THE MULTILATERAL AGREEMENT ON INVESTMENT (MAI): POLICY IMPLICATIONS FOR DEVELOPING COUNTRIES

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Part 1: The MAI

The recent worldwide interest and controversy on foreign investment policy has been sparked by the proposal of some developed countries to introduce a legally-binding regime on foreign investment. This is taking place at two places: the WTO and OECD.

At the WTO, some of the developed countries, led by the EU, are attempting to introduce a Multilateral Investment Agreement (MIA). Following the WTO Ministerial Conference in Singapore there is now a Working Group on Trade and Investment to discuss the links between trade and investment. Although there are safeguards that this is not a negotiation for an agreement, the developed countries will try their best to eventually have an MIA out of the working group.

Within the OECD, a Multilateral Agreement on Investment (MAI) is being negotiated by the OECD member countries. After the conclusion of negotiations (expected to be in mid-1997), the OECD plans to open the treaty to other countries to acede to.

The model of the MIA and MAI are basically the same.

The MAI is aimed at protecting and advancing the rights of international investors vis-a-vis host governments and countries. The main elements are:

- The right of entry and establishment of foreign companies in almost all sectors, except security. This means the government will lose its authority to determine which foreign investor it would allow or disallow from entering the country, in all sectors.

- The right to full equity ownership. This means the government would not be allowed to impose a condition that foreign companies should allow a portion of their equity to be locally owned, or that they form joint ventures with local firms or with the state.

- National treatment. This means that the foreign company must be treated on equal or better terms than a local company. It means that government will be prevented from granting better or more favourable treatment to local firms, for example in granting contracts or in allowing local banks to set up more branches etc.

- Removal of many regulations and conditions now imposed on foreign companies by the host government (eg. movement of personnel; performance requirements; allowing foreign firms to take part in privatisation projects).

- Protection of the rights of foreign investors (including regarding non-discrimination, intellectual property, expriopriation, compensation, transfer of funds, taxation). such as against closure or expropriation, or full compensation in the event of being asked to close or be taken over;

- Establish a dispute settlement system which makes the agreement legally-binding and enforceable.

From the above, it is clear the MAI is aimed at setting up an international regime for protection and advancement of international investors' rights. But correspondingly the rights and authority of the host country's government will be either removed or severely restricted. Moreover, the MAI would impose no obligations on the foreign investor to respect the sovereignty or social and development objectives of the host country. But the host country's government would have many new and heavy obligations towards the foreign investor.

The MAI is therefore very imbalanced, in favour of the foreign investor's rights, and against the rights of the host country, the host government and the local firms (which would lose their present rights to receive more favourable treatment from their government and to be protected from bigger foreign firms so that they can survive and develop).

International companies would be able to cross borders without barriers and set up projects or buy up local companies whilst facing minimal or no regulations in the host countries as to entry, conditions for establishment, ownership, operations, repatriation of profits and capital.

MAI would very significantly narrow, reduce and constrain the rights, authority and degree of freedom and policy options of the host countries and governments in the following economic areas: i) policy on foreign investment and policy on investment in general; ii) macro-economic management; iii) policy and performance on trade, current and capital account and the balance of payments; (iv) development planning; (v) policy on the balance of ownership of equity and assets between foreigner and locals and amongst various communities within the country; vi) growth and development policy at sector level (industry, agriculture, trade, finance and other services).

As the proposed MAI would cover almost all sectors (defence being an exception), the narrowing or loss of policy options in host countries would also apply to social sectors and services, and thus have significant implications for social and cultural policy and practices.

The approach taken by MAI proponents is new in that it is an extreme approach as it covers and greatly expands the rights of international investors, whilst not recognising and thus greatly reducing the authority and rights of host governments and countries.

Part 2: RESPONSE TO THE MAI FROM ASIAN COUNTRIES

In March 1996, a Workshop was organised by the OECD Secretariat in Hong Kong to explain the MAI to 12 selected "dynamic developing countries", most of them from the Asian region, including China, India, Malaysia, Indonesia, Korea, Singapore, Hong Kong. A report of this meeting is published in Third World Economics (1-15 April 1996). The following are the key points from this report.

