed many developing-country officials in techniques of effective analysis and negotiation of investment projects. And indeed, these officials themselves in many nations have, over the years, become better trained in economics. By the 1980s, younger officials in many countries were already highly technically qualified before assuming their posts, many having obtained their doctorates in economics from top universities in the United States and elsewhere. Their counterparts of previous generations often lacked college degrees, let alone a graduate-level education (or at least this was true in some countries; in others, e.g., India, there is a long tradition of officials having university degrees).

Outcomes of negotiations with multilaterals might conceivably have been even more favorable had developing countries simply gotten out of the business of screening or otherwise restricting FDI altogether. They might indeed have been better off ending all preferences to local affiliates of multinational firms, such as protection of local markets. However, few developing-country governments have been bold enough to adopt such a laissez-faire approach. In many governments, therefore, even if intelligent intervention is in some sense a second-best policy, the adoption of effective techniques of investment analysis and negotiation has gone a long way to improve the performance of local operations of multinational firms. Some of these governments might, as a result, now be prepared to adopt less interventionist policies.

But we are getting ahead of the story. These developments notwithstanding, the late 1970s and early 1980s were a time when developing countries held much antipathy and antagonism toward multinational firms. During this period, these countries took steps to create three different codes within the United Nations that would be binding on multinational firms. The first was a code of conduct, negotiated but not adopted at the United Nations; the second was a code on restrictive business practices, negotiated at UNCTAD and adopted on a nonbinding basis in 1980; and the third was a code on transfer of technology, also negotiated at UNCTAD but never adopted. The basic assumption behind all of these codes was that multinational firms were inherently likely to behave in a manner contrary to the interests of developing countries, and that the world needed enforceable rules to temper this behavior.

The 1970s also witnessed a number of nationalizations of affiliates of these firms by developing countries, in some cases through outright expropriation, and in others as a result of negotiation between the investor and the host government. Also, many developing-country governments, recognizing that they needed foreign capital to achieve their development
goals, deliberately sought to replace FDI with funds borrowed directly from international banks. One result was that FDI to developing countries largely dried up during the second half of the 1970s, a situation that would persist for about a decade and a half. And although sovereign borrowing flowed massively during the second half of the 1970s, this wave of borrowing ended in the sovereign debt crisis of the early 1980s.

This crisis served to bring home to the by now heavily indebted developing countries the problems inherent in using bank debt to finance large-scale developmental projects. All too often the proceeds of this borrowing were invested in ill-advised undertakings that yielded little or no return, leaving the country unable to service the debt. The upshot of the debt crisis was that new lending was curtailed, and some lenders sought immediate repayment of the outstanding debt. Many developing countries were forced to reschedule their debt, in effect going into default. One consequence was deep recession in most of the heavily indebted countries. For some of them, especially in Latin America, the 1980s became known as the “lost decade.”

These circumstances soon led political leaders of many developing countries to take another look at FDI. Many of these leaders began to recognize that direct investment has at least three advantages that sovereign borrowing does not. First, the direct investor cannot simply pull its investment out at short notice, because unlike bank debt it is bolted down in the form of factories, equipment, and other tangible goods. Second, if host-country policies are properly designed and implemented, FDI will lead to efficient economic outcomes and, importantly, a satisfactory return on the funds invested, giving investors the needed incentive to reinvest in that country. The significance of these first two features is that FDI is generally not associated with balance of payments or liquidity crises. Third, direct investment can bring with it external benefits that manifest themselves in positive spillovers, such as the transfer of technology and managerial skills. Additionally, it became increasingly widely recognized in the late 1980s and early 1990s that competition within national markets brings about its own long-run advantages, and that direct investment in most cases tends to increase competition within the markets of developing countries. This new perception was, of course, in sharp contrast to that of the 1970s, when multinationals were most often perceived as monopolistic. The overall perception thus was swinging, by the mid-1990s, from one that saw FDI as a hindrance to economic development, to one that saw it as making a very positive contribution.


