Economic Perspectives

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FOREIGN INVESTMENT

MULTILATERAL AGREEMENT ON INVESTMENT

TRADE-RELATED INVESTMENT BARRIERS

INVESTMENT PROSPECTS IN AFRICA

BRIBERY AND CORRUPTION

FDI IN THE U.S.

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FOREIGN INVESTMENT AND THE MAI

Foreign investment has been hailed as a key force in propelling the ongoing integration of the world economy, providing growth in the world's emerging markets, stimulating competition and innovation in industrial country markets, and transferring technology and skills worldwide. To its detractors, foreign investment means domestic firms moving abroad with job losses at home.

Currently, there are hundreds of bilateral investment treaties (BITs) governing foreign investment. Provisions in these BITs vary substantially from country to country, and they fail to address a number of key issues that have arisen with the globalization of production.

This year, the Organization for Economic Cooperation and Development hopes to conclude the first comprehensive multilateral rules for international investment. The Multilateral Agreement on Investment (MAI), once completed, will be open for signature by all countries. It seeks to give investors greater protection against expropriation and other arbitrary acts, establish legally binding procedures for settlement of investment disputes, and create a uniform set of rules on investor protection and market access currently not available under BITs.

This issue of "Economic Perspectives" examines proposed new global rules on investment, the link between trade and investment, and efforts to stop one of the major impediments to financial flows — bribery and corruption.

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ECONOMIC PERSPECTIVES

An Electronic Journal of the U.S. Information Agency *Volume 2, Number 2, April 1997*

USIA's electronic journals, published and transmitted worldwide at two-week intervals, examine major issues facing the United States and the international community. The journals — *Economic Perspectives, Global Issues, Issues of Democracy, U.S. Foreign Policy Agenda,* and *U.S. Society and Values* — provide analysis, commentary, and background information in their thematic areas. French and Spanish language versions appear one week after the English version. The opinions expressed in the journals do not necessarily reflect the views or policies of the U.S. government. Articles may be reproduced and translated outside the United States unless copyright restrictions are cited on the articles.

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❑ THE MOVE TOWARD GLOBAL RULES ON INVESTMENT

An Interview with Alan P. Larson, Assistant Secretary of State for Economic and Business Affairs

As international investment flows now dwarf the value of world trade, it makes good sense to establish global investment rules, much as has been done for trade in the World Trade Organization (WTO), says U.S. Assistant Secretary of State Alan Larson.

Larson, whose responsibilities range from trade and investment to development, says that the existing network of bilateral investment treaties is not adequate to cover the multitude of investment issues that have arisen with the increasing globalization of production.

He says that the Multilateral Agreement on Investment (MAI), currently being negotiated under the auspices of the Organization for Economic Cooperation and Development (OECD), offers a comprehensive mechanism for dealing with investment-related issues, from state-owned enterprise privatization and intellectual property rights to dispute settlement and trade-related performance requirements.

Larson says the United States remains concerned, however, over efforts by some countries to include exemptions in the name of cultural protection or for purposes of furthering regional economic integration at the expense of multilateral liberalization. Larson also argues that the time is ripe for an agreement within the OECD prohibiting foreign commercial bribery.

This interview was conducted by USIA Economics Writer Jon Schaffer.

Question: The United States has been a leader in negotiating bilateral investment treaties with other countries. Why do we need a Multilateral Agreement on Investment, particularly one that appears to be limited to the relatively rich countries of the Organization for Economic Cooperation and Development?

Larson: The decision to launch negotiations on the MAI was in large measure a response to the rapid globalization of production. While our bilateral investment treaties have helped in opening markets and obtaining protections for U.S. investors in developing countries and countries with economies in transition, there are some very important investment issues that are not subject to international rules: access as an investor to privatized state assets, the extent to which contracts that have an investment component are protected by national treatment and most-favored-nation (MFN) obligations, and whether intangible assets like intellectual property are fully protected. Access to those types of protections, backed up by a dispute settlement system, is important for all investors, particularly in industrial countries.

The OECD countries and a growing number of developing nations believe that a multilateral agreement would enhance the efficiency of global investment flows and provide a level playing field for investors in the countries to which the vast majority of foreign direct investment (FDI) is directed. As international investment flows now dwarf the value of world trade, it makes good sense to establish global rules, much as we have done for trade in the World Trade Organization.

A second dimension of this is that we think the OECD exercise can provide a model for investment rules throughout the world and a model for future negotiations, be they in the WTO, the Asia Pacific Economic Cooperation forum, or elsewhere.

Let me correct a common misunderstanding. Although the MAI is being negotiated in the OECD, it has been the intention from the beginning that the final agreement be a free-standing treaty open to accession by all countries willing and able to uphold its commitments. The OECD was chosen as an appropriate forum for this negotiation due to the demonstrated commitment of its members to high standards of investment protection and liberalization and to the OECD's experience with investment matters. The OECD and its members have been engaged in an active outreach program to nonmembers to solicit their ideas on how to make the MAI the best agreement possible and to encourage them to accede to the MAI.

Several non-OECD countries have already expressed an interest in signing on to the MAI.

Q: What provisions does the United States believe the MAI must include to be an effective tool to liberalize global investment?

Larson: The keystone provision of the MAI is the commitment of the parties to treat investors from other countries at least as well as they treat their own investors or investors from any other country. These are the national treatment and MFN provisions of the MAI, which apply to all stages of investment. One of our principal goals in the negotiation is to achieve an MAI with as few and as narrow exceptions to these nondiscrimination provisions as possible. That in itself should provide significant new liberalization.

More specifically, the key personnel provisions of the MAI will obligate member countries — subject to their laws on immigration and labor — to permit the entry and stay of those persons who are critical to the operation of an investment and members of their immediate families. Member states will not be permitted to exclude key persons pursuant to numerical limitations or market-needs tests. MAI parties will be encouraged to permit the spouses of key personnel to work in the host country.

The MAI will permit investors to pursue binding international arbitration of disputes against host countries for MAI violations. This should provide effective enforcement of MAI liberalization commitments.

In the privatization of state-owned enterprises, we wanted to make sure that foreign investors have full opportunity to participate in the privatization process from the outset. The more competition, the more firms that are interested in bidding for a property that is being privatized, the greater the return and the greater the likelihood that you will have a winning bidder that can manage this property in a dynamic and effective way that will benefit the economy. The same general principles apply to demonopolization, which is the opening up of a sector where competition has been restricted.

We also are using this agreement to get into new areas of investment. One of those areas is trade-related performance requirements — anything that conditions the right to invest on a commitment to export a certain amount of a product or buy a certain amount of the content of the product locally. Those types of trade-distorting performance requirements will be strictly disciplined. There will also be commitments not to require certain performance requirements as a condition for receiving government supports or incentives.

Another important area is taxation. MAI negotiators have found, given the difficulty of reconciling certain tax and investment concepts, that it generally makes sense to carve taxes out of the MAI, thus leaving tax issues to the global web of bilateral tax treaties. Still, there is concern that it is possible to run a tax policy in a way that amounts to expropriation. In the MAI, we want to have the capability of having disciplines over such tax practices. A taxation experts group is reviewing the draft MAI text to assure compatibility with the tax treaty regime and to suggest areas where tax matters should be specifically addressed in the MAI.

Q: What stumbling blocks remain to completing the MAI accord?

Larson: We have made excellent progress on the basic MAI text, and I do not see any significant stumbling blocks there. That said, we have only begun to negotiate the country-specific reservations to the basic commitments, and this will be a difficult task. So far, over 20 countries have submitted draft lists of exceptions they would make to the basic commitments.

Frankly, at this stage of the negotiation, we are not satisfied with the offers that have been made by other countries. We think they have not offered a degree of openness and a commitment to access that would result in a balanced agreement.

We are especially concerned about proposals for an open-ended exception for any type of economic activity that a country might deem to be cultural. This would include everything from telecommunications and broadcasting to books and literary and artistic works. Even if one accepts the idea that some countries may want to take certain measures to protect and promote culture, it isn't really necessary or appropriate to do that by discriminating against foreign investors. There is no reason why, for example, if you are trying to promote European content films, you would have to discriminate against film production companies owned by non-Europeans. That is a major problem area for us.

A second major problem area involves regional economic integration organizations. The European Commission has

asked for a very open-ended exception for anything it might deem necessary to further European unification.

Third, many of the offers that have been made call for ownership requirements that exceed those of the United States. To give just one example, the United States has agreed as the result of the latest telecom negotiation to 100 percent foreign ownership on basic telecom services. But in Japan, a foreigner cannot own more than 20 percent of KDD or NTT. That's an imbalance that I'm uncomfortable with, and I'll be urging the Japanese to open up more and look a little more like other OECD countries in terms of the access to their telecoms market for foreign investors.

We also need to agree on whether and how, in the MAI, to address issues such as protecting the environment and upholding labor standards. We are guided by the belief that most measures governments would want to take in these areas would not conflict with MAI commitments, provided they do not discriminate against foreign investors. On the other hand, we strongly support such MAI provisions as an agreement not to lower health, safety, environmental and labor standards in an effort to attract foreign investment.

Q: Hasn't the U.S. submitted its own list of exceptions?

Larson: Yes. We are requesting exceptions in those areas where we have laws that don't necessarily provide for national treatment or MFN. For example, under the Atomic Energy Act, only an American citizen can engage in certain activities related to nuclear power plant operations. Our broadcasting laws require American citizen ownership of television broadcasting stations.

Another category in which we have asked for more of an open-ended exception would include, for example, programs designed to support small or minority business. We have laws on the books, and we believe Congress might someday pass new laws that provide incentives for minority-owned businesses in poor urban areas. Those types of programs are small and targeted and are not discriminatory against foreign investors in their intent.

Q: How might the Helms-Burton law on Cuba affect the MAI negotiations? Would the U.S. accept a provision that would restrict the ability of countries to sanction foreign investors for their dealings with rogue states?

Larson: The response of some countries to the Helms-Burton legislation has been a call for disciplines in the MAI that would give precedence to host-country law and policy when they conflict with those of the home country and would prohibit enforcement of secondary investment boycotts. The United States cannot agree to an MAI that places unacceptable limits on its ability to protect its essential security interests or to deal effectively with the threats posed by rogue states. We are working closely with our MAI negotiating partners to address their concerns in a manner consistent with those principles.

Q: You stressed that the MAI, if successfully negotiated, will be open to other signatories. But a number of important developing countries have expressed outright antagonism toward an accord they did not negotiate. What do these non-OECD countries have to gain from participating, and would there be any benefit for a capital-scarce continent like Africa?

Larson: Most of the anxiety expressed by some non-OECD countries in the early stages of negotiation has been relieved through the outreach efforts I mentioned before. We have been briefing in Paris a group of about 20 non-OECD countries that are interested in following the development of the negotiations. Brazil has hosted two seminars on this subject, and other countries in this hemisphere, such as Argentina and Chile, have expressed keen interest. Singapore and some of the Pacific Rim countries are following MAI negotiations very carefully. You can say the same about Russia and the countries in central Europe.

Acceding to the MAI could help make an emerging market country, or even a capital-scarce developing country, more attractive to potential foreign investors by demonstrating that country's commitment to the highest world standards of investor protection. Some emerging market countries are now producing significant foreign investors of their own. These investors will benefit from the protections and liberalization offered by the MAI.

We also have to recognize that there are several countries around the world that are not ready to negotiate international investment rules at all. But that doesn't mean that countries that are interested in moving forward should stop and wait.

Q: How would the MAI relate to broader negotiations within the WTO to liberalize investment barriers?

Larson: The MAI negotiations complement any

agreements reached in the WTO on telecommunications and financial services under the General Agreement on Trade in Services (GATS). The GATS agreements recognize provision of services via commercial presence as subject to their disciplines. Thus, any liberalization of telecom and financial services under the GATS will strengthen the commitments in these sectors under the MAI through the operation of the MFN provision.

The work program on investment mandated by the WTO Singapore ministerial last December is designed to increase understanding of global investment trends — what international standards and rules exist and what some of the benefits of investment are to the process of development and globalization. The WTO program does not contemplate negotiation of an investment agreement.

We chose not to press the issue of WTO investment negotiations because we felt that it was important to keep the negotiating focus on the forum in which the negotiations are already underway — the OECD. We also were aware that many important developing countries were not interested at this stage in embarking on global investment negotiations. We felt it was foolish to try and force them into something that they didn't want to get into. In the future, if WTO members decide that they would like to move forward on an investment agreement, I think we could support that.

Q: The OECD is trying to complete work on another barrier to investment — bribery and corruption. Can you elaborate on separate OECD initiatives in this area?

Larson: While the MAI will not directly address the issue of bribery and corruption, it is clearly a key area where OECD members must work together for concrete results. Our discussions of foreign commercial bribery in the OECD are at a critical phase. The reasons why we must act now are abundantly clear. Bribery distorts markets and hinders economic development. It undermines democratic accountability. It disadvantages companies that refuse to engage in the practice.

International momentum to take effective action is building. The OAS Inter-American Convention Against Corruption was concluded last March and, in December, the United Nations General Assembly approved the Declaration Against Bribery and Corruption in International Business Transactions.