1. The general reaction to the meeting was cool and generally unfavourable from some key Asian countries. Participants from these countries raised several concerns and objections on the substance, procedures and institutional context of the proposed rules.

2. As explained by the OECD officials, the MAI's main goals are to: Liberalise the terms of foreign investment even further than in existing OECD rules; Protect foreign investors' rights; Establish a legally-binding dispute settlement system.

3. At the Workshop, the OECD officials kept stressing that the MAI was aiming at "high standards". This means levels of investment liberalisation and investor protection that are far higher than what exists even in OECD countries.

4. A most interesting feature is that whilst the MAI is initiated by and negotiated amongst OECD countries, it is actually intended not to be for the OECD alone but rather to be of a global nature, open to all countries to join. Most non-OECD participants were critical that they were not invited to participate in the

establishment of the MAI. They raised several questions on the OECD's procedure of establishing the MAI, as well as on the MAI's contents and implications.

5. The chairman of the Malaysian Industrial Development Authority, Mr. Zainal Abidin Sulong, said "whatever we say won't affect the process much." He said Asians are sensitive to how they are drawn into a process, and there is a considerable amount of discomfort when they are asked to accede to a treaty without being given an opportunity to get directly involved. This, he added, could even be seen as objectionable, as the process seemed to ask non-OECD countries to accede without representation. "If this MAI is intended for global accession, then it has to be a global process and all countries need to be more directly involved."

6. Another objectionable point was that the MAI is supposed to achieve a "high standard" and this had been cited as a reason why negotiations were confined to OECD countries. This seemed to assume that if non-member countries are involved the standard would be compromised or minimised, and this assumption was worrisome.

7. Mr. Zainal stressed that there were two sides to the issue of investment, as the entry of foreign firms could also have an effect on domestic firms, and thus there was a domestic dimension to foreign investment. Both aspects had therefore to be considered. The issue, said Zainal, "is not investment liberalisation per se but the effective and mutually beneficial management of this liberalisation.".

8. On a more general level, Zainal perceived problems arising from the contrasting Western and Asian approaches to negotiations. The OECD approach to the MAI but the Asian Pacific region prefers a bottom-up approach. The dynamic growth of the Asia-Pacific region is based on a highly pragmatic approach towards resolving problems and proceeding to the next stage. Regarding the OECD proposal, Zainal believed the Asian Pacific response would be for a more evolutionary and not a regulatory approach. The regional response could thus be expected in general to be negative.

9. Participants from several other Asian countries raised similar concerns about the OECD's MAI process. They also questioned whether the contents of the proposed MAI would be advantageous to developing countries.

10. An Asian participant said that the MAI stressed the rights and interests of foreign investors but had nothing to say on the rights of host countries nor the obligation of investors to observe the laws of host countries. She pointed out that without observance of domestic laws, foreign investors would not be

encouraged as it would be against the host country's interests. Thus, the protection of the host country's interests and rights should be a crucial part of an investment agreement.

11. She said, it is generally agreed that foreign investment plays a positive role. However, each country has a different situation, and countries are also at different stages of development. Each country has the right to set up its own investment regime based on iuts own social and economic conditions. Although a lot had been said about the need for a MAI with "high standards", the participant stressed that what was more important was a balanced, successful agreement, acceptable to most countries. "If an agreement is of high standard but is not acceptable, then it would not be a good or successful one. The MAI should look at the rights of both sides. If only one aspect is stressed, things will go wrong.

12. Participants from two other ASEAN countries added to the views that the MAI seemed one-sided. One of them said that an agreement usually involved a quid pro quo. However the MAI seemed to grant rights to investors without placing any obligations on them. On the other hand, the host country would have obligations but no rights. There was thus no balance between the interests of investors and host countries.

13. Not all non-OECD countries were however so skeptical. Participants from Hong Kong and Argentina were strongly in favour of the OECD's MAI process, whilst participants from a few other countries appeared to prefer a wait-and-see approach.

