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The World Needs a Multilateral Investment Agreement

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Globalization has spawned many global organizations and agreements, but a gaping hole in the current global economic architecture is the absence of a multilateral agreement on foreign direct investment (FDI). A multilateral investment agreement (MIA) was discussed extensively from 1970 to 1998, but no agreement was ever concluded. However, the need for such an agreement has increased in the last decade, and objections to it appear to have faded.

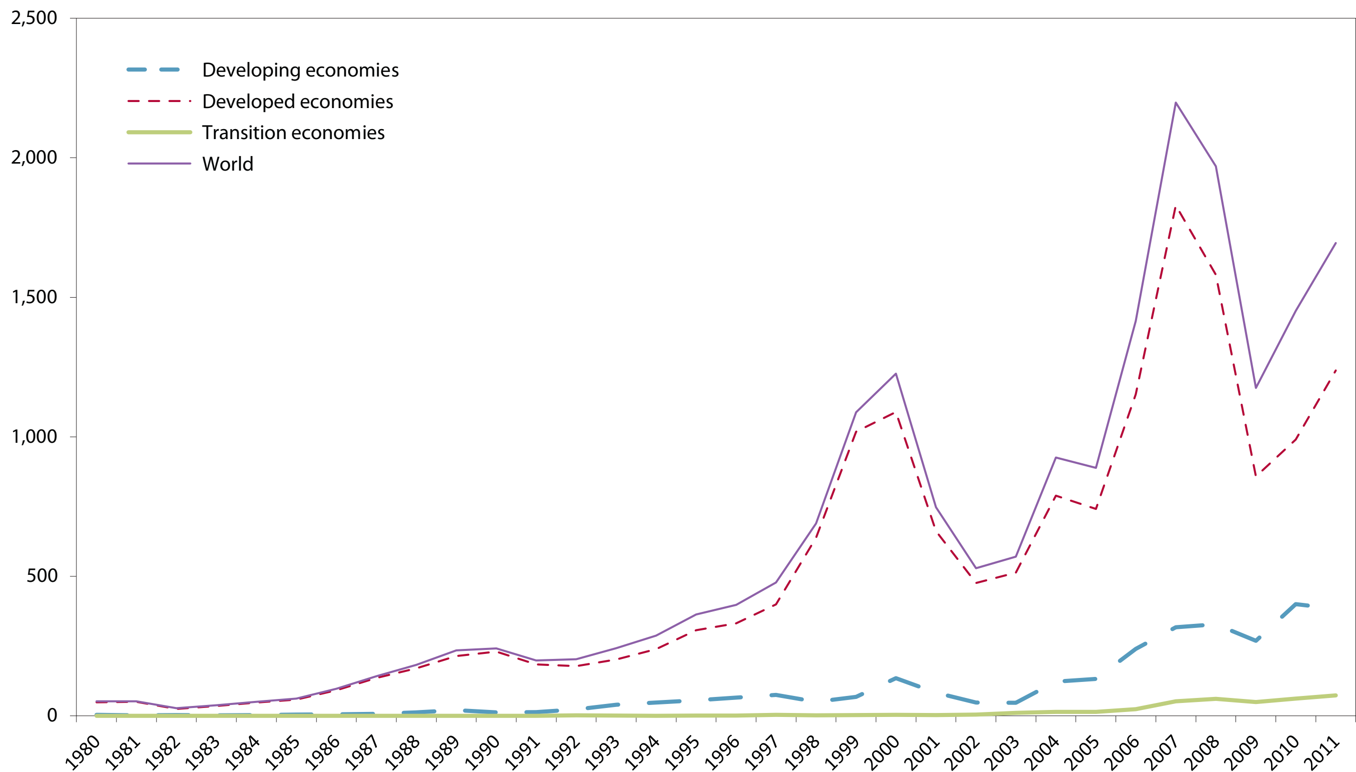
In this policy brief I propose that an MIA should be formed within the framework of the World Trade Organization (WTO). I review what an MIA sensibly could regulate, objections to it, and solutions. An MIA should, first and foremost, protect and regulate FDI. Ideally, it should be a universal agreement. Second, it should facilitate the standardization of investment protection. Third, it should regulate certain aspects of FDI that are controversial or insufficiently regulated, such as national security, state corporations, and sovereign wealth funds.