It is important that the world's economic leaders — like the United States and our partners in the OECD — demonstrate leadership on this issue. We are seeking at the May 1997 OECD ministerial meeting a concrete commitment to national legislation to criminalize foreign commercial bribery, as well as specific actions to end the tax deductibility of such bribes.

We are near agreement in the OECD on a common standard to guide national criminalization legislation and on a detailed and effective monitoring mechanism to ensure real implementation and enforcement. We expect to see domestic laws put in place during 1998.

Several European countries — particularly France and Germany — argue that the time is not ripe and that we should negotiate first a binding legal convention. U.S. experience demonstrates that an international convention is not required to criminalize foreign bribery. Such a convention could take years to complete.

We also must show leadership on eliminating the tax deductibility of bribes, which was agreed to by the OECD Council in April 1996 and endorsed by ministers. We cannot subsidize, via tax deductions, a practice that has such serious negative political and economic consequences internationally. Continued deductibility amounts to subsidizing the corruption of foreign governments.

Very soon, the European Union will conclude an agreement which will criminalize foreign bribery within the confines of the EU. European businessmen will be jailed for bribing public officials of fellow EU-member countries. Should they continue to be immune from prosecution — and receive a tax deduction — when they bribe Brazilian or American or other non-EU officials?

Q: President Clinton and his counterparts from the Group of Seven countries, Russia, and the European Union will be meeting in Denver, Colorado, this June for their annual Economic Summit. Will global investment be on their agenda?

Larson: Given the growing importance of investment in the world economy, the G-7 ministers can hardly avoid dealing with it in some manner. While it is too early to say precisely how investment will be addressed in Denver, we would expect at least an endorsement of the MAI negotiations and a recognition of the importance of investment to achievement of development goals, particularly in Africa. ❑

❑ TRADE-RELATED INVESTMENT MEASURES AND ECONOMIC DEVELOPMENT

An Interview with Wendy Cutler, Assistant U.S. Trade Representative for Investment, Services, and Intellectual Property

Governments, with the aim of furthering economic growth, impose a host of performance requirements that discriminate against foreign companies, says Wendy Cutler, Assistant U.S. Trade Representative for Investment, Services, and Intellectual Property. But, she explains, in reality, these trade-related investment measures (TRIMs) are undermining economic development by raising costs and discouraging investment.

According to Cutler, member nations of the Organization for Economic Cooperation and Development (OECD) hope to complete a Multilateral Agreement on Investment (MAI) that will build on existing rules to effectively eliminate the most onerous investment barriers.

This interview was conducted by USIA Economics Writer Jeanne Holden.

Question: What are TRIMs, and how do they act as barriers to foreign investment?

Cutler: Trade-related investment measures are a subset of performance requirements that a government places on foreign companies that invest in its country. Performance requirements are discriminatory, regulating, for example, who a company's joint venture partners should be, which products it can use as inputs in its production processes, and what kind of technology it must use in its plant.

We are not talking about nondiscriminatory measures that are set by all governments around the world, such as environmental or electrical standards, or zoning laws. Performance requirements distort investment and trade flows because they do not allow companies to operate based on commercial considerations.

Q: What are the economic costs of these requirements to the foreign investor and to the country imposing them?

Cutler: Performance requirements directly impact the economic efficiency of a foreign operation in a country. For example, if you tell a foreign company which products it should use, who it needs to partner with, or where it needs to locate, you could raise the company's business costs and costs to consumers, and ultimately discourage the company from locating in a country.

Countries typically place performance requirements on foreign companies in an effort to boost domestic production, to control their foreign exchange flows, or to balance their trade flows. But while countries impose these measures to achieve certain goals, in reality, these measures can, particularly in the long run, undermine their economic development and economic growth.

The benefits of removing investment barriers are clear: You allow a free flow of capital, technology, and foreign know-how into your country, which encourages economic growth and development.

For example, many countries that at one time had very restrictive foreign investment regimes have opened up their borders to foreign investment. Most of the redevelopment of Eastern Europe right now is going on because of foreign investment. And Chile has undergone tremendous economic growth recently, due in part to liberalizing its investment and trade regime.

A number of developing countries want to build their infrastructures. But they don't have the capital, the technology, and the know-how to move ahead. Opening up to foreign capital would help them achieve their economic growth and development objectives.

Q: How extensive are these performance requirements?

Cutler: It's hard to get a grasp on this. Under the Uruguay Round TRIMs agreement, WTO members were required to report trade-related investment measures. At least 24 countries made notifications. In WTO accession discussions, we are exploring how to eliminate and discipline TRIMs with China, Russia, other countries.

These measures are still prevalent around the world, but they have decreased in recent years as countries seeking foreign investment realize that it is not in their economic interest to put conditions on that investment.

Q: Are TRIMs concentrated in certain sectors?

Cutler: TRIMs are most prevalent in the auto sector because many countries want to have a domestic auto and auto parts industry. In an effort to support local firms, they believe they need to dictate foreign company behavior. We also have seen TRIMs in consumer goods, entertainment, electronics and other sectors.

Q: Can you be more specific about how performance requirements are used and by which countries?

Cutler: Indonesia, India, Malaysia, Argentina, Colombia, Ecuador, and Cyprus are among the countries that have notified the WTO. The performance requirement that has been most prevalent on the trade front is probably local content restrictions. These require foreign companies to use a certain percentage, a certain value, or a certain volume of local input in production in order to operate in a country.

Another is an export-balancing requirement. To the extent that a foreign company imports inputs, it is required to export a certain amount of the finished product, so that there are not more imports coming in than exports going out because of the foreign investment. In addition, there can be foreign exchange restrictions.

Foreign companies also look at expropriation rules, the ability to transfer their royalties and funds out of a country, and intellectual property protection. They look for transparent rules and a predictable climate, even taking political conditions into account. Performance requirements are an important part of such considerations.

Q: How has the United States sought to address business concerns about TRIMs?

Cutler: We have sought to limit the ability of countries to use TRIMs. The Uruguay Round agreement addressed the most important performance requirements; there are additional requirements that we have addressed in the North American Free Trade Agreement (NAFTA) and now want to address in the Multilateral Agreement on Investment. These include equity restrictions, forced joint ventures, and forced technology transfers.

Q: What exactly was accomplished by the Uruguay Round TRIMs agreement?

Cutler: The Uruguay Round TRIMs agreement provides an illustrative list of trade-related investment requirements. And these are tied to existing GATT (General Agreement on Tariffs and Trade) rules under article 3 national treatment and article 11 quantitative restrictions. The TRIMs agreement prohibits measures such as local content and trade-balancing, and requires that any such measures existing on the date of entry into force of the agreement be notified and then eliminated. There is a timetable for elimination of the notified measures, and it varies according to the development level of a country. Developed countries had to bring all notified measures into conformance with the agreement by January 1, 1997, which has been accomplished. Developing countries have until January 1, 2000, and the least developed countries have until January 1, 2002.

Q: Have countries been following through on removing those TRIMs covered?

Cutler: In certain instances, developing countries have not notified all their measures. For example, Indonesia's domestic program to create a local auto industry was not notified under the TRIMs agreement.

Also, while the government of Brazil notified the WTO of performance requirements for its auto sector, it has intensified the measures since notification, which is not allowed under WTO rules. We are pursuing the Indonesian and Brazilian auto cases under the consultation mechanism of the WTO dispute settlement procedures.

In the TRIMs committee, we are seeking a discussion with developing countries to find out how they are proceeding toward eliminating these measures by January 1, 2000. We are also using the committee to monitor overall implementation, both with respect to notified measures and to measures that were not notified. If measures were not notified, then we believe that they should be eliminated right away. The transition period should not be extended to non-notified measures.

Q: Does the WTO agreement deal with export performance requirements?

Cutler: The short answer is no. Export performance requirements themselves are not disciplined, but the WTO subsidies agreement does prohibit WTO members from paying companies to export. There are certain exceptions — for example, export promotion programs and agricultural goods. But it does apply to industrial products, for which a government might provide a 50

percent tax break to a company for the first five years if the company exports 100 percent of its product. That is inconsistent with WTO discipline.

The subsidies agreement disciplines provision of that tax break. But countries can require a company to export 100 percent of its product without receiving payment. That, unfortunately, has not been disciplined. The NAFTA and the MAI intend to discipline this.

Q: Some developing countries argue that they should be exempt from liberalization efforts on TRIMs in the WTO because their industries cannot compete. How has the United States responded to that?

Cutler: The Uruguay Round participants, including developing countries, agreed to the TRIMs agreement, and we expect countries to live up to their obligations under the agreement. The notion that a country can sign an agreement and then claim it should not be subject to its disciplines is totally unacceptable to the United States.

The TRIMs agreement is in force now. We are monitoring implementation. Article 9 of the agreement calls for a review of the agreement no later than January 1, 2000, as well as an opportunity to see whether the provisions of the agreement should be amended to address broader investment and competition policy issues.

At the December Singapore ministerial, the WTO set up a working group to examine trade and investment issues. This group, which is expected to meet shortly, will examine trade and investment issues but not negotiate rules in this area. The ministerial declaration requires that, if and when countries want to initiate WTO negotiations on investment, a decision must be taken to commence with such negotiations.

Q: How does the work in the WTO relate to what is being done now in the OECD on the MAI?

Cutler: In the OECD, we are seeking a high standard investment agreement that provides protection for investors but also achieves liberalization in the investment regimes of the signatory countries. The negotiation is mostly between countries in the industrialized world, but the agreement will be free standing and will be open to any country that wants to sign — provided it can meet the standard. The MAI negotiations were launched at the ministerial meeting in 1995 and are scheduled for completion in May.

Q: Do you expect them to be completed on time?

Cutler: It's hard to tell, but I think it is safe to say at this point that a lot of difficult issues need to be addressed. The MAI covers not only performance requirements but the gamut of investment policy issues. Among these: expropriation, transfers, national treatment, key personnel, monopolies, and privatization. It will also include a dispute settlement mechanism, not only government-to-government but also investor-to-state dispute settlement.

Q: And which are the most difficult issues?

Cutler: The thorniest ones now under negotiation include a proposal by the French, the Canadians, and the Belgians seeking a broad exception to the agreement for cultural industries. This is of great concern to the United States, and we have made it very clear that this will be a deal-breaker for us in the negotiations. While we understand that countries have legitimate reasons for preserving their culture, we do not believe that trade or investment agreements that disadvantage foreign investors and foreign suppliers are the way to do this.

Traditionally, cultural industries are regarded as entertainment industries. But the way the proposal is written, such an exception could apply to the computer industry, to telecommunications, to the Internet. Given the convergence of these technologies, in our view, it would completely undercut the value of the MAI. Any notion that this agreement would not cover some of the most important sectors in everyone's economies is extremely disturbing.

Another issue is called the regional economic integration organization exception, or REIO. Here the Europeans are basically seeking a blank check to take future discriminatory measures if they need to, as competency or jurisdiction in the investment area switches from the member states to the commission.

We need to negotiate reservations to the agreement, and we have not started that yet. We also have concerns about intellectual property, where certain countries are seeking to limit the application of this agreement.

We have made a lot of progress in a lot of areas, particularly with regard to performance requirements, to expropriation, to transfers, to key personnel. But there still are a number of very serious issues to be addressed. ❑

❑ THE BENEFITS OF A MULTILATERAL AGREEMENT ON INVESTMENT

Daniel M. Price, Partner; Powell, Goldstein, Frazer & Murphy LLP

While the creation of the World Trade Organization has done much to advance global trade liberalization, the formulation of binding international investment rules has lagged behind, says Daniel M. Price, chair of the International Practice Group at the law firm Powell, Goldstein, Frazer & Murphy. Price served as Deputy General Counsel in the Office of the U.S. Trade Representative from 1989-1992, where he negotiated numerous international investment agreements, including the Investment Chapter of the North American Free Trade Agreement.

Trade and investment flows are interdependent. To achieve the benefits of economic liberalization, investment barriers must be addressed as comprehensively as trade barriers. Yet while the conclusion of the Uruguay Round and the creation of the World Trade Organization have done much in the trade area, the formulation of binding international investment rules has lagged behind.

Developed countries have, of course, for years negotiated bilateral investment treaties with developing countries. However, there has been no multilateral agreement establishing comprehensive rules on foreign investment.

This is now changing. Negotiations on a Multilateral Agreement on Investment (MAI) at the Organization for Economic Cooperation and Development (OECD) in Paris are now entering their final stages. For the first time, developed countries are making the same commitments to each other that they have traditionally sought from developing countries.

Certainly, critical problems remain to be resolved in the negotiations, but one can now see the shape of an agreement that holds much promise for international investors and the economies that benefit from their activities.

ELEMENTS OF THE AGREEMENT

Although the negotiations have by no means been finalized, the key elements of the MAI have emerged. The following summarizes some of the central issues and highlights certain essential points to consider in concluding a truly beneficial agreement.