Part 3: THE NEED FOR NATIONAL REGULATION AND POLICY INSTRUMENTS/OPTIONS ON FOREIGN INVESTMENTS

The major issue of the MAI or the MIA is not whether or not foreign investment is good or bad or should be welcomed. The real issue is whether or not national governments should retain the right and powers to regulate FDI and to have the adequate authority and means to have policy instruments and options over investment, including foreign investment.

Most countries presently accept the importance of foreign investment and are trying their best to attract foreign investments. However, there is evidence that foreign investment can have both positive and negative effects, and a major objective of development policy is to maximise the positive aspects whilst minimising the negative aspects, so that on balance there is a significant benefit. Experience shows that for foreign investment to play a positive role, government must have the right and powers to regulate their entry, terms of conditions and operations.

The key problem is that the approach taken in the proposed MAI would remove these government rights and powers. By doing so, the negative aspects of unregulated and uncontrolled foreign investment inflow and establishment could overwhelm the positive aspects.

Most developing countries now have policies that regulate the entry of foreign firms, and include various conditions and restrictions for foreign investors overall and on a sector-by-sector basis.

There are few countries (if any) that has now adopted a total right of entry policy. In some countries, foreign companies are not allowed to operate in certain sectors, for instance banking, insurance or telecommunications. In sectors where they are allowed, foreign companies have to apply for permission to establish themselves, and if approval is given it often comes with conditions.

Of course the mix of conditions varies from country to country. They may include equity restrictions (for example, a foreign company cannot own more than a certain percentage of the equity of the company it would like to set up): and ownership restrictions (for instance, foreigners are not allowed to own land or to buy houses below a certain price).

Many developing countries also have policies that favour the growth of local companies. For instance, there may be tax breaks for a local company not available to foreign companies; local banks may be given greater scope of business than foreign banks; local firms may be given preference in government business or contracts.

Governments justify such policies and conditions on the grounds of sovereignty (that a country's population has to have control over at least a minimal but significant part of its own economy) or national development (that local firms need to be given a "handicap" or special treatment at least for some time so that they can be in a position to compete with more powerful and better endowed foreign companies).

Most developing countries would argue that during the colonial era, their economies were shaped to the advantage of foreign companies and financial institutions (belonging usually to the particular colonising country).

Local people and enterprises were therefore at a disadvantage, and require a considerable time where special treatment is accorded to them, before they can compete on more balanced terms with the bigger foreign companies.

This has been the central rationale for developing countries' policies in applying restrictions or imposing conditions on foreign investments.

The MAI proposal to liberalise foreign investment flows in so comprehensive a manner will therefore have serious consequences. For if the proposals are adopted, governments in developing countries will find that the space for them to adopt their own independent policies on how to treat foreign companies and investments will be very severely restricted.

No longer will each government have the freedom to choose its own particular mixture of policies and conditions on foreign investments. The major policies would be already determined by the multilateral set of investment rules, and the choice available would be very much constrained to more minor aspects.

Part 4: NEED TO PROTECT THE BALANCE OF PAYMENTS AND PROMOTE DOMESTIC DEVELOPMENT

One of the most important effects of the MAI would be that governments will find it much more difficult to control the balance of the payments, and especially to take measures to get out of BOP deficit problems.

One of the most important disadvantages or dangers of foreign investment is that it has a tendency to lead to a net outflow of foreign exchange and thus have a negative effect on the balance of payments. This is why government policies to regulate foreign investment is so important.

In South-east Asia, countries like Malaysia, Thailand, Indonesia and the Philippines are now facing large deficits in the BOP current account. On further analysis, it is found that the large inflows of foreign investment have contributed significantly to the deficit.