A review of the MIA discussion over the last 40 years offers a stark insight: Almost everything—volume and direction of FDI, number and nationality of multinational corporations (MNCs), ideology, and international agreements—has changed over this period. Four important preconditions for an MIA, which were not in place before the 1990s, now exist: FDI is sufficiently large; it flows in both directions between developed and developing countries, with MNCs hailing from all parts of the world; the number of bilateral investment treaties (BITs) has grown substantially, warranting an international standardized set of rules for FDI; and the WTO has emerged as the natural home of an MIA.

1. For an MIA to make sense, FDI needs to be significant. According to the United Nations Conference on Trade and Development (UNCTAD), total global FDI was as low as $27 billion in 1982. It took off in the second half of the 1980s and quadrupled in the 1990s, the decade when FDI really became significant. It peaked at $2.2 trillion in 2007 and is now rising again (figures 1 and 2). FDI has grown so substantial that it is now an ideal candidate for an international agreement.

2. FDI needs to be a two-way stream, and MNCs should belong to both developed and emerging-market economies. In the early postcolonial period in the 1960s and as late as in the 1990s, FDI was almost exclusively going from developed to developing countries, and in the 1960s and 1970s MNCs were predominantly American. At present, substantial FDI

Figure 1 Outward foreign direct investment, 1980–2011



Source: UNCTAD Statistics, Inward and outward foreign direct investment flows, annual, 1970–2011 (accessed on November 22, 2012).

is flowing in both directions, from developed to developing countries and vice versa. In 2010, FDI to developed and developing economies was actually balanced (figures 1 and 2). Transition countries have also entered the picture, contributing to equivalence. For example, accumulated FDI between Russia and the United States is almost equally large. Therefore, the key problem that developed and emerging-market economies have contrary interests no longer exists. Similarly, MNCs now come from all parts of the world, and many MNCs in emerging-market economies have become world leaders (van Agtmael 2007).

3. The best proof of the need for an international standardized set of rules for FDI is the huge number of bilateral investment treaties. At the end of 2011, 181 countries had concluded 3,164 international investment agreements. Of these 2,833 were BITs and 331 were other international investment agreements, most of which were free trade agreements (FTAs) containing FDI regulation (UNCTAD 2012, 84). This means that the average country has more than 35 international investment agreements. Most of the bilateral treaties are not covered by any international investment treaty. The BITs vary somewhat in coverage and conflict resolution, but the variations are limited.

