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Prospects for Investment Negotiations in the WTO[*]

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Fukunari Kimura
Professor, Faculty of Economics, Keio University
2-15-45- Mita, Minato-ku, Tokyo 108-8345, Japan
Phone: 81-3-3453-4511 ext. 23215, FAX: 81-3-3798-7480
E-mail: fkimura@econ.keio.ac.jp

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Abstract

This paper reviews the multilateral effort of establishing policy discipline of investment-related policies and discusses the prospects for WTO-based negotiations. We claim that FDI-related policies currently conducted by a number of countries are often distortive and the establishment of multilateral investment rule is essential to enhancing economic efficiency and reducing politico-economic costs in the globalization era. We also try to draw some lessons from the failure of MAI negotiation and the implementation of the TRIM Agreement. The discussion extends to issues on the treatment of LDCs, possible conflict with "pure domestic" policies, and the relationship with bilateral/regional investment rules.

I. Background

Just after the WW-II, the International Trade Organization (ITO) was about to be established together with the International Monetary Fund (IMF) and International Bank for Reconstruction and Development (IBRD) for the new order of world economy. It is well known that the ITO was supposed to take care of the liberalization of both trade and investment. However, the ITO did not unfortunately come into reality due to the failure of ratification by the U.S. Congress and other reasons. It is not thus a new claim at all that the liberalization of international transactions should include the liberalization of investment. But since then, we have had a hard time establishing the international policy discipline of investment-related policies at the multilateral level.

There are lots of convincing intuitive arguments, both academic and nonacademic, that support the liberalization of investment on the real economy side. As the globalization of firms' activities proceeds, foreign direct investment (FDI) becomes one of the major channels to enhance the efficiency of worldwide resource allocation. Lipsey, Blomstrom, and Ramstetter (1998) estimated that roughly 6% of world GNP was generated by foreign affiliates of MNEs in 1990. More recently, UNCTAD (2000, pp. 3-4) states that this ratio went up to about one-tenth in 1999 and the gross product of all transnational corporations (TNCs) was roughly a quarter of world GNP in 1997. Among OECD member countries, more than 25% of the value added in manufacturing sector are generated by affiliates of foreign firms in 1996 or the latest available year: Ireland (66.4%), Hungary (62.4%), Canada (50.9%), the United Kingdom (33.2%), Netherlands (29.7%), and France (28.8%).[1] Table 1 presents rough estimates of the significance of affiliates of Japanese and U.S. firms in East Asian developing countries. These evidences indicate that the role of FDI must be considerably large. In addition, it is estimated that about the one-third of world trade is intra-firm trade in recent years.[2]

Table 1

Furthermore, since 1998, we have been experiencing an unprecedented FDI boom. According to the estimation by UNCTAD (2000, pp. 289), the total outward FDI in the world increased from 391 billion dollars in 1996 to 687 billion dollars in 1998, and reached 800 billion dollars in 1999. A large part of the increase has come from a cross-border M&A boom within Europe and across the Atlantic Ocean, which has been drastically changing the map of corporate firms in developed countries. From the fear of marginalization from the world investment boom, a large number of less developed countries (LDCs) have become positive or even aggressive for hosting FDI.

Because some of the FDI-related policies have a strong nature of domestic policies, it is not easy to establish a general policy rule at the multilateral level. However, considering the recent globalization of economic activities, the liberalization of FDI is hoped for. Of course, we must take into account the needs for infant industry promotion and the backup by effective competition policy. If we can take a proper care of market

[1] From Fukasaku and Kimura (2000, Table 1).

[2] Fukasaku and Kimura (2000) discuss the magnitude of intra-firm trade based on the data of the United States and Japan.

failures due to liberalization, the majority of economists would support the general direction of liberalization.

However, in reality, FDI-related policies of a number of countries are conducted at wild discretion. Even the essential elements of international policy principles such as the most-favored-nation (MFN) principle and the national treatment (NT) principle are not systematically enforced at the multilateral level. Transparency requirement is not imposed, and there does not even exist effective dispute settlement mechanism in many cases. In particular, LDCs are imposing various FDI-related policies, some of which are highly distortive. There are two types of FDI-related policies: policies on the entry and exit of affiliates of foreign firms and policies on the activities of affiliates after entry including performance requirements. There are policies both to restrict FDI and to promote FDI. Most of these policies distort the market. In addition, the lack of policy discipline generates large room for rent-seeking activities by bureaucrats/politicians of host countries and oligopolistic investors.

Under the Uruguay Round (1986-1994), there was an extensive discussion on investment-related policies, and it ended up with the Agreement on Trade-related Investment Measures (TRIMs) in the Annex A of Marrakesh Agreement. The Agreement reassures that trade-related investment measures must follow the national treatment principle (GATT Article III) and the ban on quantitative restrictions (Article XI) and attaches a list of illustrative measures inconsistent with the GATT obligation. Although the TRIM obligation has contributed to the removal of several restrictive policies such as local content requirements, it covers only a small subset of investment-related policies after all.