Take the case of Malaysia. The BOP current account deficit has risen from RM7.4 billion in 1993 to RM17.8 billion in 1995 (9% of the GNP), causing great concern in the country. The main reason for this rising deficit was the increase in foreign investment:

- Firstly, there was a jump in the imports of capital goods and intermediate goods by foreign investors and this had a negative effect on the merchandise trade balance. According to the Deputy Finance Minister: "The rise in the trade deficit (in 1995) is mainly due to an increase in the import of capital goods brought in by foreign investors. If not for foreign investments in 1995, Malaysia would have recorded a large excess in the trade account." He said foreign investment rose 26% in 1995 to RM20 billion, and imports of capital goods through these investments accounted for RM18.5 billion.

- Secondly, there has been a high and fast increase in the profits and dividends repatriated by foreign investors. As the stock of FDI rises, the stream of "investment income" flowing out also increases rapidly. In Malaysia, the weakness of the BOP is the large deficit in the services account. In 1995, the deficit very high was RM18.8 billion or 9.4% of GNP. (In 1990 it was only $RM9.7 billion). Of this, RM13.4 billion was gross investment income of foreign companies. This was about 7% of GDP value. According to Malaysia's top economic planner, Economic Planning Unit director-general Tan Sri Dato Seri Ali Abul Hassan Sulaiman, "outflows for investment income payments (particularly repatriation of profits and dividends for foreign-owned companies) is the single major contributor" to the services account deficit.

In order to counter the impact of profit outflow, one can persuade the foreign company to re-invest its profits in the country. This however, does raise the question: if there is further reinvestment by foreign firms, this will lead to a higher stock of foreign capital and thus a higher future stream of profits and dividends, which eventually may be repatriated.
If so, there is the dilemma of reducing the present effects of the profit outflow but facing the potential of even higher streams of profit outflow in future. The problem is thus not solved but postponed, and to a potentially higher level.

The more permanent solution is to ensure that foreign investment in the country overall of a character that does not cause large foreign exchange outflows in net terms. For example, foreign firms that export a large part of their products are more welcomed. Pr else firms that apply to enter can be given permission only if they abide by conditions that they do not lead to high foreign exchange loss, for example by exporting enough of their products, and by limiting their imports through using local inputs.

In general, foreign companies that enter a country in order to exploit its market (and therefore do not export so much), and in doing so displace products or services previously provided by local firms, have a greater tendency to generate foreign exchange loss and BOP problems. Countries with a large market like China or India will face this problem more, because foreign companies are attracted to the large population and the local market there, and so a large part of these companies would want to produce for the local market rather than for export.

In any case, the most important principle is that developing countries need to have the authority to regulate the entry and terms of operations of foreign investment, for the sake of their development objectives and to protect their economy and society, for example, to protect the BOP.

To strenthen the BOP, governmentss require the authority and option to: (a) regulate foreign investment; (b) reduce imports of goods and services; (c) promote exports of local firms and services. These options are already being severely curtailed by the new Uruguay Round rules in the WTO. The MAI would make the situation worse.

In the past and at present, governments have placed conditions that firms must use specified local inputs, or a percentage of the output value must be locally sourced (local content policy). Another condition is that imported inputs of a firm must be restricted to only a certain percentage of that firm's export earnings (balancing of foreign exchange policy). Another policy may be to restrict a commodity or product from being exported (by imposing a ban or limiting export to a percentage).

All these three policy measures have been explicitly mentioned in an illustrative list and made illegal by the TRIMS (trade-related investment measures) Agreement of the Uruguay Round, on the ground it discriminates against foreign products or foreign trade. Of course, the removal of these policy measures would make it more difficult to resolve balance of payments deficits. Developing countries have 5 years (from Jan 1995) to implement this. In these negotiations, it may be possible to reopen the fairness of such prohibitions.

The MAI would make the situation worse. Governments now control the quantity and quality of foreign investment, and can limit the percentage of foreign equity, preferring joint ventures so that a share of the profits is retained by locals. Some countries limit the outflow of profits. These measures would be outlawed. Inability to regulate entry will increase the foreign share of equity. Removal of joint-venture arrangements would further raise foreign equity. Together these would raise the foreign share of profits in the economy. Given international trends, corporate tax is being progressively reduced. If foreign profit outflow is too high and can threaten the BOP or reserves and financial stability, the option of limiting profit repatraiation would not be available.