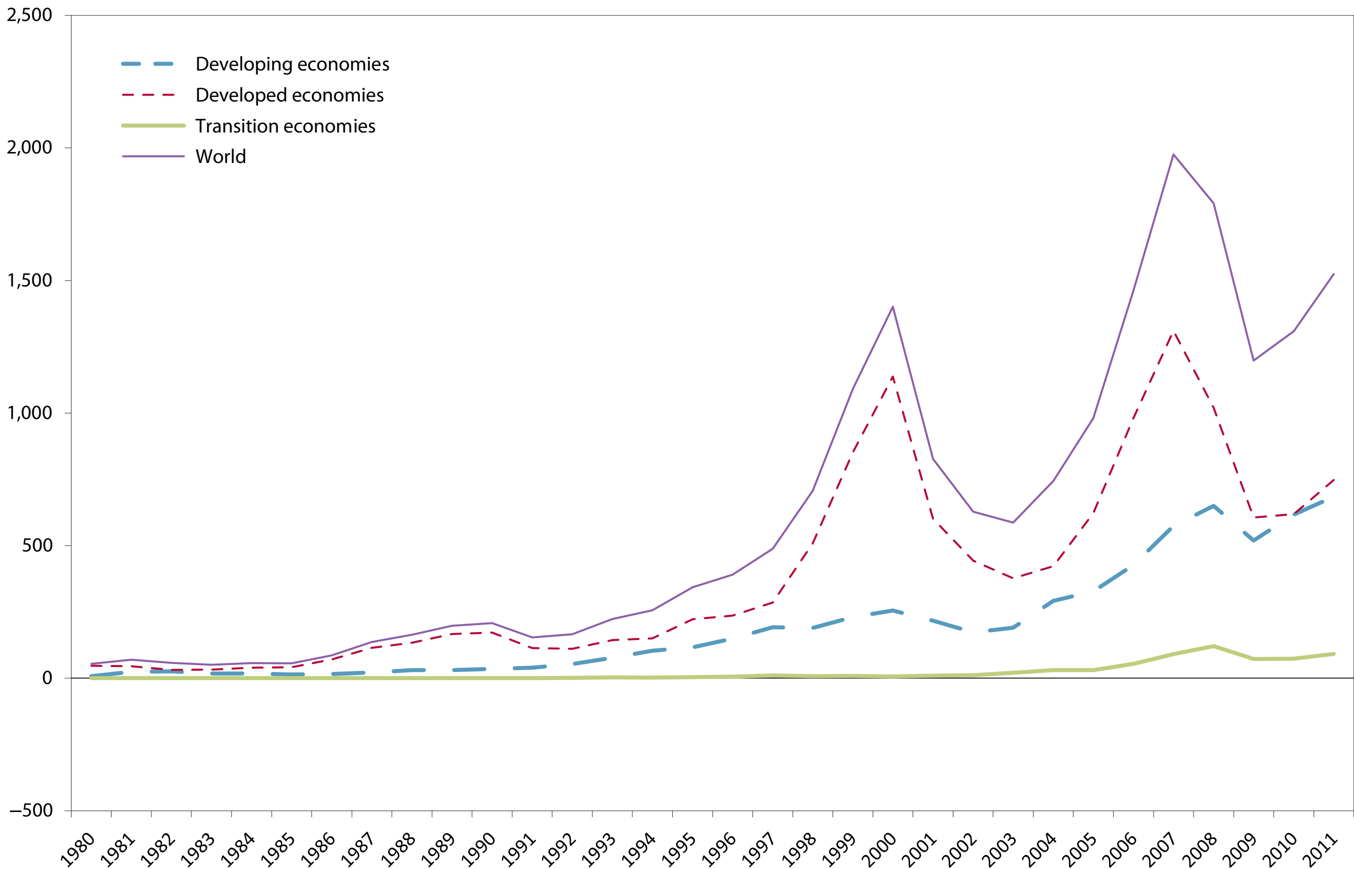
4. An international agreement should preferably be reached on the organization that would be in charge of an MIA. At present, the WTO appears to be the only natural home of an MIA. After World War II, it was not evident if investment was to be considered an enterprise activity or a capital flow, which is supervised by the International Monetary Fund (IMF), but now it is clearly identified with MNCs and integrated with trade.

EVOLUTION OF PRECONDITIONS FOR AN MIA

A number of objections and controversies led to the failure to conclude an MIA, ranging from the purpose of an MIA, its significance, and choice of home organization to ideological outlook. To understand how these issues evolved, we need to review developments in the post–World War II period, which

Figure 2 Inward foreign direct investment, 1980–2011

billions of dollars



Source: UNCTAD Statistics, Inward and outward foreign direct investment flows, annual, 1970–2011 (accessed on November 22, 2012).

have been remarkably great. I argue that these changes have intensified the need for an MIA, while the objections have dwindled.

The protection of FDI historically derived from colonial practices. As early as in the 18th century, the United States concluded bilateral Friendship, Commerce, and Navigation Treaties, which protected property rights of US companies in treaty countries, and the United States and other countries frequently intervened with diplomacy or military force if such property rights were violated (Vandevelde 2005, 158–61).

The Bretton Woods conference in 1944, which created the IMF and the World Bank, also recommended the creation of an International Trade Organization (ITO) as a complement to the two organizations. In 1948, negotiations on the ITO were completed in Havana, and the Havana Charter, containing liberal conditions for both trade and investment, was agreed. However, the Havana Charter was never ratified by the US Congress and did not come into force, because it was deemed too ambitious and intrusive at the time.

Instead, in 1947, the General Agreement on Tariffs and Trade (GATT) was concluded in Geneva. It offered a different model of international cooperation, involving fewer countries, and was formed bottom-up through negotiations among member countries rather than being a top-down organization. In effect, the failure of the ITO blocked the development of an international organization for investment, while GATT only took care of trade issues.