Broad Scope: The MAI is likely to contain a very broad definition of investment. Investment would include all forms of tangible and intangible property, ownership and other interests in an enterprise that entitle the owner to share in the income or profits, intellectual property rights, rights arising under contracts such as concession agreements and licensing agreements, rights conferred by law, and any commitment of capital or property to the territory of another party in the expectation of gain. A broad definition is essential as forms of investment are rapidly changing.

Non-Discrimination: Investors and their investments must be granted the better of national or most-favored-nation (MFN) treatment with respect to the establishment and operation of investments. Nondiscrimination is the central requirement of an effective investment agreement, and the negotiations thus far have followed this principle. By promising to accord investors of another party treatment no less favorable than that accorded one's own domestic enterprises, a party ensures equal competitive opportunity for investors and their investments.

Liberalization: To deal with areas where domestic law does not currently provide for national or MFN treatment, the MAI should contain substantial up-front liberalization commitments. An agreement that simply maintains existing barriers is insufficient. Sectoral liberalization, elimination of screening, and non-discriminatory participation and privatization are three principal market access objectives that should be pursued in finalizing the agreement.

Limited Exceptions and Transparency: The investment landscape already offers numerous examples of agreements whose rules, however well formulated, are swallowed up by the exceptions. MAI rules will be effective only to the extent that exceptions to them are limited. Exceptions, including those related to national security, should be narrowly drawn and clearly articulated. Exceptions should be (1) limited to existing measures affecting rights of establishment only, not post-establishment treatment (i.e., once an investment has been made), (2) subject to phase-out, and (3) structured to prevent future expansion of inconsistent measures. Similarly, once an exception is narrowed, whether by scheduled phase-out or unilaterally, the restriction may not be reimposed. Broad sectoral carve-outs, as distinct from exceptions for specific measures, should not be permitted. Expansionist and ill-defined exceptions, such as for "culture," are especially destructive and can eviscerate protections for a broad class of investments. The more specific the exception, the greater the de facto liberalization.

Prohibition of Performance Requirements: A broad range of trade-distorting and investment-distorting performance requirements should be eliminated. These would include domestic content requirements, domestic manufacturing requirements, trade balancing, technology transfer requirements, and other barriers commonly imposed on multinational enterprises as part of domestic technology or investment policies. Such requirements, while still attractive to some host governments, are self-defeating. Companies are increasingly unwilling to accept technology transfer or sourcing restrictions as the price for establishment rights or, indeed, for obtaining entry into government-funded research and development programs.

Freedom for Financial Transfers: Investors must be permitted to make financial transfers -- and obtain foreign exchange -- related to their investments. This includes repatriation of earnings, principal and interest payments, proceeds from liquidation or sale of investments, management and licensing fees, and payments for imports.

Movement of Key Personnel: Investors should have the right to appoint and move key personnel, including technical personnel and consultants.

Movement of Data: The MAI should provide for the free flow of data while addressing the privacy concerns related to the transborder flow of information.

Expropriation: The MAI will provide for protection of foreign investors against direct and indirect expropriation and nationalization. To protect investment effectively, expropriations must be for a public purpose, be carried out in a nondiscriminatory fashion, and be accompanied by prompt, adequate, and effective compensation.

Fair and Equitable Treatment: Investments should be accorded fair and equitable treatment. Such a provision would incorporate into the agreement evolving standards of international law.

Monopolies: An investor's market access should be facilitated by obliging signatories to prohibit the exertion of abusive power by both private and state monopolies. De-monopolization of sectors, including even those traditionally subject to limited competition in developed countries such as telecommunications, should be encouraged. Preferential treatment for state-owned entities and government-organized industry consortia should be prohibited.

Dispute Settlement: The MAI should provide mechanisms by which both state parties and investors can enforce the provisions of the MAI and seek redress for any breach.

— Investor-to-State: The MAI should enable the investor to initiate arbitration proceedings against the host state in internationally recognized forums such as the International Centre for the Settlement of Investment Disputes. Investment disputes should include those concerning alleged violations of the MAI and violations of investment agreements between a host state and an investor. The MAI should permit the investor to seek money damages and, where appropriate, a decree requiring state compliance with the terms of the MAI.

— State-to-State: The MAI should provide for binding arbitration of any disputes between state parties, and should specify sanctions for non-compliance with the resulting award. The MAI should also permit a state to bring a claim on behalf of an investor against another state, with provisions to prevent double recovery.

PROBLEMS THAT REMAIN

Much has been accomplished in laying the foundation for the basic rules governing protection of investment. Now

the difficult work begins on negotiating lists of exceptions to the broad rules of national treatment and market access. In this regard, a number of states have insisted on exceptions that could in fact overwhelm the obligations themselves. For example, the European Union has to date insisted that exceptions should be made to allow preferences among members of a regional economic integration organization. An exception permitting member states to offer investment preferences to each other that were not accorded to other OECD members would significantly limit the benefits of the MAI and render illusory the national treatment and MFN commitments.

Another contentious issue on the table is the effort to check the ability of the United States to impose extraterritorial measures such as those taken in connection with the so-called Helms-Burton law. Numerous negotiating partners are seeking to limit the ability of the United States to impose sanctions on non-U.S. entities for conduct that takes place outside its borders.

Finally, as has already been noted, some states are insisting on a so-called "cultural industries" exception that would permit derogations from the rules of the MAI. Given the revolution in information technology, such an exception could significantly choke off very important markets to foreign investors.

AFTER THE MAI

The OECD membership includes countries that are host to the largest stock of inbound foreign investment and home to companies that are the largest outbound investors. As such, OECD members have the most at stake in concluding such an agreement. As importantly, a state-of-the-art, high-standards investment agreement will serve as a model for future negotiations in this area.

The MAI should thus not be viewed as the end of the process but as the beginning. The essential next step is to broaden MAI membership through accession and eventually to incorporate its rules into an agreement within the framework of the WTO.

Global enterprises and the economies to which they contribute are vitally dependent on trade and investment flows. The states that are home to such enterprises, as well as those that are host to foreign investments, will both benefit from improvements in the international investment regime. ❑

❑ CORRUPTION REMAINS A POWERFUL BARRIER TO INVESTMENT, ECONOMIC GROWTH

An Interview with Peter Eigen, Chairman, Transparency International

Corruption can be "the single most devastating obstacle to economic and social and political development" in countries that lack open political systems and a free press, according to Peter Eigen, chairman of Transparency International (TI).

In addition to misdirected resources and investment dollars "siphoned off" by officials, corruption is a strong disincentive to foreign investment, Eigen said in a recent USIA interview.

"Without question, (businessmen) use their dollars, deutschmarks and yens to vote for the least corrupt country," he said.

TI, an independent non-profit organization based in Berlin, seeks to counter corruption in commercial transactions at the national and international levels.

The interview with Peter Eigen was conducted by USIA Economics Writer Berta Gomez.

Q: Despite the trend towards democratization and open government, corruption and bribery are still rampant in the international marketplace. What are the costs to businesses and individual countries?

Eigen: Corruption has a direct cost in terms of siphoning off resources — and it can be considerable. The payments required to get a large contract used to be about two to five percent of the total; practitioners tell us that it's now on the order of 10, 15, even 20 percent. If you look at the public sector investment program of a poor country, which might build a few power dams, a few roads, a port, and a few hospitals, an additional 10 percent or so for bribes is a direct cost to that economy and to the people these projects are supposed to serve.

At Transparency International, however, we believe that the most significant damage caused by corruption is indirect. In my work for the World Bank, as a manager of programs in Latin American and African countries, I witnessed how corruption distorts the choice, the size and the timing of projects, the choice of contractors and the quality of the work supplied.

This leads to projects that are overdesigned, suboptimal, and in some cases useless. There are many large projects in Africa and Latin America and Asia that are worse than useless, because they cause damage to the people who have to pay for them and who have to service the debt for years to come.

Q: How severely does a corrupt environment affect a country's ability to attract foreign investment?

Eigen: TI has compiled the perceptions of businessmen in the international marketplace through its "corruption perception index," and it shows that they are extremely sensitive to the prevalence of corruption in a given environment. Without question, they use their dollars, deutschmarks and yens to vote for the least corrupt country. If they do go into a corrupt country, they expect a high, quick profit. They invest only if they think they can make a killing, which of course feeds the lack of economic stability and irrationality in those countries. It's a vicious circle.

People often complain about capital flight, but there is nothing illegal about it. It's quite natural. If you are in an economy where you expect extortion and cannot predict what is happening in terms of licenses, imports, exports and exchange rates, and if you face the repeated attempts of decision-makers to put pressure on you, then you take your money and go somewhere else.

Q: Is abuse more prevalent in particular sectors?

Eigen: Certainly the sectors in which projects are very large: military procurement, power, telecommunications, road construction, pipelines, railways, and so on.

The power sector in Africa, Latin America, and Asia, is dotted with useless, overdesigned power projects. Some are extremely damaging to the ecology, and some are damaging to the people — those, for example, who had to be resettled so that large dams could be built.

Corruption is also a problem in sectors with complicated technologies. There is a lot of mystification, for example, about how expensive an airplane can be, as compared to another airplane. Corruption is also rampant in sectors such as military procurement, where there is an inevitable degree of secrecy and lack of transparency.

When all these factors come together, and when you have a non-accountable, non-democratic government, no free press, no independent government institutions and no empowered civil society, then you can expect that huge amounts of bribes are being taken.

In these cases, it is possible to conclude that corruption is the single most devastating obstacle to economic, social and political development.

Q: If democracy and a free press help to control corruption, why is the situation worsening? How do you reconcile the rising costs of bribes with the rising tide of democracy?

Eigen: There are certain countervailing trends at work. First of all, corruption has a tendency to breed its own children and to develop into a monster that its initial fathers cannot domesticate.

People used to say that a little corruption was useful in terms of cutting red tape, or that it was part of a culture that outsiders had no business changing. Once people are drawn in, however, they find a spiral of corruption that leads to ever-higher figures. Today, people simply assume that an increasing amount of money must be paid to decision-makers who abuse public trust and their public authority for private gain.

On the other hand, the opening of the international political scene — "glasnost" in the countries of transformation, and a more open democratic system in many countries in Africa and Latin America and Asia — has shed light on a lot of corruption cases which earlier could have been hidden.

I should add that these cases were hidden partly with the complicity of the industrialized countries, because during the Cold War, a corrupt Marcos or a corrupt Noriega was acceptable if he was firmly on the side of capitalism. The same thing, of course, was true on the other side. Things have changed dramatically since then. There is much greater awareness of the dangers of corruption, and tolerance for corruption has diminished. We have seen people marching on the streets in Brazil, Belgium, Italy and Japan because they are fed up with the corruption of their leaders.

Therefore, you see an increase of bribery in areas where it still persists, but you also see an awareness and an openness that will lead eventually to a system which will control corruption.

Q: Once this awareness exists, is there a blueprint that a country can follow to eliminate corruption?

Eigen: We have some general ideas on how it should happen. We believe there should be a broad societal coalition — not just the government and not just the private sector — that can develop strategies and formulate the anti-corruption measures.

The other basic tenet is that every society designs its own system of integrity; decisions must be home-grown and cannot be imposed from the outside. Corruption, perhaps more than any other area of human and political interaction, is related to the local situation, culture, and traditions. Our movement is therefore based on the strengths of more than 60 national chapters all over the world. They define their own problems. They define their own programs. They know where the opportunities are for change, and we support them in their efforts.

The Transparency International "Source Book" brings together the ideas of all of our national chapters. It's less a blueprint, however, than a checklist to remind people that an anticorruption system has to be a real system. It can't consist of a single event in which you catch one big fish and fry him in public, because that sort of thing blows over in a few months and is soon forgotten.

If you want sustainable change, you have to have an holistic approach. It's like the immune system of a human being. If one thing doesn't work properly, then the entire person will become sick.

Q: How are these national chapters established and who are their members?

Eigen: The chapters are extremely diverse. Some chapters are large, active and powerful, like the Argentine Chapter, which is called "Poder Ciudadano." It has more than 2,000 members, about 900 of whom are businessmen. They go out on the street and organize surveys of people — exit surveys at government agencies, for example.

Student volunteers will ask people leaving the building if they were asked for a bribe, and for how much, and if they got good service, and so on. They also organize song competitions for plays or competitions for posters, television shows, and so on. They are a great inspiration for all of us. To some extent, they existed before we did, but when they heard about us, they affiliated themselves to us.

Q: What must an organization do to become affiliated with TI?

Eigen: We have very few guidelines. Basically, we tell our chapters that they cannot be politically active in the sense of having ties to a party, because we want them to be neutral and independent.

Second, we do not allow our chapters to investigate individual cases for exposure because we want to build coalitions and bring in everybody who is interested in fighting corruption. You see, there are still many people representing international business who believe they have no choice but to offer bribes, because they are certain that their competitors are doing the same. They don't dare stop the practice because they will lose billions in contracts everywhere in the world.

Q: Given this fear of losing out on lucrative contracts, how can you expect international firms to refrain from offering bribes?