Measures to reduce imports or use of foreign services and measures to increase the use of local products, services and facilities, are important policy measures to reduce BOP deficit and to develop the economy. The enhanced disciplines in the WTO already make this more difficult. The investment treaty would make it more difficult.

Under the Services Agreement (GATS) in the WTO, national treatment is to be given to those sectors which are put on offer by a country. In other words, there cannot be measures discriminating in favour of local services, facilities or enterprises.

For instance, if shipping is on the offer list, then measures supporting local shipping lines may be considered WTO-illegal. According to the trade journal Straits Shipper, foreign countries are already protesting Malaysia's introduction of fiscal incentives to shippers to claim double tax deduction on freight charges paid to Malaysian shipping lines. The EU and US view this as discriminating in favour of national ships and violating the new trade regime.

Fortunately, the Services Agreement is not a catch-all agreement and applies only to those sectors or activities that the country has put "an offer." The proposed MAI would be a catch-all agreement, in which all sectors and activities are included, unless specifically excluded. Thus, any "affirmative action" measures that promotes local industries or services (through subsidies, preferential tax treatment, specified condition for investment, even R & D subsidy) could be seen as "discriminatory" against foreigners and thus prohibited.

Part 5: CONCLUSIONS

There is an important role for foreign investments in developing countries. But this role can be positively fulfilled only if governments retain the right to choose the types of foreign investments and the terms of their entry and operation.

Thus, the objection to the treaty is not out of any bias against foreign investment per se. Rather, it is because of the successful experience of those countries that have made use of foreign investment that there is realisation of the importance of the need of government to have decision-making powers and policy options over the entry, terms of equity and operations of foreign investments.

For example, Malaysia has had a very sophisticated system of combining liberalisation with regulation in a policy mix that can be fine-tuned and altered according to the country's economic condition and development needs. The ability and right to have options for flexible policy was especially needed to redress social imbalances among ethnic communities in the country. Without the application of such a policy, it is doubtful the country could have attained the social stability that underlay the high growth of the recent past. In 1970 (13 years after independence) the foreign share of equity was still 70%, the share of the majority Malay community, with 55% of population, was 1% and the share of non-Malay citizens was 22%. Due to a development policy that was based on requiring foreign companies to enter on a joint-venture basis, with 50% equity to locals and of that 30% to the Malay community, the share of equity has changed dramatically as a result of differential shares of growth going to different communities. The foreign share is now around 35%, the Malay share has grown from 1% to 20%-30% and the non-Malay citizen share is about 25%. Such a policy outcome would not have been possible if there had been the constraints of a MIA-MAI.

There must be many other examples in other countries demonstrating the need for policy instruments and options over investment policy to meet development, economic, social and political-stability goals.

Thus, from experience, developing countries need to maintain the right and option to regulate investments and have their own policy on foreign investment, instead of an international investment regime that would reduce or take away those rights. Giving total freedom and rights to foreign investors may lead to the disappearance of many local enterprises, higher unemployment, greater outflow of financial resources, and therefore to balance of payments problems. It may also worsen social imbalances within society, thereby causing social instability which will offset economic prospects.

The MAI and the MIA are not the only models for establishing relations between a foreign companies and the host governments. Another approach was earlier attempted in the draft UN Code of Conduct for TNCs, in which the rights and obligations of foreign companies and tyhe rights and obligations of the host governments were spelled out. The effors to establish this Code of Conduct was finally killed in 1992. However, the draft is still useful as an example of a different approach.

Striking a proper and fair balance is important for foreign investors and and the host countries have different goals and interests. Investors from foreign countries want to come to developing countries for three main reasons. First, they apprehend that the return on capital in their home country is not adequate; second, they want to combine their capital with the cheap labour of the host country to reduce the cost of production; and third, they want to utilize the raw materials of developing countries near their source.

The host developing countries, on the other hand, are interested in: (i) development of their services and infrastructure which may help their industrialization and development, (ii) production of exportable goods and (iii) continuous technological development in their industrial production and services.