11. This perception was bolstered by empirical studies. For example, as noted in earlier chapters, Borzenstein et al. (1998) showed a strong and significant positive relationship between FDI in developing countries and economic growth, provided that the host country has a sufficient level of “human capital.” The “demonstration effects” of other countries’ experiences...
Even so, when this investment began to surge internationally in the mid-1980s, at first it flowed largely among the OECD countries, rather than from these countries to developing countries. Only during the 1990s did this investment begin once again to flow to developing countries in significant amounts, and even then by far the greater part of this investment went to only a handful of developing countries. But those countries that did receive large amounts of direct investment also reaped significant benefits, as a number of studies have confirmed. By the late 1990s, in a large number of developing countries, the pendulum had swung from antipathy and antagonism toward FDI to active efforts to attract as much of it as possible.

Changing Attitudes Toward Multilateral Rule Making

Along with these changing attitudes toward FDI came changing attitudes with respect to the desirability of multinational rules on investment. In this regard, a landmark event was recorded in 1995, when one developing country, Mexico, entered into the North American Free Trade Agreement with two developed countries, Canada and the United States. In signing that accord, Mexico agreed to very strong rules pertaining to treatment of foreign investment from the other NAFTA countries. Beyond that, however, Mexico subsequently went so far as to grant to all countries that were home to investors with investments in Mexico most-favored-nation treatment with respect to their investments. In effect, Mexico thus extended its NAFTA investment obligations to all countries. (MFN treatment did not, however, extend to NAFTA chapter 11, part B, obligations, pertaining to dispute resolution; extension of these provisions to other countries would have required that these countries themselves participate more broadly in NAFTA.)

In agreeing to the NAFTA investment obligations, Mexico was arguably ahead of the times. Although official attitudes toward such obligations in with FDI have also been persuasive. Here the striking case is that of China, where direct investment was effectively discouraged until the late 1980s but where, since 1990, it has been encouraged, albeit with conditions attached. Chinese economic growth was spectacular throughout the 1990s, and it is clear that FDI has been a major factor behind this growth. See Lardy (1998).

12. According to various issues of World Investment Report, the developing countries received an average share of 18 percent of world direct investment flows between 1985 and 1990. By 1996 this share had risen to 37 percent of a much larger total. It should be noted that these data do not contradict those presented in chapter 4. The data presented here are for developing nations’ share of US outward FDI. A substantial portion of the total FDI in developing nations is from other developing nations.

developing countries were shifting, it must be remembered that, only slightly more than ten years ago, these attitudes were mostly hostile. For example, during 1986-93, developing countries participated in the negotiation of what would become the WTO Agreement on Trade-Related Investment Measures (TRIMs). This exercise showed that there already had developed a rift among developing nations over trade and investment issues. A relatively few countries, mostly Latin American ones, were quite willing to bind themselves to new obligations pertaining to investment. Nonetheless, even these countries sought that the TRIMs agenda be kept fairly narrow, e.g., that it address performance requirements but not restrictions on entry. They might, however, have been willing to accept wider coverage of the TRIMs agreement than that which was actually agreed upon, e.g., that the agreement cover additional performance requirements that were not covered in the final agreement. But they did so with notable reluctance and, indeed, under the presumption that this agreement would be minimalist in content.

By the late 1990s, however, some developing countries that had earlier opposed a wide TRIMs agenda were expressing a willingness to become signatories to the MAI. These included Latin American countries such as Argentina and Chile that had been among the most willing to accept wider TRIMs obligations than actually were agreed to. This was true even though the draft MAI would have imposed much heavier obligations with respect to investment than had ever been envisaged, let alone concluded, in the TRIMs. In addition, other developing countries, although not yet ready to sign the MAI, were at least willing to explore cautiously but seriously whether or not they might become signatories at some time in the future. These nations included Brazil, for example, and certain Asian nations.

Changing official attitudes in developing countries during the 1990s were also reflected in a greater willingness to enter into bilateral investment treaties (BITs) with the major home countries to FDI. Indeed, the 1990s witnessed the signing of hundreds of such treaties between developed and developing countries. In 1990 a total of about 400 BITs were in existence, but by 1997 this number had risen to over 1,300, with more than 160 countries participating in at least one such treaty. The vast majority of these were between developed and developing countries.