Eigen: We offer them a solution to this dilemma through what we call "islands of integrity." The idea is that if a competitor knows that his counterparts will not bribe, then he, too, will refrain from bribing. I know it sounds a bit like Shangri-la to talk about an island of integrity, but we at TI are pretty hard-nosed practitioners, and we have a very concrete and practical concept in mind.

For instance, when governments take bids for big power projects or big road-construction projects, there are often only five or 10 international firms that are eligible to compete. Once you know who they are, they can be gathered around a table, and they and the government can structure a contractual arrangement which makes it an offense to pay a bribe.

You can create a contractual liability among the bidders vis-a-vis one another. Firms that have participated in the bidding and have been out-bribed, for example, can file damage suits. The government can introduce additional features, such as monitoring whether officials avoid bribe-taking.

Q: There's also progress at the international level, such as the campaign launched by the Organization for Economic Cooperation and Development.

Eigen: Yes, and I have the feeling that it is an absolute breakthrough.

In May 1994, the OECD recommended six different areas of reform for its member countries. They include criminalizing bribery through civil, commercial and administrative law; terminating the tax deductibility of foreign bribes; changing banking laws to make banks the instrument of fighting corruption rather than an instrument of corruption; changing auditing and reporting standards to help the international community monitor corruption; and changing the systems of subsidies and of government contracting so that corrupt deals would not be rewarded.

An OECD working group comes together every couple of months to translate these six clusters of recommendations into specific and concrete guidelines for member countries.

In May 1996, all 27 member states of the OECD endorsed the recommendation to abolish tax deductibility and to criminalize foreign bribery. This recommendation was later endorsed again by the heads of state of the G-7 Industrialized Nations, including the United States, Canada, Germany, Japan, and France.

Q: Some OECD members, however, have recently changed their tack and suggested that an international convention is the only way to ensure that all countries abide by the same rules.

Eigen: Yes, and to our way of thinking this is a highly dubious shift of strategy. In fact, we believe it is an attempt to hold up coordinated international action.

A convention requires agreement on the text, the signature and ratification by participants, and the implementation of legislation and policies by participants. Therefore, even if we had a convention agreed by early next year, it would take many years before any country could be certain that it was binding on all of its partners.

While we are in favor of international conventions, they

should not be used as an excuse not to follow through with the momentum that exists right now in OECD. It is true that the OECD cannot impose rules on its members, but its recommendations are normally taken very seriously. This has worked quite well, for instance, in the areas of money laundering and drug trafficking.

Q: What is your take on the initiative in the Organization for American States?

Eigen: At the December 1994 Summit of the Americas, Western Hemisphere leaders announced that corruption is a big problem in the region. This was absolutely dramatic and fantastic. It was also wonderful that the OAS managed to draft a convention so quickly as it did. The convention has been signed now by 26 states in the Western Hemisphere, and as of early February, two countries — Paraguay and Bolivia — have ratified it.

However, I think the OAS and its experts would be the first to admit that this is a slow and painful process. Even the United States hasn't ratified the convention. It will be difficult.

Having said that, there are a number of wonderful features in the OAS initiative — in particular that they work closely with the OECD. This is important because the Western Hemisphere countries have to protect themselves against the corruption that comes from countries in Europe, and this they can do if they can cooperate with the OECD.

Q: Are you wary at all that the work being done by TI is going to boomerang — that some countries will reject your efforts as a form of imperialism?

Eigen: Although that perception was one of the things that made the World Bank so reluctant to get involved with this, I should stress that this effort is in no way an attempt to impose something on these countries; it is a response to what they want.

In fact, our advisory council includes many prominent representatives of developing countries, like Nobel laureate Oscar Arias Sanchez, Global Coalition for Africa Executive Secretary Ahmedou Ould-Abdallah, and the former finance minister of Nepal, Devendra Raj Panday. It's basically the leaders — the enlightened leaders of the Third World and of the countries in transformation — who come to us and say that they desperately need tools to protect themselves against corruption. I was at a conference recently in Maastricht where the Prime Minister of Ethiopia asked industrialized countries to stop subsidizing the corruption by their exporters to Ethiopia. He said that Ethiopia would work to get its own house in order, but that others have to help protect its international flank.

Q: Are there any countries that have made notable progress?

Eigen: In South Africa they have introduced some very interesting tools on the integrity of parliamentarians. It's absolutely unique. In Tanzania, the president and his whole Cabinet have disclosed their assets and the assets and liabilities of their wives.

There is a lot of change going on, and though it's too early to say whether it's sustainable, we have been invited to work in so many countries that we don't know where to get the people and the resources to respond to these demands.

Q: Your organization has an international conference coming up this September in Lima, Peru. What do you hope to accomplish?

Eigen: The theme of the conference is "The State and Civil Society in the Fight against Corruption," and we have very high expectations. There will be a number of workshops dealing with individual aspects of corruption such as auditing, banking, money laundering, its impact on economic growth, on the environment, on poverty alleviation, on small-scale enterprises.

We hope it leads to important papers and recommendations and possibly even declarations of principles that can then feed the evolution of knowledge about what to do about corruption. ❑

❑ AFRICA — NEW OPPORTUNITIES FOR FOREIGN INVESTMENT

By Mima Nedelcovych, Vice Chairman of the Corporate Council on Africa

Mima Nedelcovych, a former U.S. Executive Director of the African Development Bank, is a frequent visitor to Africa in his role as Vice President for International Marketing with F.C. Schaffer and Associates, Inc, a sugar engineering and agro-industrial group.

After almost a decade of regulatory and economic policy reform, Africa is better poised than ever before to attract foreign investment.

Though less than 1 percent of U.S. exports go to Africa, there is little doubt that the potential for expanding trade and investment throughout the continent is huge.

Big business understands this. One has to look no further than the membership list of the Corporate Council on Africa — a private, nonprofit, U.S.-based organization — to realize that Africa is a continent of opportunity, where business and governments can work together for their mutual benefit. General Motors, Coca Cola, AT&T, Eli Lilly, Mobil, H.J. Heinz, IBM, to name just a few of the council's members, are sending representatives to the continent to seek business opportunities. Those companies that are operating in Africa are doing well, and profit margins are among the highest in the world.

But Africa also presents huge risks for business — pitfalls that must be bridged largely by the countries themselves. African governments must accelerate privatization of state-owned entities, further dismantle trade and investment barriers, broaden regional integration efforts, put a stop to bribery and corruption, create a legal framework that encourages foreign investment, and establish an infrastructure that will allow business to flourish.

Clearly Africa won't develop overnight. It will require patience and perseverance on the part of reformers and international investors alike. It will require African leaders to keep a steady hand at the helm of economic reform. And it will require coordination among the international financial institutions to help ease the pressures inherent in the move toward market-based economies.

ENCOURAGING SIGNS

The International Monetary Fund projects economic growth in Africa at 5 percent this year — higher than the Middle East, Latin America, or Eastern Europe. The engine for continued economic growth is the private sector.

For too long the international community has pumped billions of dollars into Africa to promote development with minimal impact. Africans are increasingly taking their fate into their own hands as they turn to free markets and competition to lead them to prosperity.

Africans increasingly recognize that outward-looking policies that encourage trade, investment, and growth of the private sector are essential for economic development. They are beginning to understand the benefits of allowing more realistic exchange rates, privatizing parastatal monopolies in such crucial areas as power and telecommunications, and lowering barriers to intra-African trade.

The growing trend toward privatization — whether through management contracts, through the outright sale of parastatals such as public utilities, or through private operating arrangements based on lease-purchase-type options — is evidence of the growth of market-based solutions to development.

The results are clear. Foreign investment is beginning to flow into Benin, Burkina Faso, Cote d'Ivoire, Eritrea, Ethiopia, Ghana, Malawi, Mozambique, Namibia, Tanzania, Togo, Uganda, and Zambia, to name just a few of the reformers.

UNFINISHED BUSINESS

While foreign investment in Africa has increased in recent years, flows remain thin. African governments need to begin now to implement the types of policies that will convince foreign companies that they can get a fair return on their investment in a low-risk environment. Following are some key areas for further actions.

Infrastructure: If businesses cannot get the power to run their plants or if the cost of the power is too high, the plants will not be built. If businesses cannot get their goods or products to and from the plants because of poor transportation, the plants will not be built. And if the goods once at port take weeks or months to get out of storage because of excessive red tape, then businesses will go elsewhere.

The fact is that electrical power in Africa is far too costly, and it is far too scarce in rural areas to attract foreign interests. Given the continent's tremendous potential for hydroelectricity, there is no reason for this. Where Africa could have a competitive advantage in such areas as textiles manufacturing and essentially labor-intensive "cut and sew" operations, the high costs of operating, including, for example, electricity, make African textiles less globally competitive than they could be. Africans need to realize that they are not competing just with other African countries but with the rest of the world.

Similarly, without a sound telecommunications infrastructure, businesses in Africa will not be able to compete with firms in other developing regions, where orders can be placed and filled with the touch of a button on a computer terminal. Nor will businesses be keen on new investments if they cannot communicate readily with their home offices during those crucial early years.

Regulation: Investors in Africa necessarily have to import, mostly through port facilities, much of the equipment and materials for their manufacturing plants. But many port facilities services in Africa are so administratively inefficient that products may lie in port for weeks.

Just getting approval for starting up a project may take months or years in Africa compared to weeks or months in another region of the world. The costs of these delays need to be recaptured by businesses, usually by increasing the cost of the final product, which then reduces the product's global competitiveness. Even if the final cost of running a sugar factory, for example, is less in Cameroon than in Indonesia, if it takes two years to get the necessary approvals and financing in Cameroon and only one year in Indonesia, a potential investor may very well go to Indonesia.

Economies of Scale: Foreign investors remain concerned that domestic markets in Africa are too small to support investment in ventures other than extractive industries and natural-resources-based operations, which produce goods for export. The potential for larger, more attractive markets exists if Africa can expand regional integration by lowering national trade and investment barriers and by harmonizing nontariff barriers such as government product standards. The Southern African Development Community (SADC) comprises a dozen southern African nations with a combined population of nearly 150 million. In West Africa, the Economic Community of West African States (ECOWAS) includes 16 countries and a market of nearly 200 million potential customers. To date, progress toward integration has been extremely slow.

Bribery and Corruption: Generally speaking, corruption is diminishing at the highest levels of government throughout Africa, although it persists in certain countries, particularly at the "working levels." Some countries allow companies to take tax deductions for giving foreign bribes in other countries where bribes are considered a normal cost of doing business.

If successful, the effort in the Organization for Economic Cooperation and Development (OECD) to outlaw bribery could have a very positive impact on Africa because it would prohibit business persons from all 26 OECD countries from bribing officials. It comes back to the issue of knowing what the rules are. Corruption and bribery create uncertainties. They are not pleasant; they are not cost effective. When you have to bribe someone, you pass off the cost of that bribe to the consumer. An OECD agreement, backed by enforcement, will increase foreign investment because it will make business easier and allow companies to price their products more competitively.

An OECD agreement, however, will not be enough to solve the problem. Corruption at the highest level is difficult to address except through a free press, which has begun to take root. But what really irritates businesses and discourages investment is the day-to-day bribes to underpaid African public servants, be they customs officials or other regulatory officers. What can be done? Countries do not need 10 port officials, for example, to do the work of two. Cut the number of officials and raise the wages of those who remain to receive what they would if they continued to extort bribes. They could then earn a decent living wage "legally."

Legal Framework: Intellectual property rights, dispute settlement procedures, and land rights are critical to foreign investment. In Africa, there is a long ingrained feeling that no one can own the land but someone can work the land. That is fine until someone starts investing and building physical infrastructure on the land. It is very difficult to convince financiers and equity partners to come in and

build a factory or develop an agricultural plantation on land they don't own. One approach that is being employed is to secure 50-year or 100-year leases to the land.

Another issue Africans need to explore is how tax and other fiscal benefits can be used to attract investment. If an African country is serious about attracting investment, in addition to seeing what a neighboring country might be doing it should investigate how developed countries (or in the case of the United States, the individual states such as Virginia, Maryland, Tennessee) provide tax incentives and other attractions to entice foreign investment.

Political Stability: Even in high-cost economies, businesses can make profits. But nothing makes foreign investors more skittish than political instability and internal strife. Not knowing the rules of the game and not being able to reasonably predict what the future will bring are perhaps the largest single deterrents to foreign investors. One has only to look at the lack of foreign investors in such conflict-riddled countries as Liberia, Somalia, Zaire, Rwanda, and Burundi, as well as in the more subtly "unpredictable" countries as Niger, Cameroon, Sierra Leone, and Gabon, to see that when there is open political strife or the potential for it, and when the rules of business change, foreign investors stay clear.

Guinea is a classic case. Following the death of Sekou Toure in the mid 1980s, the government opened up the economy and started to do all the right things. Trade missions began going there, business interest perked up. But changes in the political situation were followed by a sharp increase in administrative barriers to foreigners seeking to do business in the country. Even though the country has recently begun to liberalize its economy again, investors, having been burnt once, are more reluctant to try again.