These two sets of objectives are not incompatible. And the interests of foreign investors and host governments, although different, may be harmonized. But it is critical that any FDI meet both sets of objectives.

From the point of view of a developing country, the government must have the right and power to determine the entry and conditions of foreign companies, so that the country's development objectives can be fulfilled. The MAI would cause a great imbalance in the relation between the host country and the foreign investor. Thus in its present form, it would be unwise for developing countries to enter into such an agreement.

ANNEX 1

THE EFFECTS OF FOREIGN INVESTMENT ON DEVELOPING COUNTRIES AND THE CONDITIONS FOR ITS SUCCESSFUL USE

In considering the implications of an MAI, it is important to examine the effects (positive and negative) of foreign investment on developing countries, and the conditions for the successful use of such investments.
The question should then be asked whether these conditions for success will be promoted or diallowed under an MAI.

A leading Malaysian economist, Dr Ghazali Atan, has done a study on the effects of FDI on trade, balance of payments and growth in developing countries. Dr Ghazali's study empirically examines various facets (effects on savings, financial inflows and outflows, trade and growth) which he then build into a model (see attached Model) with equations on each aspect an a simultaneous equation to capture the total or combined effects of the various aspects.

The study's conclusions are that:

1. Successful growth in developing countries is premised essentially on raising the domestic savings rate to a high level and productively investing the savings. This is more important than the role of foreign capital, including FDI. The East Asian growth success is based mainly on high domestic savings rather than FDI.

2. Foreign capital can help to supplement domestic savings but this has its downside. There are three types of foreign capital inflow: aid, debt and FDI. FDI has many advantages (bringing in productive capital, foreign expertise, brand names, market linkages, aiding in industrialisation, exports, employment).

3. However there are also disadvantages or costs to FDI. These impacts need to be managed to ensure a net positive outcome.

4. The study found that FDI has a negative effect on domestic savings, as it gives room for the receipient country to increase its consumption.

5. FDI has effect on the flow of foreign exchange through two accounts: financial and trade. On the financial side, FDI brings in capital, but also leads to a stream of outflows of profit and other investment income. This outflow increases through time as the stock of foreign capital rises. Thus, FDI has a tendency to lead to "decapitalisation".

Comparing aid, debt and FDI, the study finds that because of the much higher rate of return of FDI compared to the interest paid on aid or debt, the "decapitalisation" effect of FDI is greater than of aid or debt.

For instance, as shown in the illustrative case shown in the Table at 10% interest on debt, it would take 6 years before outflow exceeds inflow; whilst at 15% return on FDI it would take only 3 years before outflow exceeds inflow. By year 17, the outflow of $6300 far exceeds the new inflow of $2000.

This illustrative example of FDI's decapitalisation effect is conservative. In most cases the rate of profit is far higher than 15% thus the decapitalisation effect would be more severe. The capitalisation effect is shown by several empirical studies, as well as Dr Ghazali's own study on Malaysia.

6. On the trade side, FDI has a positive effect through higher export earnings and a savings on imports (for products locally produced) but a negative effect through higher imports of intermediate and capital goods. It may also have a negative effect in raising imports of consumption goods. In many cases, FDI is heavily reliant on large imports of capital and intermediate goods.

SUMMARY OF FDI EFFECTS ON INFLOW/OUTFLOW OF FUNDS AND ON BALANCE OF PAYMENTS

CATEGORY OF EFFECT	**POSITIVE**	**NEGATIVE**
FINANCIAL FLOWS	Inflow of capital	Outflow of profit, royalties and revenues/incomes
TRADE FLOWS	Increased Export earnings	Increased import of capital goods
	Savings from reduced imports	Increased import of intermediate goods
		Increase in imports of consumer goods

NOTE: The balance on financial flows will tend to be strongly negative over time as the one-time inflow of capital would give rise to a stream of outlows of investment income. The larger the stock of foreign investment, the greater will be the outflows.