This willingness to sign BITs, however, does not imply that most developing countries now eagerly seek comprehensive multinational rules on investment. Indeed, experience in the Asia-Pacific Economic Cooperation (APEC) forum during the early 1990s was somewhat disappointing. The APEC did produce, at its 1995 ministerial meeting, a set of nonbinding investment principles, but these fell far short of unambiguous and enforceable rules. Thus, the shift in attitude among developing countries toward multinational rules is probably best characterized as a move away from outright hostility and toward cautious consideration of their merits.
Even so, this represents a dramatic change in the position of developing countries as a group. Whereas most such countries would have been inalterably opposed to such rules as recently as ten years ago, a great many are now at least prepared to examine seriously whether such rules might not be in their interests, even if they are not yet prepared to accept them unequivocally.

Developing Countries and the Provisions of the MAI

All this serves as background to a normative examination of where developing countries should stand on the obligations that the MAI would have created. The goal is to determine which among the obligations laid out in the draft MAI are ones that these countries should be willing to accept as written, which are those where differences would exist but on which compromise is possible, and which are those on which agreement would be unlikely. Obligations on which agreement would likely be readily struck include the following:

- MFN treatment,
- national treatment in the postestablishment phase of investment,
- general treatment of investment (i.e., fair and equitable treatment, full and constant protection and security, and treatment as required by international law),
- obligations relating to expropriation and compensation for expropriated assets,
- obligations relating to transfers of funds by investors,
- obligations relating to privatization and monopolies,
- dispute settlement of state-to-state and perhaps investor-to-state disputes in modified form (i.e., not the form of the NAFTA), and
- obligations relating to transparency.

In each of these areas, it seems in developing countries’ interest to agree to currently accepted international standards, subject to specific exceptions, as would have been agreed to under the MAI. Exceptions might include grandfather clauses to an MFN obligation, to allow continuation of special treatment accorded to investors from specified countries under existing agreements. Such an exception would be less broad than the proposed exception for regional economic integration organizations that contributed to the failure of the MAI negotiations (see chapter 3). If the US-EU differences over the Regional Economic Integration Organization (REIO) exception could

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14. For views on these issues from the former Secretary of Commerce of India, see Ganesan (1999).
have been resolved so as to allow grandfathering of existing cases of special treatment, this likely would also have laid to rest any differences between developing and developed countries over similar exceptions.

The standards of the MAI with respect to expropriation and compensation for expropriation have become quite widely accepted among developing countries, as evidenced by the fact that these standards appear in almost all of the BITs that these countries have willingly entered into. Nonetheless, developing countries might appropriately join with developed countries to add language to remove regulatory takings from the coverage of the expropriation provisions of any future multilateral agreement, for the reasons discussed in chapter 2.

Developing countries almost surely would demand, and likely could negotiate, a derogation from the free transfer of payments obligation for countries experiencing severe balance of payments problems. Such a derogation was allowed in the MAI, provided it was taken in a manner consistent with existing International Monetary Fund rules. (A similar derogation is allowed under GATT Article XVIII: B.) Developing countries also would likely demand that free transfer apply only to FDI and not necessarily to other forms of investment, but this issue could be dealt with by narrowing the definition of investment (see below).

With respect to the investor-to-state dispute settlement procedures of the MAI, the most likely source of contention between developing and developed countries is that these allow an investor to take a state to international arbitration procedures (see chapter 3) but do not allow the reverse. The reasoning for this asymmetry is that the MAI was meant to be an agreement among national governments, to which only those governments could be bound. Developing countries should accept this line of reasoning (and, indeed, many likely would do so). If they did, it would eliminate a stumbling block that would have arisen ten years ago. Then many developing countries would have insisted that a multilateral agreement also impose obligations on multinational firms, and that dispute settlement provisions enable governments to sue firms for violations of these obligations. Such an arrangement (which lay at the heart of proposed UN codes of conduct, mentioned above) would not be acceptable to the developed countries.

As discussed later in this chapter, developing-nation insistence on a binding code of conduct that would apply to multinational firms thus has the potential to become a deal breaker to any future agreement on investment. There might be, however, compromise positions that could be struck. For example, there certainly is some scope for a nonbinding code that would establish standards for conduct by multinationals in developing nations. Indeed, such a code might be welcomed by at least some multina-

15. For example, the US-model BIT, upon which all such treaties entered into by the US government are based, contains language almost identical to the MAI.
tional firms, as it could establish unambiguous norms against which a firm could defend its own actions. Nonetheless, such a nonbinding code would not be part of future rules that would be binding on governments.