Then, the Organization for Economic Co-operation and Development (OECD) tried to take an initiative in establishing investment rules. The negotiation for the Multilateral Agreement on Investment (MAI) started in May 1995. The draft of MAI consisted of three pillars: investment liberalization, investment protection, and dispute settlement mechanism. The participation of LDCs was supposed to follow after the agreement is reached among developed countries. The negotiation, however, did not proceed well, and the participating countries could not reach the agreement in the initially planned period of two years and an extended one-year period. The negotiation has not resumed since then.

The WTO organized the Working Group on the Relationship between Trade and Investment in December 1996 and started background studies on investment. The report of the Working Group was submitted to the General Council in December 1998. It was not however a penetrating report in the sense that it only summarized the discussion on the relationship between trade and investment, not straightly taking care of the possible role of the WTO in establishing investment policy rules.

In the nightmare of Seattle in December 1999, we did not have enough time to discuss whether or not investment rules should be included in the new round. At least before the Ministerial Meeting, Japan, EU, and a number of newly industrializing economies (NIEs) showed a positive attitude. On the other hand, some LDCs such as India and Pakistan strongly opposed. FDI is asymmetric in nature. Investors are predominantly corporate firms of developed countries. On the other hand, it is mostly LDCs that should conduct substantial policy reform once investment rules are imposed. This asymmetry sometimes makes LDCs be ambivalent about investment rules. They

would like to host FDI while they want to keep room for policy discretion.

The United States was not quite positive or rather reluctant about investment negotiation in the WTO. After experiencing anti-globalization movements by labor unions and environment NGOs, the U.S. Government became even more cautious about investment negotiation. The disinclination partly comes from the fact that the U.S. already has high-level bilateral investment treaties (BITs) with a number of LDCs and thus does not desperately need multilateral agreements. U.S. firms are sometimes enjoying preferential status over firms of other nationalities. Another possible concern of the U.S. Government is that multilateral rules may require local governments in the U.S. to change their FDI-related policies.

Thus, the prospects of investment rules do not seem very bright at least in the short run. I however believe that trade economists have a mission to promote investment liberalization. This paper claims that we should at least establish a minimal set of policy discipline such as the MFN and NT principles on FDI in the framework of the WTO. At the same time, if we can not be quite persuasive in promoting liberalization, we must find the reason.

The next section reviews the background of FDI-related policies particularly in LDCs and discusses possible economic/politico-economic justification of multilateral investment rules. Section III examines the FDI-related policies currently conducted by a number of countries and claims that those policies are often distortive in nature. Section IV discusses the reason why MAI failed and tries to take a lesson from it. Section V reviews the current situation of BITs and discusses a possible relationship with multilateral agreements. Section VI discusses TRIMs and other efforts by the WTO. The last section summarizes what we economists should do.

II. Economic justification of multilateral investment rules

The theoretical support of FDI liberalization is straightforward. The removal of distortive FDI-related policies basically enhances the efficiency of static and dynamic resource allocation and are thus welfare improving. Along the intuition of MacDougall's model (MacDougall (1960)), both investing and host countries enjoy welfare gains though, of course, some of the economic agents in both countries may be worse off without proper income redistribution. FDI is not a simple movement of colorless capital but comes with the movement of firm-specific assets. Therefore, we often emphasize the benefits from the transfer of technology, managerial ability, and other firm-specific assets both internal and external to the market. Starting from this benchmark intuition, FDI-related policies must be justified as anti-distortionary policies to cancel out market distortions. One possibly justifiable policy is infant industry promotion policy trying to capture externalities or dynamic economies of scale in the development process. Another is competition policy to eradicate anti-competitive conduct of multinational enterprises (MNEs).

Although the theoretical intuition sounds pretty robust, the formal empirical evidence that FDI is beneficial is rather fragile. There have been a number of simulation attempts to measure the effect of FDI using applied general equilibrium models. Most of the studies, however, were not very successful in taking the special characteristics of FDI into account. Some crude empirical studies (Borensztein, De Gregorio, and Lee (1998)

for example) have tried to connect FDI with growth performance, but the relationship does not seem very robust. There is a literature proving that affiliates of foreign firms are generally more productive and pay higher wages than local indigenous firms,[3] but we are not sure whether hosting FDI helps indigenous firms grow or not. Actually, micro studies such as Harrison (1996) rather find a negative impact of hosting FDI on local industries at least in the short run. To promote the liberalization of FDI, we, trade economists, must present more convincing evidence.

Starting from the non-discrimination principle as the rule of thumb, we obviously need some special consideration for LDCs. It was not until the 1980s that LDCs overcame their hostile sentiments against gigantic MNEs. Now policymakers in LDCs understand that hosting FDI is largely beneficial to economic development. But still, MNEs are in many cases too big, too advanced in technology and managerial ability, and too sophisticated entity for them. It is thus natural for them to seek some sort of backup by proper competition policy to counteract possible anti-competitive conduct by MNEs. In addition, policymakers in LDCs naturally take into consideration the influence of hosting MNEs when they construct industrial promotion policies. When they would like to foster their own infant industry, they may want to restrict FDI. Or, when they would like to utilize MNEs for accelerating industrialization, they would rather promote FDI by providing preferential arrangements. The attitude of policymakers in LDCs toward FDI is often mixed, confused, and self-contradictory. But in any case, it is natural for them to have desire to keep room for policy discretion on FDI.