Equity Markets: Stock markets have emerged in 11 African capitals. They go hand in hand with privatization and are essential to capital formation in Africa. As public utilities and industries are privatized, they will need huge amounts of capital to remain viable and increase their profitability. Equity markets also conveniently create an environment for flight capital to come back into a country, with no questions asked about how the money left in the first place.

I am very upbeat about the prospects for African stock markets. They are producing good returns, and they are creating a base of absolutely required financing. They are also a realization by governments that, at some point, any country's industries are going to require an injection of external capital to remain viable and profitable.

International Financial Institutions: Most African nations have not developed the social safety nets necessary to protect sectors of their populations most vulnerable to economic reform. The World Bank and the African Development Bank remain essential ingredients in rehabilitating basic physical and human infrastructure and in stimulating economic growth while helping develop the parallel safety nets to ease the pain of restructuring industries and coping with the resulting layoffs. Similarly, International Monetary Fund involvement has encouraged the government fiscal discipline required by both domestic and foreign investors, while allowing the political leadership to hide from some of the inevitable internal political heat.

U.S. Assistance: U.S. exports account for only 14 percent of total African imports, and even that share is at risk. Insurance against political instability and export credits to reduce the risk of investment are critical for U.S. investment in Africa. Yet the U.S. Congress is considering reducing funding for U.S. Eximbank export credits and Overseas Private Investment Corporation (OPIC) risk insurance.

Without project development assistance funds, opportunities for U.S. businesses will not be identified and doors to investment will remain closed. Without financing, deals will not be made, and without political risk insurance, arranging for financing is that much more difficult. There is clear evidence of U.S. businesses losing out to foreign competitors that have obtained advantageous financing terms from their governments. America must make sure that OPIC, the Eximbank, and the Trade and Development Agency are adequately funded, or else be prepared to cede our relatively small, but growing, position in the African market — a market poised to grow in the future.

CREATING NEW OPPORTUNITIES

Although Americans are prone to seek short-term results, investment in Africa is only going to happen slowly, deal-by-deal. On the positive side, Africans are increasingly turning to market approaches, and the international community is helping through its support for economic reforms and growth-oriented private sector approaches. It is now up to U.S. businesses and government to forge a stronger partnership that will create new opportunities for trade and investment benefiting both Africans and Americans. ❑

❑ THE CASE FOR FDI: A LOOK AT THE UNITED STATES

By Edward M. Graham, Senior Fellow, Institute for International Economics

The major threat to U.S. economic welfare comes not from a growing foreign business presence, says Edward Graham of the Institute for International Economics, but from the potential for an "investment war" in which governments attempt to capture greater benefits from foreign investment through such measures as expensive investment incentives. Graham, an author of numerous studies on international investment, has taught economics and business at Duke University, the University of North Carolina, and the Massachusetts Institute of Technology.

Over the last decade, the value of foreign direct investment (FDI) in the United States has more than doubled — and now approaches $600,000 million. Concerns expressed about the effects of this foreign direct investment in the United States are not that much different from those expressed about FDI in other countries. With the sharp increase over the last decade in U.S. affiliates of foreign firms have come fears that foreign firms would behave differently than domestic ones in ways that reduce employment, worsen the trade deficit, inhibit technological progress, or compromise national sovereignty.

The facts just do not support these concerns. What the evidence shows is that FDI in general makes a significant positive contribution to the U.S. economy. Let me be specific.

In recent years, domestically-owned U.S. automakers have improved both the quality of their products and the efficiency of their manufacture. Without question, some of these advances have resulted from U.S. firms emulating certain practices of their Japanese competitors. The results have been not only an increased share of the domestic market for the U.S. firms but benefits for the consumer as well, as product choice has expanded and costs have been reduced.

ADDED BENEFITS

The point is that foreign firms introduce new technology that diffuses to other parts of the U.S. economy. As U.S. workers receive training from affiliates of foreign firms and then bring skills learned to new jobs elsewhere in the United States, they and the country derive benefits from FDI over and above the gains from increased international exchange.

There are also arguments that foreign owners tend to import more of their production inputs from abroad than do U.S. owners, and that the resulting reduced demand for the products of domestic suppliers both costs the United States jobs and worsens the U.S. trade balance.

What the data show is that FDI has essentially no net impact on employment at the national level, although it may have some effect on the regional distribution of that employment. A region that succeeds in attracting foreign investment may well increase overall employment in the region as a result. However, the gains in employment come essentially at other regions' expense and are likely to induce migration into the favored region from the disfavored ones. There also is no evidence from U.S. data that U.S. affiliates of foreign firms offer worse jobs or lower-paying jobs than their domestically-owned counterparts.

As to the effect on the trade balance, the available data do show that foreign-owned firms have a substantially stronger tendency to source abroad than do domestic firms. But this need not have a negative effect on the trade balance. The finished products of these foreign-owned firms are more likely to displace imports rather than domestic products, and thus reduce overall imports in the industry.

THE DANGERS OF INCENTIVES

Indeed, the major threat to U.S. economic welfare comes not from the growing foreign presence but from the potential for an "investment war" in which governments attempt unilaterally to capture greater benefits from foreign investment through such measures as expensive investment incentives and performance requirements, or attempt to use multinationals headquartered in their territories to further their own foreign policy interests at the expense of nations that are hosts to subsidiaries of these enterprises.
A big concern is the level of incentives offered by states

and localities to foreign firms — such as tax relief, provision of infrastructure and land free of charge — that are usually contingent on a promise by the foreign firm to provide certain local benefits. This amounts to a de facto performance requirement of the kind the United States is negotiating within the World Trade Organization (WTO) to eliminate. In most cases, the foreign investor would have been willing to make the investment without the incentives. The taxpayer ends up paying the costs of such incentive programs.

Cooperative action is essential if such investment wars are to be avoided. We should take seriously the possibility that an explicit multilateral agreement on direct investment can be reached. Like the WTO, such an agreement will not solve all our problems, but like the WTO, it could do us all a lot of good. ❏

❑ THE MULTILATERAL AGREEMENT ON INVESTMENT

A Fact Sheet Prepared by the Organization for Economic Cooperation and Development (OECD)

1. What is the Multilateral Agreement on Investment (MAI)?

The MAI will establish a broad multilateral framework for international investment with high standards for the liberalization of investment regimes and investment protection and with effective dispute settlement procedures.

The MAI will be a free-standing international treaty open to all OECD members and the European Communities, and to accession by non-member countries.

Negotiations were launched by the OECD member countries at the May 1995 ministerial meeting, with the objective of concluding by the ministerial meeting to be held in May 1997.

2. What is the purpose of the MAI?

The MAI will provide a "level playing field" for international investors, with uniform rules on both market access and legal security. The rules will be designed to eliminate distortions to investment flows and facilitate a more efficient allocation of economic resources.

The decision to launch the MAI negotiation was a logical step to consolidate and complete the existing OECD instruments that have helped promote international investment and economic cooperation for many years. The OECD Codes of Liberalization have been in place since the birth of the OECD in 1961, and the Declaration and Decisions on International Investment and Multinational Enterprises since 1976.

Investment is a central feature of globalization, and crossborder investments have been growing faster than trade in goods and services in recent years, yet no comprehensive international rules exist for investment.

The MAI negotiations aim to:

- Strengthen the legal status of the existing OECD instruments.
- Introduce new disciplines (e.g., on movement of key personnel, monopolies, privatization, and performance requirements).
- Design a state-of the-art chapter on investment protection.
- Add legally-binding procedures for the settlement of investment disputes through recourse to international arbitration.

The MAI is also intended to lock in the benefits of the substantial investment regime liberalization that has been achieved in recent years and to roll back measures that still discriminate against foreign investors.

The MAI once completed will facilitate the international flow of capital, technology, and expertise, with benefits for host and home countries alike.

3. Why are these negotiations taking place in the OECD?

OECD countries account for the majority of foreign direct investment flows, probably 85 percent of outflows and 65 percent of inflows, and accordingly have a major stake in the rules governing international investment.

They also share a common view of the benefits of foreign direct investment (FDI) and have reached an advanced stage of liberalization. Moreover, they have considerable expertise and experience in the operation of the OECD's existing rules on investment, and have the benefit of several years of analysis and discussion on the issues now being negotiated in the MAI.

While the OECD is better known for its research and analysis, it has always been a rule-making forum for its member countries. In addition to its investment disciplines, the OECD has rules and procedures for international cooperation in many fields, including

capital movements, taxes (including transfer pricing), competition policy, the environment, and bribery in international transactions. In all these fields, progress was possible because consensus was found to move forward in the OECD when it was lacking in other international bodies.

4. What is meant by "high standards" in the MAI?

The objective of "high standards" refers primarily to the quality of the investment environment: What rules will provide the highest degree of market access and legal security for investors and their investments? It applies to each of the main aspects of the rules under discussion — liberalization of investment regimes for new investment (establishment), national treatment and most-favored-nation treatment (MFN) for established foreign-controlled enterprises, investment protection (in particular, compensation in the event of expropriation, free transfer of profits and dividends and other returns on investment), and dispute settlement (state-to-state and investor-to-state).

This approach does not imply any relaxation of corporate responsibility, nor will it undermine the capacity of host countries to regulate their domestic economies, so long as they do not discriminate against foreign investors. Moreover, the MAI is likely to contain specific safeguards against the lowering of domestic standards (e.g., for the environment) as a device for attracting additional investment. It is also likely that the OECD Guidelines for Multinational Enterprises, containing a comprehensive (non-binding) code of conduct for international companies, will be associated with the MAI.

5. What will be the "value-added" of the MAI?

Compared to the existing OECD instruments, the MAI would offer:

- A single, consolidated, and comprehensive agreement, with legally binding force on all commitments and binding procedures for dispute resolution and enforcement.

- New disciplines on performance requirements, privatization, state-owned enterprises, monopolies and concessions, corporate practices, and key personnel.

- A reduction of existing barriers to investment.

Compared to bilateral investment treaties, the MAI would offer a uniform set of rules on investor protection of the highest quality and rules on establishment (market access) not covered by most bilateral treaties.

Compared to the GATS (the General Agreement on Trade in Services), the MAI would add:

- Comprehensive market access commitments on investment in manufacturing and natural resources, as well as in services, and a "top-down" system for scheduling country-specific reservations that would produce an effective standstill on new nonconforming measures.

- Investment protection for established enterprises, including a minimum general standard of fair and equitable treatment, and rules on expropriation and compensation.

- A dispute settlement system that includes private rights through the investor-to-state regime.

Compared to the TRIMs agreement (on Trade-Related Investment Measures), the MAI would extend rules governing performance requirements to investment-distorting measures, regardless of whether they are related to trade.

6. What interest could non-OECD countries have in signing the MAI?

Non-members may wish to sign the MAI for the same reasons as OECD countries.

- First, signatories to the MAI can expect to attract more investment flows because the MAI will set a new internationally recognized standard of market access and legal security for potential investors. Participation in the MAI will undoubtedly be more effective in this regard than bilateral treaties because the MAI will cover all phases of investment, including the entry and establishment phase and stronger dispute settlement provisions.

- Second, for countries that are also capital exporters, the agreement will offer market access guarantees and legal security in most of the world's major investment destinations. Although some benefits may flow automatically to non-MAI countries through the MFN provisions of the GATS and bilateral investment treaties, the scope of the MAI is much broader than these

agreements because it encompasses all economic activity, including all manufacturing and natural resources as well as services.

- Third, signing onto the MAI would give a country access to the "Parties Group," which will facilitate the implementation and operation of the agreement. All countries will participate in the Parties Group on an equal footing.

Many countries have signed up to the GATT (General Agreement on Tariffs and Trade) without having been part of the negotiations of the GATT rules themselves. The fact that many OECD countries are important importers as well as exporters of FDI provides assurance that the interests of FDI importers will be taken into account.

7. What will be done to facilitate MAI accession by developing countries?

MAI aims at high standards, and all signatories will be expected to accept the MAI framework of rules. In the accession process, however, country specific exceptions or reservations will be negotiated. Transition periods, as well as temporary reservations to be phased out over time, might also be envisaged to accommodate specific concerns of developing countries.

The OECD countries are very conscious of the interest these negotiations have aroused among non-member countries and are eager to respond positively to requests for information. An active outreach program of OECD seminars and other informal contacts has been organized to provide information on the negotiations as they proceed and to hear the views of non-member countries. For practical reasons, these meetings are limited in the number of countries invited, but they provide broad geographic coverage.

Interested non-members are invited to contact OECD member countries or the OECD Secretariat if they would like to have further information or express a view.

8. How does the MAI relate to the World Trade Organization?

The OECD countries have stressed that MAI rules should operate harmoniously with those of the World Trade Organization (WTO). There are several areas where the concepts and obligations overlap, but there is no reason to assume that conflicts will arise. Careful examination in cooperation with trade experts and the WTO will help resolve these questions. With this in mind, the WTO Secretariat has been given permanent observer status in the negotiating group.