But in exchange for accepting that only governments would be bound by the agreement, developing countries would surely seek provisions establishing narrower scope under investor-to-state dispute resolution procedures for a firm to sue a government than the MAI would have allowed. For example, developing countries might seek a provision stating that such procedures could be invoked only for violations by a government of core obligations on a postestablishment basis, and then only where other remedies in the countries themselves have been exhausted or have resulted in decisions at odds with international obligations. Given recent experience with investor-to-state dispute resolution procedures under NAFTA (see chapters 2 and 3), it is quite possible that developed countries themselves would be quite ready to accept a more restricted access to these procedures for international investors than was envisaged under the MAI.

On these obligations, then, the differences between developing and developed countries are likely to be fairly minor and certainly bridgeable. Thus, we turn next to those obligations where there is greater potential for major differences to arise. We first consider those issues with some, but not strong, potential to be deal breakers. We then turn to the truly difficult issues.

One major issue is investment incentives. The case is strong that developing countries are at a disadvantage vis-à-vis the developed countries in the use of incentives to compete for FDI. Multilateral disciplines to restrain the use of incentives would therefore seem to be in the developing countries’ interest. This view is, of course, largely consistent with that advanced elsewhere in this volume (see chapters 3, 4, and appendix B). As noted in chapter 2, however, in the MAI negotiations the United States and certain other countries were unwilling to bind their subnational governments to any such disciplines. This position could create a major stumbling block for developing countries that would like to see such disciplines imposed.

As just suggested, however, investment incentives are not likely to be a deal-breaking issue, but for all the wrong reasons. There appears to be

16. In an earlier work (Graham 1996), this author proposed that investor-to-state dispute settlement procedures function along the lines just proposed. Under these proposals, international arbitration would proceed in two stages. In the first stage, the investor would have to show three things. First, it would have to show some reasonable substantive basis for lodging the complaint. Second, it would have to show that local remedies have been exhausted or are unavailable. Third, it would have to show that, where local remedies have been sought, a decision has been handed down that appears inconsistent with the country’s obligations under the relevant multilateral agreement.

17. See the discussion of investment incentives in chapter 3 as well as in Moran (1998).

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very little demand on the part of developing countries for restrictions on investment incentives, mainly because many developing countries currently offer such incentives (or offer subsidies that might be covered by future restrictions on incentives). This is one area where the actual position of developing countries is likely to be less of a stumbling block than would be the position that is arguably in their best interests.

Another issue that might raise problems but is unlikely to be a deal breaker is cross-border movement of personnel. Here the major problem is that certain developing countries might reasonably assert that the provisions as drafted in the MAI do not go far enough to meet their interests. India is one country that has a number of specific concerns with respect to the immigration policies of the United States and the EU countries. India would like to see far fewer restrictions on its highly trained computer software engineers, for example, with respect to temporary residence in the United States. In fact, India would advocate a provision allowing multinational firms who employ these engineers to transfer them to their home operations in the United States virtually without restriction. On this, India’s government is joined by many US firms.18

However, other developing countries do not necessarily share India’s concerns. One result is that these issues are not likely to be comprehensively addressed in the context of an investment agreement. Rather, if multilateral investment negotiations were to be initiated at the WTO, India would likely raise the issue, joined perhaps by a few other developing countries. But in the end, without a consensus among all developing countries, they would likely welcome any aspect of an investment agreement that had the effect of liberalizing to some degree the immigration policies of the developed countries. In other words, they probably would be willing to settle on an agreement that went at least as far as the MAI on these issues, without insisting on new provisions that go significantly further.

The provisions of the MAI that do have the potential to be deal breakers are those that, in some sense or another, go too far to be acceptable to most developing countries. The most important of these is preestablishment national treatment.