Then a question is how far the WTO policy discipline, particularly the nondiscrimination principle, should immediately apply to LDCs and on what aspects temporary exempion from the principle should be allowed for LDCs. As for the MFN principle, we can hardly think of a case in which the diversion should be granted. For the purpose of infant industry promotion, LDCs may want to limit the number of foreign firms to enter the market or to receive preferential arrangements. Even in such a case, nothing prevents LDCs from selecting foreign firms in a transparent, nondiscriminatory procedure such as competitive bidding. As for the NT principle, on the other hand, there is more room for temporary exemption. Particularly, in the case of FDI-related policies to regulate entry, we must provide limited discretionary room for LDCs as we grant "special and differential (S&D) treatment" in commodity trade liberalization.[4] In the case of FDI-related policies after entry, however, much less occasions can be thought of for differential regulations between indigenous firms and foreign firms. Because indigenous firms are often weak and fragile compared with affiliates of MNEs, there would be a case in which temporary policies disadvantageous for affiliates are justifiable as anti-distortionary policies. However, such discriminating policies after entry may generate larger frustration of foreign companies than policies on entry.[5]

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[3] See, for example, Aitken, Harrison, and Lipsey (1995), Globerman, Ries, and Vertinski (1994), and Doms and Jensen (1998).

[4] As for the S&D treatment for LDCs, see Hoekman and Kostecki (1995, Chapter 10 and Annex 6).

[5] Some countries provide for foreigners investment incentives more favorable than domestic indigenous firms. Because the NT principle usually requires policy environment for foreigners "no worse than" that for domestic economic agents, the

Some of the performance requirements imposed by LDCs' governments are possibly the issues beyond the MFN and NT principles. Then a delicate problem of demarcation between international commercial policy and domestic policy would emerge on surface. Once we stop confining our scope to the liberalization of "trade-related" policies and step forward to investment liberalization in general, we have to redefine a new borderline between pure domestic policies and international commercial policies under the WTO. Considering the heterogeneity of economic institutions across countries, we must certainly grant more room for policy discretion in general investment liberalization. However, some essential codes such as investment-facilitating institutional convergence should not face much resistance.

So far our discussion is limited to the implication of FDI-related policies for efficient resource allocation in a narrow sense. In addition, we should not underestimate the politico-economic implication of FDI-related policies. Discretionary FDI-related policies provide a lot of room for rent-seeking activities on both investing foreign firms and hosting governments and possibly cause the formation of undesirable politico-economic coalitions. Immature governance of LDCs' government and the oligopolistic character of MNEs would enhance the danger of such political economy. It may even divert the effort of liberalization to a wrong skewed direction and interfere the development of transparent and accountable governance and competitive business practice. The establishment of international discipline for FDI-related policies is the best solution to avoid such disturbing outcomes.

In summary, the establishment of comprehensive policy discipline for FDI-related policies requires careful consideration on the borderline between pure domestic policies and international commercial policies. However, we can reach consensus on a decent set of policy principles such as MFN, NT, transparency requirements, and restrictions on some obviously distorting performance requirements. Both the efficiency and the political-economy arguments support the multilateral effort of specifying and enforcing a certain level of policy discipline, with considering some modest special treatments for LDCs.

III. FDI-related policies in LDCs

Right now, at the multilateral level, little policy discipline is imposed on each country's FDI-related policies. The TRIM and the GATS (General Agreement on Trade in Services) take care of some limited aspects of investment-related policies, but there does not exists any global policy rule covering FDI as a whole. Some regional preferential arrangements and bilateral investment treaties (BITs) include investment rules, but they do not apply on the MFN basis. No rule means no effective dispute settlement mechanism. As a result, the policy environment related to FDI is far from the ideal situation with non-discrimination and transparency, particularly in LDCs.

Since a serious negotiation on multilateral investment rule has not been commenced yet, there does not even exist a clear definition of investment-related policies. There is no consensus on the scope of issues: for example, issues such as

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above case is not treated as a violation of the principle. However, economic theory suggests that such policy would also distort a market in general.

whether to include portfolio investment and other capital flows in addition to FDI,[6] where we should set the borderline between pure domestic policies and investment-related policies under the international policy rule, and others. However, there have been a few plurilateral attempts to classify investment-related policies and list each country's policies along the category. The ASEAN Secretariat compiled investment-related policies of nine member countries (Brunei, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam) "in the effort to enhance transparency and to make ASEAN investment environment better known to investors" (The ASEAN Secretariat (1998, p. 1)). Table 2 presents the classification of investment-related policies the report applies. "Relevant legislation" and "applications" present laws and government agencies in charge of incoming FDI, which indicates that each country has a different administrative structure. "Investment fields/sectors" and "foreign equity policies" summarize regulations on incoming FDI in terms of industrial sectors and capital shares. "Incentives" include preferential treatments for investment as well as those in exchange of obeying performance requirements. "Taxation" and "financial regulations" itemize general conditions for both indigenous and foreign-owned firms as well as differential treatments for the latter. "Employment of foreign workers" and "land ownership" list regulations often claimed as restrictive by foreign-owned firms.[7]