This failure of multilateral action moved investment protection into the bilateral sphere. BITs originally arose as a response by developed countries against the threat of expropriation by developing countries. The first BITs were concluded in 1959, between Germany and Pakistan and the Dominican Republic, respectively. In the early 1960s, they were followed by BITs between various West European countries and mainly African countries.

Browsing through the list of early BITs, it is striking how few they were and that they were mainly concluded between West European countries and small, weak developing countries, while the big developing countries abstained from BITs. A total of 387 BITs were concluded by the end of the 1980s: 76 BITs in 1959–69, 92 BITs in 1970–79, and 219 BITs in 1980–89 (Vandevelde 2005, 168–72).

The early BITs were quite similar to each other. They dealt exclusively with investment and not with trade. They were concluded between a developed and developing country, with the aim to protect the investment of a developed country in a developing country. They were nonreciprocal in nature, because all the obligations fell on the developing country, and their key obligation was to protect FDI. The BITs contained a guarantee of national or most favored nation (MFN) treatment on the investment covered, promising adequate compensation for expropriation or other damages imposed by the host country. Usually, they also included a provision on settlement of disputes through arbitration (Vandevelde 2005, 168–74).

A problem with the early BITs, as mentioned above, was that they were driven by the interests of developed countries to protect their investments against expropriation in newly independent states, while developing countries aspired to attract FDI. Yet, they were reluctant, being fiercely protective of their newly won independence and suspicious of foreign control of their means of production. The United States was so strong that it had other means to defend its companies and it did not conclude any BIT until the 1980s.

In 1965, a Convention on the Settlement of Investment Disputes between States and Nationals of Other States was concluded. It led to the establishment of the International Centre for Settlement of Investment Disputes (ICSID), an international arbitration institution for the settlement of legal disputes between international investors and countries. It is formally autonomous, but the World Bank is its parent organization. Many BITs refer to ICSID for arbitration.[1]

In parallel to this development, a major ideological evolution occurred. Until the great decolonization circa 1960, FDI had a colonial tinge. In the three ensuing decades, statist ideologies held sway in the Third World and communism in the Second World. The high ideological point was the adoption of the New International Economic Order by the General Assembly of the United Nations in 1974. It emphasized "the right of nationalization or transfer of ownership to its nationals" as a matter of state sovereignty without specifying any obligation to pay any compensation (Vandevelde 2005, 167). Astoundingly, confiscation was perceived as a state right.

In 1964, UNCTAD was founded as a permanent UN body. Its goals were to "maximize the trade, investment and development opportunities of developing countries and assist them in their efforts to integrate into the world economy on an equitable basis." It was formed as an advocate of developing countries in trade and investment. In the 1970s and 1980s, when the New International Economic Order ran high, UNCTAD was its key spokesman. UNCTAD tried to develop a code of conduct of MNCs, but it never went far because the United States resisted international control of US corporations (Graham 2006, 117). In practice, UNCTAD lost out to GATT on trade and became the main international organization recording FDI. It has published the annual *World Investment Report* since 1991 and collects statistics on FDI and BITs.

In 1970, Paul Goldberg and Charles Kindleberger (1970) published an important article, "Toward a GATT for Investment: A Proposal for Supervision of the International Corporation." Their focus was on limiting the power of MNCs. They feared that "individual nation-states [may be left] relatively helpless in the face of a powerful, closely interlocked, and geographically mobile network of industrial enterprise…. Some students of the problem believe that the power of international corporations poses a threat to world order" (Goldberg and Kindleberger 1970, 296). Their concern was that MNCs undermined the regulations of sovereign states, and they identified problems with MNCs in the areas of tax evasion, antitrust, balance of payments controls, export controls, and securities regulation. Recognizing that the more ambitious ITO had failed, they pinned their hopes on the formation of a General Agreement for the International Corporation, similar to GATT.

Fred Bergsten heralded another line of thought on FDI (Bergsten 1974; Bergsten, Horst, and Moran 1978), but he focused on the behavior of government and advocated the principle of nondiscrimination. He feared that government measures, such as tax incentives, domestic production requirements, and export requirements, would be tantamount to protectionism and lead to investment wars similar to the trade wars of the 1930s. Bergsten argued that foreign-owned enterprises should be given national treatment. Government measures should not discriminate against foreign-owned enterprises, with well-defined exceptions, such as the protection of national security (Graham 2006, 117–18).

