

# Liberalization of Investment

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Direct foreign investment in Asia has helped vitalize local economies and improve technologies, playing a key role in the region's rapid growth. Funds that streamed into Asia to meet growth-induced capital demand began to flow out with the sudden plunge of the Thai baht in the spring of 1997. Regional economies faced a crisis due to capital shortages and declining demand. As is clear from such trends, international investment activity is assuming increasing importance as the economy globalizes.

This article deals with international investment activities whose role in the international economy is rapidly expanding and recent trends in international arrangements, including the World Trade Organization (WTO).

## International Rule-making

Amid a phased removal of barriers to international trade and investment, corporate investment abroad has been increasing rapidly, making it all the more important to improve the legal business environment for overseas investment. While trade rules were quickly prepared under the GATT system, international rules governing investment target only some countries or some fields.

An overview of international arrangements shows that rules were instituted in the OECD concerning capital liberalization and the granting of national treatment in the 1960s and 1970s. However, these arrangements were concluded only among advanced nations in the absence of an adequate system for settling disputes. Bilateral arrangements were concluded, but most of them were for the protection of investment till the 1980s. Although some countries entered into bilateral arrangements with liberalization provisions in the 1990s, they were basically limited in content and the

number of signatories. An inherent problem posed by bilateral agreements is that they are not easy to develop in keeping with changes in economic relations. Bilateral agreements are open to several questions, including their poor adaptability to the need for dispute settlement.

In the WTO, TRIMs and GATS were established as a result of the Uruguay Round of tariff-cutting negotiations. TRIMs is an ambitious investment rule adopted by the WTO, which had focused discussions on trade liberalization. As such, TRIMs is extremely important, but it only bans the imposition of four restrictions — local content, demand for export-import balance, exchange control and export restrictions — on foreign companies. For instance, it fails to explicitly stipulate obligations like export obligation that have a close bearing on trade. And TRIMs does not cover requirements for technology transfer and other performances, nor does it contain investment rules pertinent to national treatment and most-favored-nation treatment. GATS virtually includes investment rules by providing rules for supplying services through a subsidiary that an investor establishes abroad, but GATS only covers services industries.

## Multilateral Agreement on Investment

### (1) Background

OECD started negotiations in 1995 to formulate a Multilateral Agreement on Investment (MAI), intended to be a comprehensive, high-level investment agreement, mainly among advanced countries. MAI was an extremely ambitious attempt. The negotiations first targeted a ministerial conference in 1997, but were suspended temporarily at the 1998 ministerial meeting. Though the negotiations

were expected to resume in October 1998, they lost momentum because France refused to participate in October.

It was a regrettable consequence for Japan, which had been assuming a positive stance toward the negotiations. During the three years of MAI negotiations, the OECD members infused an enormous amount of human resources to carry on a high-level dialogue. It is at least necessary for the OECD to continue work in the investment field so that it can make full use of such experiences.

### (2) Key Point for Discussions on MAI

In the MAI negotiations, there remain many conflicting points for discussion. For instance, one vital point is what exceptions should be set for MAI, which imposes an extremely high level of liberalization obligations on its member countries. Liberalization under MAI attempts to provide that recipient countries, in principle, will not impose any restraint on investment from abroad. This accompanies a very strong obligation of standstill that restrictive measures registered as exceptions to liberalization and recognized by various countries, are not allowed to revert to the path of restriction if they are once altered in a direction of liberalization. According to this rule, if a member country violates the rule, the enterprise affected may file an appeal against the violating government under the international arbitration system and obtain a mandate for change in the system, and compensation for damage. In this context, the rule is liberalization endorsed by a strong mechanism for dispute settlement.

Though MAI is an ambitious attempt to heighten efficiency in the world economy at one swoop through

investment liberalization, the scope of its coverage naturally weighs heavily. Many points are open to discussion as to what the measure should cover: whether the so-called cultural exceptions should be accepted, what to do with exceptions for the maintenance of security and public peace and order, how exceptions should be set, and to what countries such exceptions should apply and how far.

Other major questions about MAI include; how rules about environment and labor should be woven into it and whether and how they should address the issue of extraterritoriality in respect of investment. Among other points for discussion are the definition of investment to determine the scope of application, dispute settlement, the contents of rules about requirements performance, relationships with other international investment rules and the handling of such a regional agreement as the European Union (EU).

### *(3) Relationships with Environment and Labor NGOs*

Criticisms were leveled at the MAI negotiations by non-governmental organizations (NGOs) and other groups, causing the negotiating momentum in each country to wane. With regard to fears related to environmental protection, several approaches were discussed at the MAI negotiating table.

One of these approaches was to make foreign enterprises moderate their actions lest they should resort to such undesirable acts as environmental damage. Such approaches were needed to prevent the abuse of power by foreign enterprises as MAI included provisions which place investment recipient nations under strict discipline and give strong dispute settlement mechanisms to foreign enterprises.

Discussed next were measures whereby investment recipient countries may easily take restrictive measures concerning the environment lest the influence of such foreign companies should obstruct necessary



*The secretariat of the WTO in Geneva*

Photo: Kyodo News

controls by the recipient nations. The approach concerned a case in which a government tries to tighten controls from the viewpoint of environmental protection. If enterprises move to claim compensation under the direct dispute-settlement system by contending that such controls come under the category of "de facto expropriation," developing countries may hesitate to impose controls. Such fears entertained by the governments of developing countries are not necessarily wide of the mark, given that experts may not always make a balanced judgment under the international arbitration system and that the governments of developing countries are not fully prepared to face up to international legal disputes.