The reason preestablishment national treatment is a potential deal breaker is that, if the standard were implemented strictly, developing countries would be unable to pursue policies of infant-industry protection. (As explained in chapter 4, infant-industry policies are designed to protect domestic firms in the local market from competition from international firms until the domestic firms can compete successfully with their foreign counterparts.) A key issue for our normative analysis is, of course, whether or not infant-industry protection is effective in building internationally com-

18. Thus, for example, Microsoft Corporation’s president Bill Gates has frequently testified before the US Congress in favor of reduced barriers to US residency for persons of non-US nationality with high technical qualifications.
petitive industries. On this, the evidence is mixed but, as noted earlier, mostly negative. Many efforts at infant-industry protection have fostered, as it were, infants that have never matured. In Brazil, to cite but one example, a program of protection of domestic computer manufacturers has been in place for over twenty years, accompanied by domestic content requirements placed on foreign-owned computer manufacturers operating in Brazil. The result of this policy, by most accounts, is that computers produced by domestic Brazilian firms (including foreign-owned ones) remain technologically laggard and more expensive than comparable imports.19 In other cases, however, such as that of Korea’s steel industry, infant-industry policies appear to have produced at least some firms that have become very competitive internationally.20 Certain economists (e.g., Rodrik 1999) therefore defend infant-industry policies as viable. However, the majority of development specialists, it is safe to say now, believe that these policies have hurt development more than they have fostered it.

It should be noted that the reasoning underlying infant-industry policies often is used to justify what are ostensibly other types of policies, e.g., policies to support “strategic sectors”. These latter policies are to give government support or protection to domestic firms in sectors that are considered to be in some sense “strategic”. Often these sectors include telecommunications, computers, and other “high-technology” activities. Although the terminology used to justify special treatment for these sectors is often quite different from that used in the lexicon of infant-industry protection, the reasoning comes down to much the same: notably, that there is some special case for domestic ownership of these activities, but for domestically owned enterprises to thrive, they must at least temporarily be protected from competition from stronger international rivals.

But whatever the arguments for or against infant-industry protection, the governments of a large number of developing countries seek to retain the option to pursue these policies, and therefore are not currently willing to agree to rules binding them to preestablishment national treatment. Since, as we have seen, the evidence does not overwhelmingly indicate that these countries should give up such policies entirely, it is not clear that developing countries would be wrong to decline to enter into an international agreement to do so.

Even so, developing countries might wish to consider a generalization of the approach taken by the GATS on this issue. The GATS incorporates both a positive list of sectors and activities in the services sectors that are open for foreign investment, and a negative list of the applicable limitations on national treatment and market access.21 Also, in practice, many

21. The negative lists attached to the GATS commitments thus apply essentially to postestablishment national treatment. See chapter 7 for more detail.
developing countries (and, indeed, some developed ones) reserve the right to screen FDI proposals, but routinely approve them where the total amount to be invested is below a certain threshold. Thus, developing countries might be prepared to grant national treatment on a preestablishment basis for projects falling below a stated threshold but may wish to reserve the right to require approval for larger projects.

All this suggests that there is scope for a mutually acceptable compromise on the issue of preestablishment national treatment between developing and developed countries. In particular, the hybrid approach of the GATS—a positive list whereby only ventures in the listed sectors would be subject to this treatment—appears promising. It is noteworthy that the sector where such an approach has been agreed to—the services sector—is one where restrictions on entry are quite prolific (see, e.g., Sauvé and Wilkie 2000). Thus, it would seem a fairly straightforward extension to create a national treatment provision that would cut across all sectors based on this approach.

Major differences also exist between developing and developed countries on the issue of performance requirements (see chapter 3). This issue is linked to that of investment incentives, but also to that of restrictive business practices. The latter dominated discussions of investment policy between developed and developing countries during the 1970s, and the issues that were raised then have not entirely gone away. Development experts reasoned at that time that multinational firms may behave as monopolists, achieving benefits for themselves by implementing restrictive practices that are suboptimal from the host country’s point of view. Among these practices are, allegedly, the withholding of technology from the host country, the suppression of exports, and the use of transfer prices to avoid taxation. These experts argued that the need for performance requirements of various types derives from the need to compensate host countries for these practices that, arguably, reduce their welfare.

The strongest argument against this position is that many of these performance requirements do not produce the desired results. Thus, in a recent study that builds on a large body of accumulated empirical research, Moran (1998) concludes that local content requirements, requirements for local equity participation, and technology transfer requirements are all typically counterproductive. Not only do they not help meet development goals, such as the development of locally owned, internationally competitive suppliers of inputs to multinational operations, and increased technology transfer into developing countries, but indeed they have the reverse effect: they retard this development and transfer. Multinational firms tend to be reluctant to transfer their best technologies to suppliers or to joint venture partners that the host government forces upon them. The crucial element of trust is often lacking in such relationships.