During the 1980s, free market thinking revived in the United States and the United Kingdom, and the socialist worldview suffered a major blow with the collapse of communism in 1989. The ideological objections to FDI and MNCs dwindled. Instead, emerging markets started competing for foreign investment.

1. See the ICSID website at https://icsid.worldbank.org.

From 1986 to 1994, GATT negotiated its Uruguay Round, which led to substantial, positive results on multilateral agreements. In 1995 it transformed GATT into the WTO, a full-fledged international organization. The Uruguay Round concluded agreements on three broad areas of trade: Trade Related Investment Measures (TRIMS), the General Agreement on Trade in Services (GATS), and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).[2] Each of them involved investment, marking a new integration of trade and investment. Yet, TRIMS was only a modest code with some regulation of FDI. In particular, it banned requirements of local content, trade balances, and foreign exchange balances (Graham 2006, 123).

An MIA is needed now more than ever because FDI has skyrocketed in the last few decades.

In parallel, the debt crisis of the 1980s limited the volume of credit available to emerging-market economies, and the evident alternative was FDI. Developing countries tried harder to attract FDI by creating favorable conditions, As a consequence, the number of BITs exploded. During the 15 years, from 1990 to 2005, some 2,000 BITs were concluded, five times as many as had existed before.

At the same time, various regional and bilateral FTAs were concluded as well, and increasingly they also contained stipulations on FDI conditions. By 2005, 215 preferential trade agreements contained investment provisions. Trade and investment were seen not as alternatives but as complements (Vandevelde 2005, 181–82).

The need for an MIA appeared evident. The idea of a new international organization for investment was abandoned, as many thought the number of international organizations was excessive. Instead, the discussion focused on which organization should house an MIA. At the time, three organizations were discussed, the Organization for Economic Cooperation and Development (OECD), the WTO, and UNCTAD (Drabek 1998). With its specialization in FDI, UNCTAD would have appeared the most natural home, but it was not interested for primarily ideological reasons. The OECD worked hard on an MIA for its members in the period 1995–98. It negotiated an extensive draft MIA of 144 pages (OECD 1998), but eventually the negotiations failed. The main cause of the failure was that France vetoed it (OECD members have veto power).

Politically, the OECD MIA fell victim to the antiglobalization movement, a Western countercurrent that surged in the late 1990s. A large number of nongovernmental organizations formed a protest movement against not only MNCs but also globalization, international economic organizations, and international agreements. In the late 1990s, the unwieldy antiglobalization movement organized large mass demonstrations against the WTO, the IMF, the World Bank, the G-7, and the European Union. Its peak was the demonstrations against the failed WTO summit in Seattle in 1999, and it abated gradually over the next several years (Graham 2000).

Moreover, the OECD was still a small Western club of 26 countries until 1995, and its members reckoned that they could trust one another in any case so that an MIA would add little benefit. For EU countries, common EU law provides much stronger legal guarantees and the services of the European Court of Justice. Developed countries do not really need an MIA for their mutual relations. The United States remains one of the Western countries least interested in concluding BITs, since it can resolve many conflicts through direct bilateral action. For an MIA to be beneficial, country coverage will have to be broader.

After the OECD negotiations had failed, the MIA ball went back to the WTO. Originally, an MIA was considered in the Doha Round. At its ministerial meeting in Singapore in 1996, the WTO put investment on the agenda of the impending Doha Round, but it was dropped at the ministerial meeting in Cancun in 2003 at the insistence of a group of developing countries led by Brazil and India (Hufbauer and Schott, forthcoming). Several other issues, such as services, were also dropped. The exceedingly narrow range of the Doha Round is considered a reason why it has been so difficult to conclude the Round: Too little is on the table (Hufbauer, Schott, and Wong 2010).