Furthermore, in the third approach MAI rules try directly to restrict recipient countries' environment-regulation activities, assuming that the recipient countries will not be able to take necessary restrictive measures because of their balance of power with foreign companies. What is an appropriate level of environmental control? This question should be addressed by each country concerned. When the matter is extremely important from an international point of view, rules are prepared by specialists on environmental affairs. Therefore, it is not basically necessary that environmental control measures by the governments of recipient nations are covered in investment rules unless foreign companies are given strong powers in relation to the governments of investment recipient

nations, and unless such governments are denied the ability to properly restrain foreign enterprises. However, as MAI called on member countries to accept high level obligations backed by dispute-settlement procedures, studies were made on the introduction of rules to ban recipient countries from downgrading environmental controls as an investment incentive.

The task of shaping rules on investment liberalization and protection, and that of maintaining international standards about environmental protection and labor do not conflict with each other. Both can and should be pursued simultaneously. For both objectives to be attained, however, it is necessary that thorough discussion is based on concrete rules and is not trammled by a vague sense of anxiety about the might of foreign enterprises.

### **Status Quo of WTO Arrangements**

In the WTO, a working group to study the relationship between trade and investment was set up at the first ministerial meeting of 1996 that followed the formation of the TRIMs rules. The study lasted two years. The group conducted extensive, constructive discussions ranging from such basic matters as the effect of investment on economic development to the necessity of rules. It was agreed last year to keep the working party in existence for a further period.

The WTO is preparing to select themes for discussion in the next round of negotiations, scheduled to begin in 2000. Many countries, including Japan, insist that the making of investment rules should be placed on the agenda. While the EU, Canada, South Korea, East European countries and some Latin American countries are showing strong interest in such rule-making, many countries in Southeast Asia and South Asia are more cautious.

### **Rule-making in the WTO**

#### *(1) Basic Concept*

Japan has made a positive

contribution to the making of investment rules in the OECD. Recognizing that rule-making in the WTO is different from that in the OECD, Japan believes that discussions on rule-making should be pushed forward apart from trends in the MAI dialogue. In the OECD, some developing countries are included among the observers, but basically the work of making rules has been conducted among advanced nations and other countries prepared to accept an extremely high standard of rules. Corporate investment activity, however, has been directed not only to advanced countries but also to developing countries. High-level rules are desirable, but hopefully certain investment rules will be established even in countries not ready to adapt to high-level rules.

In making rules in the WTO, efforts should be made to take the characteristics of the organization into consideration besides the presence of developing nations. In the WTO debate, it must be noted that the trade body (a) encompasses developing nations, (b) has rich experiences in international economic rules aimed at trade liberalization, (c) has expert knowledge of and experience in dispute settlement, and (d) provides a framework to promote gradual liberalization.

### *(2) Relationships with Developing Countries*

Developing nations constitute a majority of member countries in making investment rules in the WTO. In this case, investment rules are required to allow for the peculiarities of developing countries while being able to cover a majority of world nations. In other words, developing nations are in a position to unilaterally accept investment, have a very strong interest in economic development policy and their administrative organizations have a fragile base. It is necessary, for instance, to deepen discussions on the merit of accepting foreign investment and the impact investment rules will have on

economic development policy.

### *(3) Experiences of Trade Liberalization*

The WTO, since the GATT days, has had long experience in trade liberalization, and has such investment-related rules as TRIMs and GATs. Its knowledge about the improvement and operation of these rules can be of assistance. In the investment dialogue, developing nations contend that competition policy should be taken up. In this respect, the WTO has certain rules on competition.

### *(4) Expert Knowledge of and Experience in Dispute Settlement*

The WTO, since the GATT days, has had long experience in settling trade disputes and structuring mechanisms that make prompt dispute settlement possible. It is important that the rule-making process should be studied by making use of such experience. The investment rules, bilateral rules and MAI rely on the utilization of international arbitration systems, which are not necessarily fully developed. In the WTO, there is no need to stick to the existing international arbitration systems since it is known to settle disputes quickly.

### *(5) Framework for Gradual Liberalization*

The WTO has undertaken trade liberalization through several rounds of tariff-cutting talks. In other fields, such as the liberalization of services, the WTO has mechanisms to proceed gradually with liberalization according to the initial agreements.

### *(6) Report by Industrial Structure Council*

The WTO Division of the Industrial Structure Council, an organ to make policy propositions to MITI, conducted discussions about investment rules at the WTO from last September and compiled a report in February this year. The division, which brought together scholars and learned industrialists, studied the subject from an industrial viewpoint.

The report analyzes the problems Japanese industry faces by citing definite examples. It calls especially for improvement in such problems as the lack of transparency and stability in the legal systems that enterprises face in the countries where they invest.

As a basic concept, the report (a) calls strongly for WTO rules that embrace developing countries, (b) urges the making of rules on transparency and stability rules, (c) recommends rules on liberalization, and (d) points to the need for due consideration for developing countries.

The report points out that the scope of investment for the rules should be based on direct investment in making investment rules and that dispute settlement procedures should center on country-to-country disputes. Regarding the domestic rules in investment recipient nations, it proposes that such nations should not only be obligated to make relevant legislation public to ensure full policy transparency but should also maintain appropriate approval and licensing procedures.

### **Future Approaches**

Further studies on investment rules will be carried out at the Trade and Investment working party, and in the course of the selection of themes in the next round, discussions are to proceed on whether investment rules should be formulated. Japan intends to participate in both forums and will prevail on other nations to work closely together. In the immediate future, a Quadrilateral Trade Ministers Meeting is scheduled for the middle of May under the sponsorship of Japan. Through such a forum, Japan hopes to compare notes with other advanced countries and, in parallel, to deepen dialogue and bridge the gap in thinking with developing countries that respond cautiously to the rule-making process.

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