To avoid BOP difficulties, the balance on trade flows should be strongly positive to offset the deficit on financial flows. However this is not necessarily so. In some cases the trade balance from FDI may be positive but weakly so: in other cases it may even be negative as the high imports of foreign companies exceed their export earnings. In the latter case, a trade deficit is added to the finance deficit, which may cause BOP problems.

The high import content reduces the positive trade effect. Ghazali's study shows there is a weak positive trade effect and in some cases a negative trade effect.

7. In order for FDI to have a positive effect on balance of payments, there must be a strong enough positive trade effect to offset the negative decapitalisation effect. However, due to the weak positive trade effect, or even a negative trade effect in some cases, there is a tendency for FDI to cause a negative overall effect on the balance of payments. Without careful policy planning, the negative effect could grow through time and be serious as profit outflow builds up.

8. Too rapid a buildup of FDI could also lead to "de-nationalisation", where the foreign share of the nation's wealth stock increases relative to local share. To avoid economic or social problems that this may cause, Ghazali proposes obeying Moffat's rule, that the rate of growth of domestic investment should exceed FDI growth.

9. On FDI's effect on growth, there are direct effects (which are generally positive) and indirect effects (which are generally negative, due mainly to the decapitalisation effect). Whilst the inflow of new FDI exerts a positive effect, the outflow of investment income arising from the accummulated foreign capital stock exerts a negative effect.

10. The use of the model for the Malaysia case (1961-86) using equations for impact of FDI on investment, savings, exports, imports, factor payment etc. show that there was an overall negative impact on growth. Each percentage increase in the FDI to GDP ratio slowed growth down by 0.03%. Looking at the long term impact of FDI, debt and aid on growth over time, the study find that: "For FDI the effect starts off from a negative position and worsens over time: for debt the effect starts off being positive but turns progressively negative longer term; the effect of aid shows the opposite tendency, i.e. negative on impact but turning more benign later. The key dynamic influence was found to be the factor payment effect (ie the decapitalisation effect).

11. Given the various ways in which FDI affects the host economy, Ghazali proposes that for FDI to be used successfully (with net overall benefit), the following conditions should be met:

(a) Availability of foreign capital does not detract from own savings effort.
(b) The factor payment cost must be minimised and prudently managed
(c) Encourage or require joint ventures so that part of the returns accrue to locals and is retained by the local economy.
(d) Get foreign firms to list themselves on local bourses
(e) To enhance positive trade effects, DFI must be concentrated in the tradable sector, especially in export-based activities.
(f) Local content of output should be raised over time to improve trade effect.
(g) Moffat's rule should be adhered to (growth of domestic investment should exceed FDI growth).
(h) To avoid reliance on foreign capital, developing countries should increase their savings rate and maintain sound economic and political conditions.

12. Ghazali's conclusions are that: "The above are among preconditions for ensuring successful use of FDI. Countries using DFI without regard to the above conditions would do so at their own peril. Any moves designed to prevent host countries from instituting such policies, however they are couched, are moves designed to keep developing countries at the bottom of the global economic ladder...With the correct policies, DFI can be of great help to host countries. Without the correct policies, however, the use of DFI can lead to severe problems especially with regard to the long-term viability of the recipient's balance of payments."

ANNEX 2

THE MIA-MAI APPROACH COMPARED TO OTHER APPROACHES ON TREATMENT OF INVESTMENT

The initiatives on MIA-MAI are of course not the first attempts at establishing an international framework on foreign investment.

However, the approach taken by the MIA-MAI proponents is new in that it is an extreme approach as it covers and greatly expands the rights of international investors, whilst not recognising and thus greatly reducing the authority and rights of host governments and countries. Moreover the attempt to bring this into the WTO is moved by the objective of having strong enforcement mechanism in the WTO's dispute settlement system which includes the use of trade retaliation and sanctions. This means that the foreign investors' rights can be effectively enforced, and the host countries would be effectively disciplined to fulfil their obligations.

This one-sided approach on behalf of foreign investors' interests is in contrast to some earlier attempts within the UN system to set up an international framework on foreign investments that attempted to balance the rights and obligations of foreign investors and host countries. On a specific issue, this includes the Draft International Code of Conduct on the Transfer of Technology under UNCTAD. The draft Code appears to have been dropped.