Table 2

Actual conditions for FDI are based not only on formal laws and regulations but also on operations and discretionary judgment of administrators. Thus, one effective way of picking up possible problems on policy environment for FDI is to listen to the complaints of foreign investors. The Business Council on Facilitation of Trade and Investment in Japan is a coordinating body of about 150 industrial/business associations and helps Japanese firms exchange views on trade- and investment-related issues in their international operations. Every year, it lists issues and problems that Japanese firms face in their activities in foreign countries and publishes it in a report titled *Barriers to Trade and Investment* in both Japanese and English. Because this is a list of requests by private companies, some claims are naturally biased toward individual firms' interest, rather than taking care of public interest with regard to desirable investment policy discipline. Some companies successfully adapt themselves to the existing distorted policy environment and are perhaps earning some gains out of it. Hence, we must read the list with caution. However, most of the complaints and requests are useful to identify hidden problems and the real cost of regulations.

Table 3 presents the classification of issues as well as the number of issues

[6] MAI tried to define investment in a wider sense including FDI, portfolio investment, and others. This move was paralleled by the IMF's trial to expand its mandate to capital account liberalization in 1997. However, after the Asian economic crisis started, a number of economists think more of the separation of FDI from other types of investment. Particularly on the treatment of short-term capital flows, see Fischer, et al. (1998) and IMF (1999).

[7] More detailed information on investment-related policies of Asian countries and others can be obtained from JETRO (various years) and JMCTI (various issues).

pointed out by Japanese firms (Business Council on Facilitation of Trade and Investment (1999)). Figures do not necessarily indicate the degree of seriousness or unfairness of issues. The larger the presence of Japanese firms is, the more issues are naturally raised. However, we can still obtain a rough idea of major barriers Japanese investors are facing and consider what can be solved by establishing international policy discipline.

Table 3

Issues #1 and #4 in Table 3 present a large collection of requests for removing or easing regulations on entry and exit, including foreign ownership restriction. We see that entry restrictions seriously affect the activities of foreign firms and those restrictions do not often seem to make sense as reasonable infant industry promotion policies. Another problem is that those restrictions are not clearly written or announced so that ad-hoc decision making by administrators is sometimes crucial. Issues #2, #3, and #5 are on regulations after entry or performance requirements, which do not conform to the national treatment principle in many cases. These include requirements on domestic production, local procurement, and exports, sometimes linked with some incentives such as tariff reduction. Again, there is much room for discretionary practices by administrators of host countries. Some of the regulations must be removed under the obligation of the TRIM Agreement in the case of original member countries of the WTO. Issues #6 and #10 include complaints on sudden removals of investment incentives after entry. Issue #9 is on trade regulations, some of which are related to the operation of MNEs. Issues #11 to #14 are on profit recovery, exchange controls, finance, and taxation, some of which are partly related to investment protection and the national treatment principle. Issue #16, employment, includes problems of both local labor and foreign labor. Issues #21 and #25 are on land-holding restrictions and government procurement, which can also be discriminatory practices for foreign investors. Issues #7, #8, #23, #24, and #26 are related to the quality of governance and legal systems on which many problems are again pointed out. Together with the lack of effective dispute settlement mechanism, transparency and accountability of policy implementation tend to be lost, which ends up with large room for potential rent-seeking activities.[8]

Overall, we must conclude that the cost of nonexistence of multilateral investment rule is not at all negligible even though it is hardly quantifiable in empirical studies. Taking into account an extremely skewed pattern of FDI destination across LDCs, we must conclude that FDI is very sensitive to host country's policy environment. In the era of globalization, channels of international transactions are diversified, and the liberalization of FDI seems to be a natural step next to commodity trade liberalization. An urgent issue is to set up a minimal set of multilateral discipline on FDI-related policies. The set must include i) the confirmation of non-discrimination principle, i.e.,

[8] There are also a number of cases that FDI-related policies are not consistent with the MFN principle. For example, the zoning system in Thailand is applied for firms from Japan and other countries while U.S. firms do not have to follow because of the US-Thai bilateral treaty. There are also a number of unconfirmed claims of MFN-inconsistent implementation in China. There does not, however, exist any legal basis to criticize such practices.

the MFN and NT principles, ii) phasing out of distortive performance requirements, iii) enhancing transparency of policy implementation, and iv) setting up an effective dispute settlement mechanism. Going that far should be much less controversial than intellectual property issues, or even less ambitious than the liberalization of services, in terms of the borderline argument of domestic policies and international commercial policies.

IV. Lessons from the failure of MAI

The MAI negotiation was an ambitious effort. In addition to the standard provisions on investment protection, the draft of MAI includes core principles of liberalization; i.e., the NT and MFN principles, transparency requirement, and the prohibition of performance requirements with a wide coverage. Furthermore, it contains a strong dispute settlement mechanism.