The question of an investment agreement in the WTO is for consideration by the contracting parties of the WTO. There can be no question of the MAI being transferred to the WTO for adoption on a take-it-or-leave-it basis. The MAI would no doubt be an important reference for WTO negotiations (as would other investment agreements such as North American Free Trade Agreement, the Energy Charter, bilateral investment agreements, and regional agreements among developing countries such as MERCOSUR). But any WTO agreement would have to be designed for the WTO membership and in the framework of WTO disciplines and institutional arrangements. ❑

❑ U.S. BILATERAL INVESTMENT TREATY PROGRAM

U.S. Department of State

The Bilateral Investment Treaty (BIT) Program supports key U.S. policy objectives of promoting U.S. exports and enhancing the international competitiveness of U.S. companies. Its basic aims are: to facilitate and protect U.S. investment abroad; to encourage adoption in foreign countries of market-oriented domestic policies that treat private investment fairly; and to support the development of international law standards consistent with these objectives.

Since 1982, the United States has signed 38 BITs, of which 28 are now in force. The other 10 await legislative action in the United States or the other country. The investment chapter of the North American Free Trade Agreement (NAFTA) is also in force with Mexico and Canada and is comparable to a BIT. The United States is also involved in negotiations aimed at achieving BITs with many other countries.

The U.S. government has placed a priority on negotiating BITs with countries undergoing economic reform and where it believes it can have a significant impact on the adoption of liberal policies on the treatment of foreign direct investment. BITs also complement and support regional initiatives on investment liberalization in the Asia Pacific Economic Cooperation forum (APEC) and the Free Trade Area of the Americas initiative. They also lay the policy groundwork for broader multilateral initiatives in the Organization for Economic Cooperation and Development and eventually, the World Trade Organization.

U.S. BITs provide investors of one party to the treaty who invest in the other parties territory with six basic guarantees:

First, BITs ensure that a party's companies will be treated as favorably as their competitors. They receive the better of national or most favored nation (MFN) treatment when they seek to initiate investment and throughout the life of that investment, subject to certain limited and specifically described exceptions.

Second, BITs establish clear limits on the expropriation of investments and ensure that investors covered by the treaty will be fairly compensated. Expropriation can occur only in accordance with international law standards, that is, for a public purpose, in a nondiscriminatory manner, under due process of law, and accompanied by payment of prompt, adequate, and effective compensation.

Third, BITs guarantee that a party's investors have the right to transfer funds into and out of the country without delay using a market rate of exchange. This covers all transfers related to an investment, including interest, proceeds from liquidation, repatriated profits and infusions of additional financial resources after the initial investment has been made.

Fourth, BITs limit the ability of host governments to require a party's investors to adopt inefficient and trade distorting practices. In particular, performance requirements, such as local content or export quotas, are prohibited.

Fifth, BITs give a party's investors the right to submit an investment dispute with the treaty partner's government to international arbitration. There is no requirement to use that country's domestic courts.

Sixth, BITs give a party's investors the right to engage the top managerial personnel of their choice, regardless of nationality. ❑

United States Bilateral Investment Treaties
Country - Treaty Signature Date

Country	Date	Country	Date
Albania	(1/10/95)	Kyrgyzstan	(1/19/93)*
Argentina	(11/4/91)*	Latvia	(1/13/95)*
Armenia	(9/23/92)*	Moldova	(4/21/93)*
Bangladesh	(3/12/86)*	Mongolia	(10/6/94)*
Belarus	(1/15/94)	Morocco	(7/22/85)*
Bulgaria	(9/23/92)*	Nicaragua	(7/1/95)
Cameroon	(2/26/86)*	Panama	(10/27/82)*
The Congo	(2/12/90)*	Poland	(3/21/90)*
Croatia	(7/13/96)	Romania	(5/28/92)*
Czech Republ.	(10/22/91)*	Russian Fed.	(6/17/92)
Ecuador	(8/27/93)	Senegal	(12/6/83)*
Egypt	(3/11/86)*	Slovakia	(10/22/91)*
Estonia	(4/19/94)*	Sri Lanka	(9/20/91)*
Georgia	(3/7/94)	Trinidad/Tobago	(9/26/94)*
Grenada	(5/2/86)*	Tunisia	(5/15/90)*
Haiti	(12/13/83)	Turkey	(12/3/85)*
Honduras	(7/1/95)	Ukraine	(3/4/94)*
Jamaica	(2/4/94)*	Uzbekistan	(12/16/94)
Kazakstan	(5/19/92)*	Zaire	(8/3/84)*

* BIT has entered into force.

❑ CAPITAL FLOWS TO EMERGING MARKET ECONOMIES

A Report by The Institute of International Finance, Inc

Private capital flows to emerging market economies rose 19 percent in 1996, to reach a new high of about $230 billion. They are likely to remain at this record level in 1997, as strong, continued growth in equity flows offsets a moderation in borrowing. Net official flows fell sharply last year, and total flows in 1996 remained virtually unchanged from their 1995 level of slightly under $240 billion.

The record high for private capital flows in 1996 reflected the persistent trend toward higher capital flows to emerging market economies since the beginning of the 1990s. Because Mexico borrowed heavily from private markets to repay U.S. and IMF (International Monetary Fund) emergency loans, private flows were particularly strong in 1996, while net official flows were much lower than in 1995. Special circumstances in some important countries such as Brazil, Russia, and South Korea also boosted private flows last year.

Moderate international interest rates, progress in economic reform in emerging market economies, and a continued expansion of investor interest in these new markets meant a strong availability of capital. Many borrowers, particularly in Latin America, took advantage of these favorable conditions, and the number of bond issues reached a new record. The buoyant supply of capital was evident in falling interest rate spreads paid by emerging market borrowers above rates on comparable U.S. Treasury maturities, and by the continuation of a brisk buildup of foreign exchange reserves held by emerging market countries. In some cases, especially outside Latin America, interest spreads became so thin that it may reasonably be asked whether they adequately cover the inherent risk.

Emerging Market Economies' External Finance (billions of dollars)

	1993	1994	1995	1996e	1997f
Current account (1)	78.1	-71.4	-74.0	-107.1	-149.9
External financing, net (2)	200.9	184.7	238.1	239.2	243.3
Private flows, net	178.3	162.0	194.4	231.5	231.2
Equity investment, net	86.5	90.5	98.7	103.6	116.0
Portfolio equity, net	42.1	29.8	25.8	33.1	36.7
Direct equity, net	44.4	60.7	73.0	70.4	79.3
Private creditors, net	91.8	71.5	95.7	127.9	115.2
Commercial banks, net	25.1	29.1	77.6	64.9	60.9
Nonbank private creditors, net	66.7	42.4	18.1	63.0	54.2
Official flows, net	22.6	22.7	43.7	7.8	12.1
IFIs, net (3)	7.7	3.6	20.0	6.8	6.8
Bilateral creditors, net	14.9	19.1	23.7	1.0	5.3
Resident lending/other, net (4)	-57.9	-69.5	-69.2	-59.1	-44.5
Reserves excl. gold (- = increase)	-64.9	-43.9	-94.8	-73.1	-50.8

e = estimate, f = forecast

(1) Net external financing minus net resident lending and minus reserves other than gold.

(2) Net private flows plus net official flows.

(3) International financial institutions.

(4) Including net lending, monetary gold, and errors and omissions.

TRENDS IN THE 1990s

The expansion of nearly one-fifth in private flows last year continued the strong growth in these flows, which averaged over 30 percent annually in the first half of the 1990s. Private capital flows to 30 emerging market economies rose from $64 billion in 1991 to $178 billion in 1993 and $231 billion in 1996 (see table). Equity flows, primarily direct investment, have risen from about 30 percent of the total at the beginning of the decade to about half in 1995-96.

Within this trend there was sharp expansion of private capital flows in 1992-93 and retrenchment in 1994. Mexico has accounted for the bulk of the fluctuations around the upward trendline. Private flows to Mexico dropped $44 billion from 1993 to 1995, and then surged $27 billion in 1996. When Mexico is excluded, private flows to 29 emerging market economies have shown a smoother, rising but decelerating path over the 1990s. The principal exception was in 1994, when U.S. interest

rates rose. Even then, however, non-Mexico flows simply paused rather than collapsed.

In 1996, the largest private flows once again went to Asia, which accounted for 56 percent of the total. Private flows reached $38 billion for China, and rose by about 40 percent to $36 billion for South Korea, where there was a shift toward a large current account deficit and increased use of the international bond market. Latin America accounted for 29 percent of private capital inflows, with Brazil representing over 40 percent of the region's total. Private flows to emerging market economies in Europe eased somewhat, to about $30 billion. Policy shifts in the Czech Republic and Hungary reduced demand for capital inflows, largely offsetting a surge of flows to about $12 billion for the Russian Republic.

THE 1997 PICTURE

Private flows are likely to plateau in 1997 after the record year in 1996, but special factors disguise the upward trend.

In 1997, more moderate flows to a few large countries are likely to offset continued expansion in flows to most emerging market economies. Conditions in the global capital markets are likely to remain conducive to further strong flows of private capital. Relatively low interest rates in the leading industrial countries and an ongoing reallocation of assets in global portfolios suggest that there will be a ready supply of capital available to borrowers in emerging markets. The volume of these flows will thus be determined more by demand from borrowers in these countries than by the availability of funds, barring any unforeseen shocks.

We expect equity flows to continue to rise by about 12 percent in 1997, reflecting an increase in both direct investment and portfolio flows.

This would return equity flows to their 50 percent share average in total private flows in 1993-96. The share of equity has tended to rise about five percentage points around this average during years of low lending (such as 1994) and fall about five percentage points during years of high lending (1993, 1996). Net bond flows are likely to ease, as the frenetic pace of bond issues in 1996 returns to more normal levels and as repayments rise. Although favorable interest rates are likely to encourage borrowers in emerging markets to continue to access the syndicated loan market for medium- and long-term funds, net flows from banks are likely to fall because of sizable repayments of arrears.

For a handful of key countries, lower private flows in 1997 are likely, offsetting continued increases in flows to most other emerging market economies. The special cases include five countries that accounted for about one-third of private flows last year.

- **Mexico:** The government is likely to reduce its borrowing from private capital markets in 1997, following a year of high borrowing for the purpose of repaying emergency loans from the IMF and the U.S. Treasury.

- **Brazil:** Domestic interest rates have fallen from their high levels of the first two years of the country's stabilization program (Real Plan), and foreign capital inflows are unlikely to sustain their high 1995-96 range of $25 billion to $30 billion annually, despite a prospective rise in the current account deficit.

- **Russia:** Private inflows are likely to slow in response to lower domestic interest rates and from repayment of interest arrears under the debt rescheduling agreement. Assuming that resident capital outflows decline after surging in 1996, a buildup in reserves should be possible despite a shift from current account surplus to deficit.

- **Thailand:** Weaker credit demand, together with investor caution about large external imbalances and an increase in nonperforming bank loans, is likely to continue the dampening of capital inflows begun last year.

- **Turkey:** In the absence of stronger fiscal adjustment measures, commercial banks and other private creditors seem likely to scale back their lending in 1997 in response to growing perceptions of increased risks.

For Mexico, Brazil, and especially Russia, lower flows this year would represent strength rather than weakness, as the declines would reflect more nominalized economic conditions. For the five countries together, private flows are forecast to fall by about $15 billion in 1997. By contrast, private flows to the remaining 25 emerging market economies are forecast to rise by about 13 percent this year.

HIGHER GROWTH, LARGER EXTERNAL DEFICITS

Growth should rise in 1997, as will current account deficits, which should nonetheless generally remain within prudent ranges.

Continuation of record private capital flows in 1997 reflects not only favorable capital supply but also the strong growth performance expected for emerging market economies. Because of higher growth in Latin America and Europe, aggregate growth for emerging market economies as a whole should reach 5.7 percent, one percentage point higher than the 1993-96 average. As imports rise along with domestic growth and additionally with sizable swings from surplus to deficit in China and Russia, the aggregate current account deficit for emerging market economies is likely to rise by nearly half, to a record high of nearly $150 billion. This magnitude represents less than 3 percent of the combined gross domestic product of these countries, although there are important individual cases in which reliance on foreign saving is much higher. At the aggregate level, the use of external resources on this scale by emerging market economies broadly represents an efficient allocation of world capital toward high-return investments, rather than a slide toward overborrowing of the type that preceded the debt crisis of the 1980s. Moreover, capital flows should exceed the current account deficits by nearly $100 billion, providing a further buildup in the cushion of foreign exchange reserves even after allowing for resident capital outflows.

UNCERTAINTIES IN THE OUTLOOK

In view of low U.S. unemployment, any new signs of inflationary pressure could cause the Federal Reserve, the U.S. central bank, to raise interest rates. Higher rates would moderate capital flows to emerging market economies, as increases of one percentage point in the U.S. bond rate have been associated with reductions of about $20 billion in these flows in recent years. Growth could be weak especially in Europe and Japan, eroding exports of emerging market economies. Low inventories of oil suggest volatility in oil prices. A correction in the U.S. stock market, if severe, could adversely affect flows. Finally, some individual emerging market countries could enter serious economic destabilization, although sustained negative spillover effects to emerging market economies as a whole are unlikely.