On a general level, the most well known has been the Draft UN Code of Conduct on Transnational Corporations, which underwent a decade of negotiations from 1982 to the early 1990s. The Code of Conduct on TNCs had a section that dealt with the obligations of TNCs to host countries (Section on "Activities of TNCs"), as well as a section on the obligations of host countries to TNCs (Section on "Treatment of TNCs"). It was an attempt at balancing the rights of host countries with the rights of foreign investors, and the obligations of TNCs with the obligations of host countries.

The section on "**Activities of TNCs**" includes the following areas:

(A) General and Political aspects, including:

- respect for national sovereignty and observance of national laws and regulations;
- adherence to economic goals and development objectives and priorities of host countries
- adherence to socio-cultural objectives and values

- respect for human rights and fundamental freedoms
- non-interference in internal political affairs
- non-interference in intergovernmental relations
- abstention from corrupt practices

(B) Economic, Financial and Social Aspects, including:

- Ownership and control
- Balance of payments and financing
- Transfer Pricing
- Taxation
- Competition and restrictive business practices
- Transfer of technology
- Consumer and environmental protection

(C) Disclosure of information

The section on **"Treatment of Transnational Corporations"** include the following areas:

(A) General Treatment of TNCs by host countries

(B) Nationalisation and compensation

(C) Intergovernmental Cooperation

Whilst the draft Code recognised the right of TNCs to fair and equitable treatment, it also recognised that "States have the right to regulate the entry and establishment of transnational corporations including determining the role that such corporations may play in ecopnomic and social development and prohibiting or limiting the extent of their presence in specific sectors."

Unfortunately the attempt at a balanced approach through the Code failed, due mainly to the reluctance and hostility of some developed countries that did not favour the obligations placed by the Code on TNCs. In the early 1990s, the Code process was abandoned. The UN Centre on TNCs (which was secretariat for the process) was itself closed down and some of its staff were transferred to UNCTAD's Investment Division, where the functions are now different from the Centre.

At the same time as developed countries were downgrading and eventually eliminating the TNC Code and the Centre on TNCs, they initiated negotiations on Trade Related Investment Measures (TRIMS) in the GATT Uruguay Round. The TRIMS proposal initially contained two components. The first part involved foreign investment policy and rights per se (including the right of entry and establishment of foreign companies and granting of national treatment to them).

The second part dealt with investment measures (such as local content policy) which have direct effect on trade.

Many developing countries initially objected strongly to TRIMS being brought into the GATT system. They eventually succeeded in removing the first part (investment per se), on the grounds that governments had the sovereign right and the necessity on development grounds to regulate the entry and terms of operations of foreign investments, and that the GATT system was not the competent body to deal with the issue. (Please refer to Annex for a report on developing countries' counter-arguments against TRIMS in Uruguay Round negotiations in 1989).

The second part was retained as the present TRIMS agreement in the WTO.

Developed countries are now arguing that since "investment" is already an issue in the WTO under TRIMS, it is not a new issue at all, and therefore it is legitimate to bring in "trade and investment" for discussion.

The proponents omit to mention that it is precisely the issue of investors' rights, investment policy per se and the investment regime as a whole that was eliminated from the TRIMS proposals (and is now not part of the WTO system) because developing countries believed this was an area outside the competence or legitimacy of the WTO. The developed countries are now trying to bring back the rejected issue through the phrase "trade and investment" (no longer "trade-related investment measures"), with the main aim of starting negotiations towards an MIA and thus gain what was (temporarily) given up in the Uruguay Round.

Given this recent history of evolving an international framework for foreign investment, it is clear that the proposed MIA-MAI is only one approach, and in fact an extreme approach covering investors' rights to the exclusion of their obligations and to host countries' rights. A proper discussion of evolving a framework must take into account the larger approach or paradigm, in which the rights and obligations of host countries and foreign investors are properly balanced, with the objective of attaining development.

(Paper written in 1997.)