We have already had an extensive discussion on the reason why MAI failed. If we wish to proceed investment negotiation in the WTO, we must seriously review what happened in the collapse of MAI negotiation. Bhagwati's newspaper article (Bhagwati (1998)) publicized just after the withdrawal of France from re-negotiation is a good starting point. Bhagwati first wrote that MAI was unbalanced in three ways. First, it failed to claim that preferential arrangements for FDI are as distortive as restrictions for FDI. Second, it advocates the rights of MNEs, but not their obligations. Third, it makes little concession to the political environment of host countries. Then he continued that there were more powerful reasons why the investment issue should be dropped altogether from the WTO agenda. He claimed that the negotiation must inherently include controversial issues, and thus the WTO may gratuitously go into a politically supercharged domain, ending up with endangering the real mission of the WTO, i.e., to free trade. He added that the WTO already went too far on intellectual property protection (IPP) and the tension on labor and environmental issues would be enhanced. Then he concluded that "with IPP and MAI both in, it would be hard to refute the charge that what is good for 'capital' at the WTO is not good for 'labour' or for 'nature' (quote)."

After looking at mass turmoil in Seattle and Washington, DC, even we, East Asians, realized that Bhagwati's concern is a real one. However, I think that trade economists should make more effort to disseminate the idea that FDI liberalization is important, rather than simply putting on the brake to compromise with politico-economic pressure. When we call for commodity free trade, we say that free trade is good not only for exporters but also for the majority of people including consumers in importing countries. Why don't we claim that the liberalization of FDI is good not only for 'capital' but for the majority of people in both investing and hosting countries? We are not at all against a large number of conscientious NGO activists supporting 'labor' (though not for the protectionists' purposes) or 'nature'!

We must of course pay much more attention to LDCs. Developed countries should be generous for LDCs to have enough time period for seeking their own industrial promotion. If competition policy helps LDCs to overcome the traditional fear of MNEs, we must support their effort for institutional building. These do not necessarily bother the establishment of policy principle and setting the long-term target.

When going beyond the liberalization of border policies, we inevitably face

difficult issues of how far international policy discipline should affect policies traditionally regarded as "pure domestic." This issue will potentially connect with a more fundamental issue on the relationship between national sovereignty and international organizations. From the viewpoint of international laws, Kotera (2000) pointed out that the draft of MAI had a serious problem on dispute settlement mechanism. He claimed that MAI has an enforcement mechanism with arbitrage, which potentially has a much stronger power than the WTO procedure to force countries to change policies. In addition, MAI was supposed to handle private-government disputes as well as government-government disputes. This goes far beyond the current dispute settlement mechanism under the WTO where dispute settlements are conducted only on the government-government basis.

The negotiation over MAI collapsed. However, the draft of MAI becomes a starting when we begin to discuss investment rules in other policy forums.[9] We need more careful discussion on the MAI draft in order to use it as a concrete benchmark.

V. Connection with bilateral investment treaties (BITs)

We have not yet established comprehensive investment-related policy rules at the multilateral level but have already had a number of arrangements at the bilateral and regional level. According to the UNCTAD (2000, p. 6), we had 1,856 BITs in the world at the end of 1999.

At the bilateral level, treaties of friendship, commerce, and navigation (FCN) were traditionally concluded mainly among developed countries and covered a wide range of bilateral economic, cultural, and political cooperation, including investment protection. No new FCN treaties have been concluded since the 1960s though. Bilateral investment treaties (BITs) began to be formed in the late 1950s and have recently been popular. Table 4 shows the number of BITs being signed (by Prof. Yokokawa of Seijo University). West Germany, Switzerland, and other European countries were forerunners while the United Kingdom and the United States followed in the 1980s. BITs were traditionally concluded between a developed country and an LDC, but BITs between LDCs are also increasing recently (see the row of "Others").

Table 4

The contents of BITs are mainly for investment protection. However, some BITs include articles promoting FDI liberalization such as national treatment before and/or after entry and the ban on performance requirements. In particular, recent BITs by the U.S. include the prohibition of performance requirements.[10] The U.S. also has high-level investment arrangements with Canada and Mexico under the NAFTA scheme. This is actually one of the reasons why the U.S. is not very positive about multilateral investment negotiations particularly when the proposed investment rule does not seem to

[9] Actually, the draft of MAI has already influenced some negotiations on investment such as the Japan-Russia bilateral agreement and the ASEAN Investment Area.

[10] See UNCTAD (1999, p. 119) for the contents of the BIT between Bolivia and the U.S. for example.

reach to a high level. A problem is that the liberalization of investment at the bilateral or regional level is not conducted with the MFN principle.

Japan has not been an active player on BITs. As of April 2000, there are only six effective BITs (with Egypt, Sri Lanka, China, Turkey, Hong Kong, and Bangladesh) and two BITs (with Pakistan and Russia) signed but not effective yet. The Japanese Government has recently recognized the importance of BITs and started negotiating with Korea, Viet Nam, Mexico, and Mongolia, possibly followed by the negotiation with Indonesia. The negotiation with Korea is particularly a politically symbolic one for regional cooperation, seeking a high-level BIT.