EQUITY FLOWS, PRIVATIZATION

Equity has become an increasingly important source of external finance for emerging market economies in the 1990s. It has risen steadily in recent years and been noticeably resilient during periods of capital market volatility, reflecting the longer-term perspective of equity investors. In 1996, net equity flows rose to $104 billion, from $99 billion the previous year. Equity was the largest component of private flows and represented about 43 percent of total external financing. In 1990, by contrast, equity accounted for just 18 percent of total flows.

Several factors have combined to encourage equity flows to emerging markets in the 1990s. These include:

• **Privatization programs:** Governments in many emerging market countries have undertaken structural reforms in an effort to improve efficiencies. An important element of this process has been privatization. These programs have generated significant foreign flows and have acted as a catalyst for equity investment.

• **Direct investment:** The growing need for multinational corporations to broaden their production facilities to compete effectively in the global marketplace has led to a steady rise in direct equity investment in many countries. It has become increasingly more efficient to base manufacturing plants close to new markets and where labor costs are lower.

• **Stock market liberalization:** The increase in portfolio flows has been facilitated by the opening up of local stock markets to foreign investors, growing liquidity, and gradual improvement in settlement procedures. In addition, strong returns in certain markets have encouraged investment managers to diversify their portfolios to include a greater proportion of emerging market equities.

• **International equity issues:** The use of depository receipts by companies in emerging markets has grown since the early 1990s. International equity issues, which amounted to just $1.2 billion in 1990, rose to a peak of $17 billion in 1994. Issues dropped sharply in 1995 in the wake of the Mexican crisis, then picked up again in 1996 to $10.2 billion. Asian companies are the most active in this market. ❑

❑ THE LINK BETWEEN TRADE AND FOREIGN DIRECT INVESTMENT

World Trade Organization (WTO) Secretariat

The following are excerpts from "TRADE AND FOREIGN DIRECT INVESTMENT," a report issued by the WTO Secretariat, October 1996.

Trade polices can affect the incentives for FDI (foreign direct investment) in many ways. A sufficiently high tariff may induce *tariff-jumping* FDI to serve the local market. Other types of import barriers can have the same effect, of course. It is no coincidence that Japanese automobile manufacturers began producing in the European Union and the United States following the imposition of so-called "voluntary export restraint" agreements limiting the number of automobiles that could be shipped from Japan.

FDI may also be undertaken for the purpose of defusing a protectionist threat. Such *quid pro quo* investments are motivated by the belief that the added cost of producing in the foreign market is more than compensated by the reduced probability of being subjected to new import barriers on existing exports to that market. There is evidence, for example, that the perceived threat of protection had a substantial impact on Japanese FDI in the United States in the 1980s, and that these investments reduced the subsequent risk of being subjected to contingent protection resulting from anti-dumping and escape-clause actions.

While some host countries intentionally use high tariffs as an incentive to induce investment, the gains from doing so may be limited. FDI attracted to protected markets tends to take the form of stand-alone production units geared to the domestic market and not competitive for export production. Indeed, high tariffs on imported raw materials and intermediate inputs can further reduce international competitiveness, especially if local inputs are costly or of poor quality (as suggested by the need to protect the domestic producers of those goods in the first place). To counteract the negative effects of high input tariffs, host countries often provide duty drawback schemes for foreign inputs entering into production for export. This is part of the standard incentive package offered to foreign investors, particularly in export processing zones.

A low level of import protection — especially if it is bound — can be an even stronger magnet for export-oriented FDI than duty drawback schemes. Comparing FDI flows to the relatively open markets of certain Asian countries with the (until recently) relatively protected Latin American markets, a recent study found that the former tended to attract export-oriented FDI, while the latter tended to attract local market-oriented FDI. These results are supported by another study that found that, in 1992, the ratio of exports to total sales of Japanese affiliates in the manufacturing sector in Asia was 45 percent, while the corresponding figure for Japanese affiliates in Latin America was just 23 percent.

The evidence supports the view that low tariffs represent the preferred strategy for host countries with ambitions to integrate themselves more fully into the global economy — and those tariffs need to be bound in order to give the tariff regime credibility. Investment decisions are by their very nature long-run, and investors are certain to be affected by uncertainty about the durability of duty drawback schemes and other incentive packages that can be withdrawn or altered at the discretion of the government.

REGIONAL TRADE AGREEMENTS AND FDI

Market size is an important consideration for an MNC (multinational corporation) contemplating a particular FDI. By removing internal barriers to trade, a free trade area or customs union gives firms the opportunity to serve an integrated market from one or a few production sites, and thereby to reap the benefits of scale economies. This can have a pronounced impact on investment flows, at least while firms are restructuring their production activities. The single-market program of the European Union stimulated substantial investment activity both within the Union and into the Union from third countries, and similar effects on FDI flows have been observed for other regional trade agreements.

The most common form of regional trade agreement is a free trade area, which differs from a customs union in

that each member retains its own external tariff schedule. This creates a need for "rules of origin" to determine whether a product that has been imported into one of the members and undergoes further processing is entitled to free trade treatment between member states (in other words, is it still a product of the third country from which it was purchased, or is it now a product of the partner country?).

Because rules of origin can have a protectionist effect (if not an intent), they can affect the location of FDI. For example, under NAFTA (North American Free Trade Agreement) rules of origin, clothing produced in Mexico gains tariff-free access to the U.S. market provided it meets the "yarn forward" rule, which for many products requires virtually 100-percent sourcing of inputs in North America. Mexican clothing manufacturers face a choice between sourcing all inputs beyond the fiber stage in North America to obtain free trade area treatment or sourcing inputs outside NAFTA at potentially lower cost but foregoing duty-free access to their most important market. Because MFN (most favored nation) tariffs on clothing are still high, they may choose to source inside the area rather than outside. This obviously creates greater incentives for third-country textile producers to invest in production facilities inside the NAFTA area to regain lost customers than would less restrictive rules of origin.

Some regional integration agreements have evolved into "hub-and-spoke" systems. This can happen, for example, if members of a customs union sign individual free trade agreements with country X and country Y, but there is no free trade agreement linking X and Y — in which case the customs union is the "hub" and countries X and Y are the "spokes." Such trade arrangements distort the pattern of FDI because there is an added incentive to locate FDI in the hub, from which there is duty-free entry to all three markets rather than in one of the spokes, since goods do not move duty-free between the two spokes.

These examples indicate that trade policy can have a significant impact on FDI flows. The opposite relation also holds, as is shown below.

THE IMPACT OF FDI ON TRADE

It is frequently alleged that FDI reduces home-country exports and/or increases home-country imports and thus has negative consequences for the home country's employment and balance of payments. The counterpart is the belief that FDI reduces host-country imports and/or increases host-country exports. The origin of these views is the traditional thinking about FDI, which has focused on the possibility of using foreign production as a substitute for exports to foreign markets.

Two developments explain much of this traditional view that FDI and home-country exports are substitutes. An influential theoretical article published in 1957 demonstrated that, under certain restrictive (simplifying) assumptions, the free movement of capital (and labor) was a substitute for free trade — that is, that the completely free movement of factors of production would produce the same results as the completely free movement of goods and services. A substitute relationship between capital flows and trade obviously is at the heart of this analysis. The other development was the popularity of import-substitution policies in large parts of the developing world until the early 1980s. As has already been noted, high import barriers encouraged — often at the explicit wish of the governments imposing the barriers — tariff-jumping FDI, with the result that local production replaced imports.

Whatever its origin, this traditional view of trade and FDI as substitutes ignores the complexity of the relationship in the contemporary global economy. To begin with, just because FDI causes the displacement of certain home-country exports by production in the host country, it does not necessarily follow that the home country's total exports to the host market decline. To see why, consider a firm that is initially prevented from undertaking FDI and instead serves the foreign market through exports. If the firm is then allowed to invest in the foreign country, the total effect on the home-country exports is the result of several forces. First, at given levels of sales in the foreign market and with the same productive activities taking place within what is now an MNC as prior to the liberalization, there could be a replacement of previous exports of the final product by the new production in the foreign (host) country. This could stimulate exports of intermediate goods or services from the home country. But with the MNC's total production of the final good or service unchanged, that would not be sufficient to prevent an overall decline in exports.

However, the *raison d'etre* of the investment is presumably to improve the firm's competitive position vis-a-vis other firms in the industry at home and abroad. This gain in competitive position may be due to access to cheaper labor or material inputs, but it may also stem from lower

transactions costs, closer proximity to local customers, and so forth. Total sales are likely to increase as a result of the investment, which would imply increased demand by the affiliate for intermediate inputs. This will increase home-country exports to the extent that the affiliate continues to purchase intermediate goods and services from the parent company or from other firms in the home country. Depending on the extent to which the affiliate relies on the home country for inputs and the extent to which the MNC's total sales increase (in the host-country's market and/or in third countries), there could be a net increase in total exports from the home country (the composition of exports, of course, is likely to shift toward intermediate goods and services). In addition, if the FDI stimulates economic growth in the host country, as appears to be the case, the result will be an increase in demand for imports, including from the home country.

Now consider the impact of the FDI on home-country imports. Some portion (perhaps all) of the inputs that were imported before the FDI for use in the production that is relocated abroad will not be imported into the home country after the FDI has been undertaken. On the other hand, the foreign affiliate may begin serving the home country market, in which case imports of the final product would increase. Again, because of these and other possibly offsetting effects, there is no reason per se to expect FDI and home-country imports to be either substitutes or complements.

The discussion so far has been concerned with the complexities of the relationship between FDI and home-country trade. But it should be clear that, for many of the same reasons, it is no easier to determine *a priori* the relationship between FDI and host-country trade. Again, the question of the relationship between FDI and trade can be settled only by looking at the empirical evidence. This is particularly true because the wider and largely dynamic effects of FDI in the host country — such as the stimulus to competition, innovation, productivity, savings, and capital formation — can be important. Since these and other FDI-related dynamic effects are likely to affect the level and product composition of the country's imports and exports — including its trade with the home country — it is evident that the relationship between trade and FDI is considerably more complex than is often suggested....

POSITIVE IMPACT

Empirical research suggests that, to the extent there is a systematic relationship between FDI and home-country exports, it is positive but not very pronounced. Certainly, there is no serious empirical support for the view that FDI has an important negative effect on the overall level of exports from the home country. There is less evidence on the relationship between FDI and home-country imports, but what exists tends to suggest a positive but weak relationship....

The available evidence (also) suggests that FDI and host-country exports are complementary, and that a weaker but still positive relationship holds between FDI and host-country imports. Except for the apparently stronger complementarity between FDI and host-country exports (than between FDI and home-country exports), these results are very similar to those reported for the relationship between FDI and home-country trade.

The full text of this WTO Secretariat report is available on the Internet at
http://www.wto.org/wto/Whats_new/chpiv.htm ❑

❑ FOREIGN DIRECT INVESTMENT IN THE UNITED STATES

Outlays by foreign direct investors in 1995 to acquire or establish businesses in the United States increased for the third consecutive year, although they remain well below the peak levels of 1988-90, when new investments from Japan were much higher.

In 1995, the last year for which data are available, foreign direct investment in the United States valued at historical cost — the book value of foreign direct investors' equity in and net outstanding loans to their U.S. affiliates — was $560,088 million, up more than 11 percent over 1994 levels.