Moran also concludes, however, that some performance requirements, especially export performance requirements, are nonetheless effective. If
multinational firms are required to achieve a certain level of exports from their operations in developing countries, the goods they produce there must be competitive on international markets. Hence these requirements create incentives for firms to use their best technologies in these operations. Of importance here is the fact that a multinational firm that faces a transparent export performance requirement at entry can choose whether or not to accept this requirement, but if it does not choose to accept the requirement, it must walk away from the venture. This can induce bargaining between the firm and the host government, which may result in the firm offering to export some categories of products, often including intermediate goods, but not others. (For example, US automakers in Mexico export certain components of cars and some classes of vehicles. But other components are imported, and some classes of vehicles are assembled for local consumption only.) If both sides bargain competently, the result can be a win-win situation. The host country receives investment in activities that enable it to realize a latent comparative advantage, and the firm gains a low-cost source of a product that it can offer on international markets. The outcome is consistent with national comparative advantage and hence tends to enhance world welfare.

Other performance requirements, by contrast, seem to be a particularly ineffective means of offsetting most restrictive business practices that are implemented to generate rents. This is particularly true in the rather common case where a performance requirement is imposed on a direct investor but to offset this the investor is granted protection from import competition or competition from other direct investors. It is difficult to imagine that a firm could successfully appropriate a rent if the host country’s market is open both to imports and to additional FDI. But developing countries, in order to induce investment, have often been only too willing, in effect, to grant the local market as a monopoly to the investor. Fortunately, as noted earlier, many countries have backed away from this self-defeating practice as their governments’ analytical capabilities have improved. And even markets that once were considered natural monopolies increasingly appear to be contestable, if government policy allows them to be. The bottom line is that control of abusive business practices by foreign investors in many countries and in many sectors begins with reform of domestic policy, not with the imposition of performance requirements.

Some practices, to be sure, might require regulation rather than market opening. Transfer price abuse, which in a globalized world economy is a matter of concern to developed as well as developing countries, is a clear candidate. But, as even the US government is beginning to realize, control of transfer price abuse requires an international, not a unilateral, solution (see Hufbauer and van Rooij 1992; Graham and Krugman 1995). Developing countries that are concerned about this abuse should be pressing to include taxation as part of a multilateral agenda on investment, not backing away from such an agenda.
Moran (1998, 2000) and others note that, today, certain policies and practices of developed-country governments create more formidable barriers to the achievement of their own goals than do the practices of multinational firms. These policies and practices include restrictive rules of origin and policies governing “less than fair value” (LTFV) imports, including most importantly antidumping policies. (The latter are laws by which governments impose higher than standard import duties on products that are deemed to be priced excessively low. The former are rules used to determine whether imported products should be accorded preferences under agreements such as NAFTA. Both have been used to favor domestic products over imported ones.) Government policies and practices in this area, and the creation of binding obligations relating to them, are of course the legitimate business of multilateral trade negotiations, and such negotiations could include links with multilateral investment negotiations. It follows that developing countries should be much more concerned with getting these policies and practices onto the negotiating table than with insisting that future multilateral rules on investment address firms’ restrictive business practices. Indeed, Moran (1998) suggests that the “grand bargain” that developing countries should seek is to trade away all their performance requirements (including export performance requirements) for substantial progress toward making the trade and investment policies of the developed countries “developmentally friendly.” This grand bargain would surely include disciplines on investment incentives as well as a substantial reining in of policies on LTFV imports.

Whether or not Moran’s grand bargain is achievable, from a normative perspective, developing countries should not object to MAI obligations that do away with most performance requirements, for the reason noted above: they simply are not effective in achieving their objectives. Indeed, the best policy that a country can undertake to achieve these objectives is not to restrict entry by multinational firm B once entry has been gained by multinational firm A.