When BITs are working in the direction of FDI liberalization, we must appreciate them in general. But it is unfortunate if the existence of BITs discourages some of the countries from establishing multilateral policy discipline. How can we prevent the discussion from degenerating into a narrow-sighted politico-economic one?

In addition, as Kotera (1999) pointed out, once we can start out a multilateral investment negotiation, we must carefully consider the consistency between the multilateral rule and BITs. When a BIT has a higher standard of liberalization obligation than the multilateral rule, we may need to introduce a special arrangement similar to Article XXIV of GATT. The treatment can be different depending on whether the BIT is concluded before or after the establishment of multilateral rule. In addition, we may need to build a system minimizing the risk of "forum shopping" in dispute settlements.

VI. The TRIM Agreement and beyond

The TRIM negotiation was an epoch-making effort to try to establish policy discipline on investment, but the scope was narrowly confined from the beginning. The starting point was to examine the operation of GATT articles related to the trade restrictive and distorting effects of investment measures. Thus, "the focus of the negotiations was to be the adverse trade effect of investment measures and not the legitimacy of the measure per se" (Grimwade (1996, p. 326)). The scope of the TRIM Agreement was limited to investment measures related to trade in goods, and the logical structure was constructed in the spirit of reaffirming the implementation of GATT Article III (national treatment) and Article XI (general elimination of quantitative restrictions).

The Annex of the TRIM Agreement presents an illustrative list of TRIMs that are inconsistent with the GATT obligation. It includes i) local content requirements, ii) trade balance requirements, iii) import restriction through foreign exchange control, and iv) export restriction. Other parts of the Agreement reaffirm the commitment to obligations on transparency/notification and the application of GATT dispute settlement mechanism.

The TRIM Agreement obviously takes care of a very small subset of policy discipline on investment. However, it has already given some real impacts. The TRIM Agreement requires member countries to notify all nonconforming TRIMs within 90 days and to eliminate them within two years in the cases of a developed country, five years in the case of a developing country, and seven years in the case of a least-developed country (TRIM Article 5). This means that original-member developing countries had to eliminate nonconforming TRIMs by the end of 1999, though they were able to request the extension of the transition period by demonstrating particular difficulties. Table 5

lists the notified nonconforming TRIMs.[11] The ban on TRIMs is affecting LDCs' policies particularly on automobile industry.

Table 5

When the contents of the TRIM Agreement were virtually completed in October 1991, the time framework of removing nonconforming TRIMs was set rather strictly in exchange of narrowing the scope. Because the TRIM Agreement was included in the single-undertaking portion of the Marrakesh Agreement, LDCs perhaps signed on it without much serious thought. However, LDCs later realized that it was a serious commitment with enforceable dispute settlement mechanism and the transition period of five years was pretty short. As shown in Table 4, a number of LDCs are now submitting extension requests to the WTO. The WTO announced that these requests will be examined in the Council for Trade in Goods,[12] which means that some sort of compromise would be sought.

If we can expand the scope of investment rules in the next round (if any), we must reconsider a proper time framework of removing barriers, particularly for LDCs. The TRIM Agreement was asking LDCs to remove nonconforming TRIMs too quickly, and the negotiation process of transition period extension was not well specified. In the case of trade in goods, member countries are first requested to switch nontariff barriers (NTBs) to transparent tariffs and then lower tariffs gradually. LDCs are not forced to remove all barriers in a short period as five years. Actually, even developed countries have not eliminated all NTBs and tariffs yet. Thus, it seems to be natural to specify "dirty" and "clean" investment measures and conduct a sort of "purification" as a first step. Then we had better take a comprehensive approach for special and differential (S&D) treatment for LDCs including various types of liberalization obligation.

VII. Agenda for economists

I believe that the establishment of multilateral investment rules is a natural step beyond commodity free trade and is essential to the world economy with rapidly globalizing firms' activities. The current political environment, however, does not seem to fit for such a trial very well. Thus we, trade economists, have a lot of things to do now.

First, we must tell a more convincing story for the importance of multilateral investment rules. In the political economy of international negotiations, MNEs in developed countries are obvious supporters of investment liberalization. However, it does not mean that they are the only beneficiaries of liberalization. We must convince the general public that both investing and hosting countries can enjoy welfare improvement in most of the cases. As well as the theoretical justification, strong empirical support is needed. In particular, it is important to accumulate studies on the

[11] In addition, Brazil, Canada, and India were claimed to have nonconforming TRIMs in the automobile industry, and the cases went to the WTO Dispute Settlement procedure. Brazil actually removed the TRIM at the end of 1999.

[12] According to *Nihon Keizai Shinbun*, May 9, 2000.

quantification of liberalization effects.

Second, we have to prepare backstops for possible market failures accompanied with investment liberalization. As for the S&D treatment for LDCs, we must develop a comprehensive approach including various types of measures not conforming to the principles but being allowed temporarily. In addition, if necessary, the institutional building for competition policy in LDCs should be supported through moderate international policy coordination or technical assistance.