The United Kingdom regained the top spot as the largest investor, followed by Japan and the Netherlands. ❑

FOREIGN DIRECT INVESTMENT IN THE UNITED STATES
(millions of dollars, on a historical-cost basis)

COUNTRY	1991	1992	1993	1994	1995
All Countries	419,108	427,566	466,666	502,410	560,088
Canada	36,834	37,843	40,487	42,133	46,005
Europe	256,053	255,570	287,940	309,415	360,762
Austria	573	594	653	853	1,635
Belgium	3,228	4,177	3,837	3,882	3,637
Denmark	448	445	1,068	1,913	3,043
Finland	1,416	1,629	1,638	1,787	2,498
France	25,078	24,729	30,672	34,139	38,240
Germany	29,335	29,768	35,086	40,297	47,907
Ireland	1,863	2,211	4,568	4,354	7,146
Italy	3,227	1,380	780	2,387	2,258
Liechtenstein	100	39	121	128	53
Luxembourg	734	639	1,234	2,457	4,636
Netherlands	63,113	69,191	71,860	68,212	67,654
Norway	721	888	1,030	1,469	1,931
Spain	1,811	2,103	1,230	1,777	2,568
Sweden	5,404	7,367	8,137	8,891	11,740
Switzerland	18,482	19,048	22,302	25,342	33,070
United Kingdom	100,085	90,931	103,270	111,058	132,273
Other	435	432	454	470	474
W. Europe	232	247	298	266	353
E. Europe	202	185	156	204	121
South and Central America	6,818	7,375	6,091	6,966	7,278
Brazil	534	544	726	712	864
Mexico	747	1,289	1,091	2,342	1,952
Panama	4,500	4,556	4,131	3,751	4,061

COUNTRY	1991	1992	1993	1994	1995
Venezuela	512	475	-347	-277	-213
Other	525	511	491	439	614
Other Western Hemisphere	7,728	10,098	13,625	18,075	15,438
Bahamas	-881	645	1,161	1,071	-2,159
Bermuda	1,871	1,106	748	2,060	1,859
Neth. Antilles	7,750	8,680	7,477	8,349	7,159
U.K. Islands	-1,468	-1,008	3,423	6,365	8,515
Other	456	675	817	231	63
Africa	937	896	1,003	925	936
South Africa	-17	-20	-9	-20	-21
Other	954	917	1,013	945	956
Saharan	13	6	60	7	3
Sub-Saharan	941	911	953	937	954
Liberia	935	898	942	908	934
Middle East	4,864	4,797	5,220	5,565	5,053
Israel	1,391	1,292	1,839	2,188	2,168
Kuwait	1,663	1,640	1,563	1,581	1,420
Lebanon	-23	-29	-35	-42	-49
Saudi Arabia	1,624	1,671	1,630	1,668	1,353
UAE	74	91	98	74	75
Other	135	133	125	97	86
Bahrain	59	61	42	38	12
Jordan	55	57	71	—	55
Asia and Pacific	105,873	110,987	112,299	119,331	124,615
Australia	6,011	6,146	7,040	7,928	7,788
Hong Kong	1,162	1,358	1,438	1,614	1,387
Japan	95,142	99,628	100,272	104,529	108,582
Korea	800	920	870	1,279	1,914
Malaysia	57	89	305	465	429
New Zealand	92	111	107	159	121
Philippines	63	67	59	86	83
Singapore	947	972	266	1,139	1,338
Taiwan	1,098	1,165	1,342	1,451	2,117
Other	502	531	599	680	855
China	192	167	189	274	404
Indonesia	30	45	103	138	146
Thailand	155	164	227	182	199

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

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Organization for Economic Cooperation and Development
— Home Page: http://www.oecd.org/
— FDI Trends: http://www.oecd.org/daf/cmis/statist.htm
— FDI Country Reviews:
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DEPARTMENTS

ECONOMIC TRENDS

The U.S. economy continued to grow in the first quarter of 1997 — completing its sixth year of expansion — with low unemployment, low inflation and no apparent signs of a recession, or even a significant slowdown.

The private sector Blue Chip Financial Forecast, a poll of more than 50 independent economists, estimated that gross domestic product (GDP) grew at an annual rate of 3.1 percent in the first quarter.

The continued strength follows GDP growth in the fourth quarter of 1996 at a 3.8-percent annual rate, according to the U.S. Commerce Department's final estimate, released March 28. The department's first quarter 1997 estimate will be published April 30.

Consumer spending, which accounts for about two-thirds of GDP, continued to rise in February, but not quite as much as in January, according to a March 31 Commerce Department report. Personal income, meanwhile, rose in February by the largest amount in eight months and faster than personal expenditures, the report said.

The economic momentum appeared in other measures as well. The U.S. index of leading economic indicator rose in February for the 13th straight month, according to the report released April 1. The National Association of Purchasing Managers (NAPM) index on business activity rose by its fastest rate in two years during March. The index, based on a NAPM survey of manufacturers, showed increases in orders, deliveries and employment. An index of the prices of raw materials, however, declined. Construction spending was also up, rising in February by the largest amount in 11 months, and factory orders also continued to rise.

The economic strength has helped keep unemployment at historically low levels. In March, the unemployment rate fell to 5.2 percent. The unemployment rate has been below 6 percent — traditionally considered full employment — since September 1994.

Inflation also appears subdued. The consumer price index (CPI), the government's main index of inflation, rose 0.3 percent in February, up from a 0.1-percent rise in January, but consistent with levels of the preceding six months. During 1996, CPI rose 3.3 percent, the biggest increase since 1989, but still lower than any year from 1972 to 1990, except 1986 when collapsing oil prices pushed prices down by 1.1 percent.

Nonetheless, citing concerns about possible inflationary surges later this year, the Federal Reserve — the U.S. central bank — took a small step toward slowing down the economy March 25 when it raised one of the two key short-term interest rates it controls, the first such increase in more than two years.

The action "was taken in light of persisting strength in demand, which is progressively increasing the risk of inflationary imbalances developing in the economy that would eventually undermine the long expansion," the Federal Reserve said in announcing the rate increase.

The "slight firming of monetary conditions," the Federal Reserve said, "affords greater assurance of prolonging the current economic expansion by sustaining the existing low inflation environment through the rest of this year and next." Major commercial banks followed the Federal Reserve's action with their own rate increases.

In congressional testimony, Alan Greenspan, Federal Reserve chairman, said "the performance of the U.S. economy remains quite favorable." He cautioned, "there is no evidence, however, that the business cycle has been repealed." ❑

CONGRESSIONAL CURRENTS

(Key economic issues before the 105th Congress)

BUDGET RESOLUTION

Congress is currently debating federal budget proposals for the fiscal year that runs from October 1, 1997 to Septembner 30, 1998. The point of departure in these discussions is the $1,687,000 million budget submitted by President Clinton in February. Sometime in May, the House of Representatives and the Senate expect to pass a "budget resolution" to set spending limits for the 1998 budget, establish procedures to enforce those limits, and outline a plan to balance the federal budget by 2002.

TRADE

Fast Track: Key lawmakers say Congress this year will consider renewal of the president's "fast-track" trade negotiating authority, which expired in 1994. Fast-track requires Congress to vote on trade agreements within a specified time limit and without possibility of amendment. Renewal would facilitate two major administration goals: Negotiating NAFTA expansion to Chile and other countries in the hemisphere, and achieving freer trade among members of the Asia Pacific Economic Cooperation forum (APEC).

Trade with China: President Clinton is expected once again to approve a one-year extension of China's most-favored-nation (MFN) trading status, which gives Chinese imports the same tariff treatment as goods from most other countries. The expanding U.S. trade deficit with China and concerns over the future of Hong Kong will add fuel to the annual controversy over whether Congress should overturn the president's action. In the past, heated debate has not seriously threatened extension of China's status. Some members of Congress have also introduced legislation that would require congressional approval prior to formal U.S. support for a Chinese bid to become a member of the World Trade Organization.

Encryption Technology: Legislation that would further relax U.S. export controls over sophisticated encryption software has already drawn stiff opposition from administration officials, who cite law enforcement and national security concerns. Congress is nevertheless expected to consider some relaxation of existing controls, particularly in the face of heavy pressure from the electronics and computer software industry.

Generalized System of Preferences (GSP): The GSP program allowing duty-free entry for some imports from designated developing countries is set to expire May 31; supporters of the program hope it can be reauthorized as part of a larger bill.

Trade with the Caribbean: Despite the failure of previous efforts, pro-trade lawmakers are likely to push a measure to provide the 24 countries of the Caribbean Basin Initiative the same trade treatment that is accorded Mexico under the North American Free Trade Agreement (NAFTA).

INTERNATIONAL AFFAIRS

Spending: President Clinton has asked Congress to approve $19,500 million in budget authority (money obligated for various purposes, some of which may be spent in future years) and about $14,900 in actual outlays for international affairs in fiscal year 1998. Some highlights:

— $1,500 million to pay U.S. debts and finance new commitments to the multilateral development institutions, such as the World Bank.
— $100 million towards payment of U.S. debts to the United Nations and other international organizations, with a commitment to provide an additional $921 million for that purpose in 1999.
— $900 million for former Soviet countries, including $528 million for a new "Partnership for Freedom" program.
— $3,000 million in economic and military aid for Israel and $2,100 million for Egypt.

Budget-conscious legislators have already questioned the proposed outlays for international organizations and multilateral banks although most of the president's bilateral spending proposals — particularly for U.S. allies in the Middle East — have broad bilateral support. ❑

CALENDAR OF ECONOMIC EVENTS

Apr. 26-28	Asia Pacific Economic Cooperation (APEC) environmental ministerial meeting on sustainable development, Toronto, Canada
Apr. 28-29	International Monetary Fund and World Bank annual spring meetings, Washington, D.C.
Apr. 28-May 2	The Inter-Pacific Bar Association annual meeting, Kuala Lumpur, Malaysia. Plenary session to be devoted to a discussion of "WTO: Implications for the Pacific Region."
May 9-10	APEC Trade Ministers Meeting, Montreal, Canada
May 11-13	Asian Development Bank annual meeting, Fukuoka, Japan
May 12-19	APEC senior officials meeting, Quebec City, Canada
May 13-16	Summit of the Americas trade ministerial, Belo Horizonte, Brazil
May 17	World Telecommunications Day
May 17-19	Association of Southeast Asian Nations (ASEAN) regional forum senior officials meeting, Kuala Lumpur, Malaysia
May 26-27	Organization for Economic Cooperation and Development (OECD) annual ministerial meeting, Paris, France
May 28-29	African Development Bank annual meeting, Abidjan, Cote d'Ivoire
June 18-27	International Telecommunications Union (ITU) Council, Geneva, Switzerland
June 20-22	Denver Economic Summit, Denver, Colorado
June 27	Transatlantic Business Conference, Berlin, Germany
July 11	World Population Day
July 27-29	ASEAN regional forum, Kuala Lumpur, Malaysia
Sep. 7-11	Transparency International, 8th International Anti-Corruption Conference, Lima, Peru
Sep. 23-25	International Monetary Fund and World Bank annual meetings, Hong Kong
Oct. 16	World Food Day
Oct. 24	World Development Information Day
Nov. 14-16	International Convention for the Conservation of Atlantic Tuna (ICCAT) annual meeting, Madrid, Spain
Nov. 24-25	APEC Leaders Meeting, Vancouver, Canada

WHAT'S NEW IN ECONOMICS: ARTICLE ALERT

Calvo, Guillermos A.; Leonardo Leiderman; Carmen Reinhart. INFLOWS OF CAPITAL TO DEVELOPING COUNTRIES IN THE 1990S (Journal of Economic Perspectives, vol. 10, no. 2, Spring 1996, pp. 123-139)

From 1990 to 1994, $670 billion in foreign capital flowed to developing countries in Asia and Latin America — about five times the $133 billion total of the previous five years. While this capital helped finance investment and stimulate economic growth in many economies, it in some cases exacerbated inflationary pressures, widened current account deficits, and led to rapid monetary expansion. The authors review the causes behind the heavy inflows of the 1990s and discuss options for the sound management of capital inflows.

Moody-Stuart, George. THE COSTS OF GRAND CORRUPTION (Economic Reform Today, No. 4, 1996, pp. 19-24)

The monetary costs of official corruption are overshadowed by the damage caused by officials whose decisions are motivated by personal gain, according to this article. Personal gain "rapidly becomes the only factor that matters — pushing aside cost, quality, delivery and other legitimate considerations in the awarding of contracts," says the author, who is chairman of the British chapter of Transparency International (TI). Moody-Stuart focuses on the "grand" corruption practiced by senior officials, as opposed to "petty" corruption by lower-level employees, because "grand corruption can destroy nations: where it is rampant, there is no hope of controlling petty corruption."

Mataloni, Raymond J., Jr.; Mahnaz Fahim-Nader. OPERATIONS OF U.S. MULTINATIONAL COMPANIES: PRELIMINARY RESULTS FROM THE 1994 BENCHMARK SURVEY (Survey of Current Business, vol. 76, no. 12, December 1996, pp. 11-39)

U.S. multinational companies invest in foreign production primarily for sale in markets near the production sites — not for cheap labor or for access to natural resources or for export back to the United States, according to U.S. Department of Commerce analysts Mataloni and Fahim-Nader. Nearly 70 percent of their foreign affiliates' output of goods and services was produced in the wealthy countries of Europe and the Pacific. U.S. multinational companies account for a large share of U.S.trade — 66 percent of goods exports and 38 percent of goods imports in 1994 — but less than in 1982, when they accounted for 77 percent of goods exports and 50 percent of goods imports.

Owen, Henry. DEFENDING THE G7 (The International Economy, vol. 11, no. 1, January/February 1997, pp. 31-33)

The annual Economic Summits of the Group of Seven (G-7) industrial nations have not always dealt effectively with the problems the group faces, but they have made progress toward fiscal constraint and freer trade. "They are notable less for the good things that they have made happen than for the bad things that they have prevented from happening," the author, a former high-level State Department official and now a senior advisor to Salomon Brothers and co-chairman of the Bretton Woods Committee, argues. Citing examples of the positive influences of the G-7 meetings, Owen urges critics to respect the role that annual summitry can play and "not burden this useful process with tasks that lie beyond its will and competence."

Handy, Charles R.; Phil Kaufman; Steve Martinez. DIRECT INVESTMENT IS PRIMARY STRATEGY TO ACCESS FOREIGN MARKETS (Food Review, USDA periodical, release date March 1997, pp. 6-12)

Foreign direct investment is the major way large food firms reach international markets, say three economists with the U.S. Department of Agriculture's Economic Research Service. Sales from foreign affiliates of U.S. food processing firms were four times larger than U.S. exports of processed foods in 1994. Typically foreign parent firms own at least half of assets, with two-way technology transfers. Also foreign direct investment is one way to circumvent some trade barriers, the authors say, citing the example of Besnier producing more Brie cheese in the United States than it would be allowed to import from its operations in France. ❑