One last issue that could be a deal breaker is the definition of investment that would be covered by multilateral rules. The draft MAI’s definition, as chapter 3 noted, is very broad, encompassing not only direct investment but also portfolio investment and even intangibles such as intellectual property. Developing countries are quite right to object to such a broad definition. Their governments, looking to the experience in East Asia and elsewhere during the financial crises of 1997-98, might be on quite solid ground to wish to regulate short-term capital movements but to exempt direct investors from such regulations. A multilateral agreement on investment with coverage as broad as that of the draft MAI would prevent them from doing this, however.

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22. In this they are supported by a number of prominent economists who are not generally in favor of heavy regulation (see, e.g., Krugman 1999).
But does this issue really have the potential to be a deal breaker? This author’s best guess is, probably not. Given the East Asian experience of 1997-98, as well as experiences under NAFTA where investors have lodged disputes that would have been disallowed had the NAFTA investment provisions had less broad coverage, the developed countries might themselves no longer be convinced of the wisdom of a very broad definition of investment. Thus, on this issue, although the developing countries would likely be the \textit{demandeurs} for a significantly narrower definition of investment than appeared in the MAI, the developed countries might very well offer little resistance.

\textbf{Is There a Deal Breaker?}

There is, finally, one issue that has real potential to be a deal breaker in any future negotiations on investment involving both developing and developed countries. That is the issue of whether multilateral rules on investment should include some binding code of conduct on multinational investors. This is something that the developed countries have long resisted. As noted earlier, an effort within UNCTAD to create such a code of conduct was undertaken in the late 1970s, but without conclusion. An effort to revive the UNCTAD exercises was attempted in the early 1990s but was quickly abandoned.

The issue remains a deal breaker for the simple reason that the developed countries, which refused to accept a binding code during the 1970s, have now been joined by quite a large number of developing countries. However, some specific remaining concerns of developing countries have merit. Chief among these is their fear that multinational investors operating in their territories might act to carry out the law or policy of a powerful home country when this law or policy is contrary to that of the host country.

This is a real issue, and indeed, the broader issue of extraterritorial application of law and policy surfaced in the MAI discussions. But as this author suggested in an earlier study (Graham 1996), a relatively simple fix can be envisioned that does not require an elaborate code of conduct that is binding on multinational enterprises. All that would need to be done is to bind the affiliates of multinational investors to obey, under normal circumstances, the laws of the host country in which they are incorporated and operate. (Exception should be made for national laws that violate international laws or conventions.) Normally, such an obligation goes without saying. The situation can arise, however, where an affiliate is required to take some action to comply with host-country law, but that action violates the law of another entity (typically the home government of its parent firm). In such an instance, the proposed provision would in effect require the affiliate to take the action required by the host country. This is an
obligation that multinational firms should be willing to undertake, as it would serve to insulate them from the conflicts imposed when one country attempts to enforce its own law on an extraterritorial basis. This would be the case especially when this law conflicts with the law of some other country in whose territory the first country attempts to enforce its law.

Whatever the merits of this last argument, some developed countries are likely to reject it. The US government, for example, is inclined from time to time to enforce its own law and policy on an extraterritorial basis, and is disinclined to enter into any international obligation that might reduce its capacity to do so. And although the European Union has generally been less extraterritorial in enforcing its own law and policy than the United States has been, it has nonetheless been quite willing to reach beyond its borders in enforcing mergers policy, for example.

**Is Any Negotiation on Investment Between Developing and Developed Countries Doomed to Failure?**

This brings us to the final point to be made in this chapter. This is that the positions that appear to be the normatively correct ones for developing countries and developed countries, as revealed by those provisions of the MAI on which there was agreement, are not so far apart as to be unbridgeable. To be sure, for the two groups of countries to reach consensus on a multilateral investment agreement would require intense and hard negotiating. Nonetheless, the basis for good faith negotiating with some reasonable chance of success does appear to exist, whereas ten years ago any such effort would likely have led to an impasse. Thus, on this set of issues, the passage of time has changed quite a lot. Even today, a favorable outcome is not certain, but it cannot be ruled out as a nonstarter.

The bottom line seems to be that the argument used five years ago to begin MAI negotiations in the OECD rather than the WTO—that is, that developing countries would block any such effort in the WTO—no longer carries significant weight. What today most constrains the feasibility of achieving multinational investment rules within the WTO is not a blocking coalition of developing countries but rather lack of political will among the developed countries. Chapter 7 addresses this issue.