Third, we should discuss more the scope of the WTO. One issue is on the borderline between international commercial policies and "pure" domestic policies. As the globalization of economic activity proceeds, the borderline has inevitably become blurred. However, we cannot say anymore that everything is related to international commercial policies and thus should be under the international policy discipline. Another issue is on the legal background of the WTO. The WTO is not a "super-government" in the sense that the EC Commission is. It is not directly legitimized by the sovereignty of people but is supported as an international treaty among sovereign states. Taking a virtually effective dispute settlement mechanism into consideration, the scope of the WTO may need to be set rather conservatively. Without boiling down the discussion on our side, we cannot make a constructing talk with anti-globalization hardliners.[13]

Fourth, if it is really difficult to initiate investment negotiation as Bhagwati claimed, we may need to consider alternative channels. One possibility is to proceed investment liberalization by using other negotiation forums such as GATS and TRIM, even if the scope is limited. In this case, we must carefully examine the possibility of undesirable sequencing problem and try to minimize distortion.

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[13] One of the typical stance of hardliners is found in *Foreign Policy*'s article titled "The FP Interview: Lori's War" (No. 118, Spring 2000: 28-55).

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Table 1 Significance of affiliates of Japanese and U.S. Firms in East Asian countries (1996)
(%)

	Value added		Employment		Exports		Imports	
	Affiliates of Japanese firms	Affiliates of U.S. Firms	Affiliates of Japanese firms	Affiliates of U.S. Firms	Affiliates of Japanese firms	Affiliates of U.S. Firms	Affiliates of Japanese firms	Affiliates of U.S. Firms
Korea	0.46	0.49	0.33	0.17	6.95	n.a.	6.34	n.a.
Hong Kong	5.24	1.91	2.66	3.18	17.02	17.17	16.38	n.a.
Singapore	11.90	7.69	4.73	5.68	33.17	55.13	33.38	n.a.
Malaysia	4.61	4.68	2.67	1.62	13.11	18.47	15.19	n.a.
Thailand	4.54	1.89	0.89	0.26	33.28	n.a.	29.76	n.a.
Philippines	1.56	2.60	0.34	0.24	13.98	31.02	9.70	n.a.
Indonesia	1.12	2.61	0.26	0.06	11.33	18.93	15.26	n.a.
China	0.42	0.26	0.05	0.02	3.82	5.32	4.51	n.a.

Affiliates of Japanese firms: Affiliates abroad with more than 10% Japanese ownership (except those whose parent firms are in finance & insurance or real estates). Data for 1996 F.Y.
Affiliates of U.S. firms: Affiliates abroad with more than 50% American ownership (neither parents nor affiliates are banks). Data for 1996.

Note that the ratio of returned questionnaires is as low as 59.1% for the data of affiliates of Japanese firms.

The definitio of "value added": "sales minus purchases" for affiliates of Japanese firms, and "gross product" for affiliates of U.S. firms.
Value added and exports/imports for affiliates of Japanese firms are estimated by using the data for total NIEs and total ASEAN4.

Source:
MITI (1999), U.S. Department of Commerce (1998), and IMF (2000).

Table 2 The classification of investment-related policies by the ASEAN Secretariat

- Relevant legislation
  - Investment act
  - Companies act/factory act
  - Other legislation
  - Minimum investment level
- Applications
  - Agency involved in administering investment application and granting incentives
  - Conditions
  - Special services
- Investment fields/sectors
  - Fields/sectors
  - Restrictions
- Foreign equity policies
- Incentives
  - Corporate income taxes
  - Exemption from or reduction of taxes on imported capital goods
  - Exemption from or reduction of taxes on imported raw materials
  - Other incentives
  - Foreign loan
- Taxation
  - Corporate tax
  - Value added tax/sales tax
  - Withholding tax
  - Personal income tax
  - Other taxes
- Financial regulations
  - Borrowing
  - Foreign exchange
  - Source of financing
  - Special regulation
- Employment of foreign workers
  - Conditions for approval of foreign employees
  - Work permit
- Land ownership
  - Acuisition of land and building (for business and residential purposes)
  - Restriction

Source: The ASEAN Secretariat (1998).

Table 3 Barriers to trade and investment listed by Japanese firms

		Brunei	China	Hong Kon	Indonesia	Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam
#1	Restrictions on entry and foreign ownership		10		10	5	12	5		2	7	1
#2	Regulations concerning domestic production ratios and local procurement ratios		5		2		1	3		2	3	3
#3	Export requirements		4			1		3		2	1	2
#4	Withdrawal regulations		5		1							
#5	Restrictions in parts industry policies						1					
#6	Preferential policies for foreign capital		3		1			1				1
#7	Procedures for the operation of the Foreign Affiliate Law		1								2	2
#8	Investment recipient organization				1			1		1	5	12
#9	Export-import regulations; tariffs; customs clearance	1	31		14	11	13	11		13	9	
#10	Regulations on activities in free trade areas and others		4		3		1			1	1	1
#11	Recovery of profit and technical fees; demands for technological transfer		3			2	2	1				1
#12	Exchange controls		8		1	6	6	1		3	5	4
#13	Finance		2		3	3	3	3		2	4	4
#14	Taxation		17		13	4	4	6	1	4	8	7
#15	Price control				1						1	
#16	Employment		7		9	1	10	2	6	5	4	5
#17	Infringement of intellectual property rights		7	1	3	5	2	1	3	5	9	1
#18	Demands for technology transfer		1									2
#19	Industrial specifications and standards		6	1		2	1		1	3	1	
#20	Monopoly						1			1		
#21	Land-holding restrictions		2		1		1	1	3	1	1	3
#22	Environmental pollution, waste disposal						2	2	1		1	
#23	Systems, practices and administrative procedures		18		6	5	1	7	1	1	2	7
#24	Underdeveloped legal systems, sudden changes		7		2		1			2	1	5
#25	Government procurement						5			1		
#26	Other		8	1	3	1	4		2	4	6	4