Yet an MIA is needed now more than ever because FDI has skyrocketed in the last few decades. As Gary Hufbauer (2012, 1) puts it: "In the three decades since 1980, nominal world GDP has expanded three times; merchandise trade has expanded six times; while the stock of FDI has expanded twenty times." He argues, "Quite plausibly, world income is more than 20% larger today than in 1990 because of the huge expansion in world FDI—conveying better technology and higher wages." He concludes that FDI "and international trade not only rank as twin emblems of globalization but also serve as twin engines of world prosperity."

In recent years, UNCTAD has recorded a slower growth in the number of BITs. The reason is not that the need has

2. World Trade Organization, The Uruguay Round, www.wto.org/trade_resources/history/wto/urug_round.htm.

been exhausted. One cause is that more FTAs now contain investment protection. Another is that many agreements include several countries. A big change is that after the Lisbon Treaty came into force in December 2009, the European Commission is responsible not only for trade negotiations but also for investment negotiations, which until then had been handled bilaterally by the European Union's 27 members. This means that many BITs between individual EU countries will be replaced by common EU treaties (UNCTAD 2012, 84). Thus, while the coverage of investment protection is likely to spread, the number of agreements is likely to decline. Given this development toward broader regionalization, the argument for a broad multilateral order appears all the greater.

Another development has also amplified the need for an MIA, namely the expansion of state capitalism and sovereign wealth funds.

Another development has also amplified the need for an MIA, namely the expansion of state capitalism and sovereign wealth funds (SWFs). Free market capitalism has not won out altogether, and a new form of state capitalism has arisen, especially in China and Russia, with state companies wanting to invest abroad but being looked upon with suspicion. A large number of countries have set up SWFs that are considered dubious. Countries that are recipients of these state funds question the transparency and objectives of the funds. Their ultimate concern is national security (Truman 2010). Rather than being an impediment to an MIA, these problems are a reason why an MIA is needed to mediate the interests of state investors and national security worries in the recipient countries.

To conclude, there are many good reasons to conclude an MIA at this time, and they are better than ever. First, the volume of FDI is huge. It is too large to be left unattended by international regulation. Second, FDI is now flowing in both directions between developed and developing countries and is reasonably balanced. FDI's benefits are widely appreciated, and the ideological stigma against FDI or MNCs has abated. Third, the large number of bilateral and regional agreements including some investment protection indicates the need for a multilateral agreement with broader coverage as well as a simplified and standardized set of rules. Fourth, the growing role of the WTO and integration of trade and investment suggest that the WTO is the natural home of a future MIA. Fifth, expanding FDI by state corporations and SWFs needs both standardized regulation and facilitation of such investments.

WHAT SHOULD AN MIA CONTAIN?

The content of an MIA is relatively easy to outline because of the many existing treaties with investment protection. One source is the numerous, rather similar BITs. Another source is the investment chapters in FTAs, notably the North American Free Trade Agreement (NAFTA). A third source is the lengthy draft MIA negotiated by the OECD (1998). It contains 12 chapters, most of which are formal, but three are essential:

- *Treatment of investors and investments.* Specifications on national treatment and MFN, two similar principles, are pretty straightforward. In its new model BIT, the United States demands national treatment also of prior investment, which some countries find that controversial.
- *Investment protection.* The essence is simple: compensation at full market value in the case of expropriation. Although most investment is commonly recognized, intellectual property rights raise a question. The United States considers them investment, while China and India are reluctant to agree.
- *Dispute settlement.* It falls into two categories, state-state procedures and investor-state procedures, and is the most complicated and controversial issue. There is no commonly agreed system for dispute resolution but multiple alternatives exist. Two-thirds is handled by ICSID or its additional facility. Other arbitration alternatives are the United Nations Commission on International Trade Law (UNCITRAL), the Stockholm Chamber of Commerce, the Permanent Court of Arbitration in The Hague, the International Chamber of Commerce, or ad hoc resolution (UNCTAD 2010).

In the last few years, the number of arbitration cases has increased sharply. Venezuela has taken the lead, and it has notified that it wants to withdraw from the ICSID Convention, which Bolivia and Ecuador have already done. These and other countries complain arbitration is biased, exceedingly expensive, and nontransparent. The penalties are also increasing sharply (UNCTAD 2012, 86–88). Other countries, such as Australia, refute foreign arbitration in principle. Thus, the dispute settlement mechanism has not become easier but more complex, and it is likely to be the most difficult question to settle in a negotiation on an MIA. However, there are many options to reach a solution, and the MIA should leave several of them open.