		Australia	N.Z.	P.N.G.	Canada	Mexico	U.S.A.	Chile	Peru	Russia
#1	Restrictions on entry and foreign ownership	1			2	2	3	1		1
#2	Regulations concerning domestic production ratios and local procurement ratios				1	1	6			
#3	Export requirements					1				
#4	Withdrawal regulations									
#5	Restrictions in parts industry policies					1				
#6	Preferential policies for foreign capital				1					1
#7	Procedures for the operation of the Foreign Affiliate Law									
#8	Investment recipient organization									2
#9	Export-import regulations; tariffs; customs clearance	5			7	12	19	1	3	10
#10	Regulations on activities in free trade areas and others					1	2			
#11	Recovery of profit and technical fees; demands for technological transfer				1					
#12	Exchange controls			1		1				6
#13	Finance						2			5
#14	Taxation	3		1	8	7	6	2	2	13
#15	Price control									
#16	Employment	4	1		6	4	7		1	1
#17	Infringement of intellectual property rights	1	1				7		1	2
#18	Demands for technology transfer						1			
#19	Industrial specifications and standards	1			3	1	3		1	16
#20	Monopoly									
#21	Land-holding restrictions	1								
#22	Environmental pollution, waste disposal				2	1	2			
#23	Systems, practices and administrative procedures				3	4		1		10
#24	Underdeveloped legal systems, sudden changes				1	3		2		12
#25	Government procurement	1					2			
#26	Other					1				6

Figures in the table indicate the number of issues raised by Japanese firms.
Figures do not necessarily indicate the degree of seriousness or unfairness of issues.

Constructed from Business Council on Facilitation of Trade and Investment (1999).

Table 4 The number of bilateral investment treaties being signed

(As of September 1997)

	-1959	1960-64	1965-69	1970-74	1975-79	1980-84	1985-89	1990-94	1995-	Total
Germany	2	21	16	7	6	10	11	24	26	123
United Kingdom					7	16	18	31	18	90
Switzerland		11	8	9	5	2	7	27	16	85
France		1		7	13	10	7	23	13	74
Netherlands		1	3	9	3	3	11	20	9	59
Belgium and Luxembourg		1	1	2	5	6	12	10	7	94
Italy			4		2		12	22	10	50
United States						5	5	23	7	40
Spain							2	21	16	39
Sweden			3		3	5	2	15	7	35
Denmark			4			1	4	18	5	32
Finland						3	4	15	5	27
Greece		1*			1		1	14	6	23
Austria					1	1	6	11	11	30
Norway		1				2	1	9	2	15
Australia							1	10	4	15
Canada							1	6	14	21
Portugal						1*	1	15	9	26
Japan					1	1	1	1	1	5
Iceland								1		1
New Zealand							1		1	2
Others		1		1	7	11	23	177	106	323
Total	2	36	40	35	54	76	131	493	293	1162

* indicates a BIT with Germany.

Obtained from the MITI material. Originally constructed by Professor Yokokawa of Seijo University.

Table 5 Trade-related investment measures notified to WTO				
	Local content requirements	Trade balance requirements	Import restriction through foreign exchange control	Export restriction
Argentina	Am(e)	Am(e)		
Bolivia				O
Barbados	Ag			
Chile	Am(e)	Am(e)		
Colombia	Am, Ag(e)	Am, Ag(e)		
Costa Rica	O			
Cuba	Am, O			
Cyprus	Ag			
Dominican Rep	O	Ag, O		
Ecuador	Am			
Indonesia	Am, Ag, O			
India	O			Am, Ag, O
Mexico	Am(e)			
Malaysia	Am(e)			
Pakistan	Am(e), O			
Peru	Ag			
Philippines	Am(e)		Am(e)	
Uganda*	O	O		
Romania	Am(e), O(e)			
Thailand	Am, Ag, O			
Uruguay			Am	
Venezuela	Am			
S. Africa	Am, Ag, O			
Egypt	?	?	?	?
Nigeria	?	?	?	?
Am: TRIM in automobile industry				
Ag: TRIM in agriculture				
O: TRIM in other fields				
(e): Extension request submitted to WTO				
*: Uganda is classified as a least-developed country, and thus the TRIM obligation will be effective on Jan. 1, 2002.				
Source: MITI (2000, p. 167).				