A fourth essential issue that an MIA should cover is corporate social responsibility, meaning corporate policies on social and environmental issues. A fair degree of consensus

on this issue has evolved so it should be feasible (UNCTAD 2012, 93–95).

A fifth development that should be regulated is FDI by state corporations and SWFs. Since such FDI is rising sharply, both investors and recipients have an interest in better rules that can facilitate such investment by providing widely accepted rules. The rights and obligations of states as investors need to be clarified, because the alternative is often bureaucratic resistance, as Chinese high-tech companies and Russian energy companies have experienced. National security is a valid concern, but it should be spelled out clearly. On the one hand, state-owned enterprises should be required to be sufficiently transparent. On the other hand, the process of vetting investment by state-owned enterprises or SWFs should be transparent and clearly regulated, as the United States has done through its Committee on Foreign Investment in the United States (CFIUS) (Graham 2006, Graham and Marchick 2006).

The general acceptance of large flows of FDI and of MNCs from all corners of the world makes an MIA as uncontroversial as necessary.

To sum up, the general acceptance of large flows of FDI and of MNCs from all corners of the world makes an MIA as uncontroversial as necessary. An MIA should level the playing field for companies when investing abroad, offering national treatment or MFN wherever applicable. It should also guarantee property rights, that is, offer a guarantee of market-adjusted compensation in the case of expropriation. Given the integration of trade and investment, the WTO appears the natural home of an MIA. An MIA could be considered in a stand-alone negotiation or as part of a future, broader WTO round (Hufbauer and Schott, forthcoming).

HOW CAN AN MIA BE FORMED AND ADOPTED?

The time is ripe for an MIA to be formed and successfully adopted. The G-20 and Russia as its chair can and should play an essential role. The G-20 should give the necessary political impetus to an MIA negotiation at its St. Petersburg Summit in September 2013. Russia and China are the two nations best placed to revive this issue, since they are now major foreign investors whose state-owned investments have encountered impediments.

The G-20 was resurrected in the midst of the global financial crisis, and its summit in November 2008 instilled new confidence in global financial markets and resisted potential protectionism. In April 2009, the G-20 helped mobilize substantial new financing for the IMF, which arguably calmed the prevailing financial panic. Since then, the G-20 has touched upon ever more subjects but increasingly without adding any substance. For the G-20 to be meaningful, it needs to concentrate on a few top-level initiatives that formal international organizations later follow up on.

When negotiating an MIA, the parties should try to be reasonably ambitious. Otherwise, the MIA would not be meaningful but become the least common denominator. Still, a few WTO members are likely to oppose any MIA. Therefore, an MIA would have to be a plurilateral agreement within the framework of the WTO and not a universal one. Given that the WTO already harbors several plurilateral agreements, such as the Information Technology Agreement and the Government Procurement Agreement, this should not be problematic.

An MIA should not undermine already achieved benefits in BITs or FTAs. Therefore, it should not cancel prior agreements on investment but rather provide a floor of standards and obligations. Indeed, when the GATT came into force, it did not cancel old bilateral trade agreements, but as the GATT developed, the old bilateral agreements were overtaken and became insignificant. Presumably, the same development would occur with an MIA. Over time, it would become more ambitious. The most difficult issue would be resolving state-investor conflicts, and an MIA would likely have to keep several options open.

A wider issue is how an MIA would be negotiated. It could form its own round of WTO negotiations or become part of a new WTO round, which would include other issues such as a broader multilateral agreement on trade in services. It could even be introduced as part of a WTO negotiation on services or intellectual property rights. This is a political choice that hopefully can be brought up and decided at the G-20 summit in St. Petersburg.

To conclude, few international agreements are more justified than an MIA in terms of coverage and economic effects. Negotiating such an agreement should be easier now than at any prior occasion because both the volume of FDI and number of investment treaties have multiplied and involve almost all countries in the world. Since increasingly broad international investment agreements are being negotiated and concluded all the time, the issue is not whether they will be concluded but how broad and standardized they will be.

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