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Christa Randzio-Plath\*

## A New Chance for Trade and Investment

*International investment flows have increased rapidly with the growing globalization of markets and production. These flows will be of greatest benefit to the world economy as a whole if they can be based on a transparent and predictable system of generally recognized rules. What strategy should the EU adopt to help create those rules?*

With the radical changes occurring in information technology, telecommunications and transport and with markets being deliberately opened up, the various forms of economic activity have similarly undergone fundamental changes. When the GATT was established, enterprises usually operated within a legal and regulatory framework prescribed by national economic policy. Now they are able to operate globally. Strategic agreements with companies abroad, the rapid transport of products to virtually anywhere in the world, the use of computer-aided manufacturing, whereby programs are developed here, transmitted to some distant place on information super-highways and activated on machines installed there, and the location of subsidiaries abroad mean that companies have contributed to a level of economic globalization inconceivable 50 years ago. Globalization has advanced farthest in the international financial markets, which operate round the clock throughout the world and have a global information and communications network that has been partly to blame for the recent instability of these markets and has created a new kind of economic activity, namely purely speculative "casino capitalism", which does not necessarily have any link with the real economy.

### Economic and Trade Development

The volume of international trade has expanded, as a result of the elimination of barriers over eight rounds of multilateral GATT negotiations, to more than 13 times what it was in 1950, bringing an increasing internationalization of economic activities whilst sectoral and regional disparities have grown. An increasingly important role in this process of

internationalization has been played not only by trade flows, but by international direct investment aimed at securing competitive positions abroad and gaining new markets.

Direct investment was initially made almost exclusively between western industrialized countries, but the dynamic economies of Asia and Latin America have, for a number of years, been gaining importance both as sources of capital and as recipients of direct investment. In many developing countries and countries on the verge of industrialization, as well as in some industrialized countries, there are numerous forms of discriminatory restrictions on foreign direct investment, capital and profit transfers.

The trend in flows of foreign direct investment has changed in the recent past. While the exchange of capital between industrialized countries, especially the USA and Europe, dominated in the 1960s and 1970s, the non-OECD countries' share of worldwide direct investment is now approaching the 50% mark. The dynamic economies of Asia and, more recently, Latin America, the transforming countries of Central and Eastern Europe and the CIS countries have become particularly significant recipients of direct investment. Some now also play a major role as countries of origin.

Viewed worldwide, international investment flows have increased rapidly with the growing globalization of markets and production. Foreign direct investment, excluding investment within the EU, is estimated to have reached US\$ 1,650 billion in 1993, compared to US\$ 68 billion in 1960. This is equivalent to an average annual rise of 11%, a significant increase even after allowance has been made for inflation. The number of multinational enterprises rose from about 7,000 in the late 1960s to 37,000 in the early 1990s. As a result of this trend the marketing of goods and

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services abroad through associated enterprises ("intra-company trade") now exceeds exports. The Community is by far the most attractive target for foreign investors. Of the total foreign direct investment of US\$ 1,650 billion in 1992, some 30% (US\$ 460 billion) was invested in the Community.

US\$ 420 billion, somewhat higher than the figure for all non-OECD countries (US\$ 370 billion), was invested in the USA. With US\$ 40 billion, Japan lags well behind. The other OECD countries account for the remainder (US\$ 350 billion).

Recently, there has been a significant net inflow of foreign direct investment into the EU. The sharp rise in investment flows in the EU since the mid-1980s has been due not least to the programme for completing the internal market, which promised an appreciable increase in the profitability of foreign direct investment in the EU.

Accounting for some 30% of global investment outflows (US\$ 470 billion), the Community is also one of the most important sources of foreign direct investment financing. The largest investor is the USA, with outflows of US\$ 490 billion, while Japan, at US\$ 250 billion, makes a major contribution. At US\$ 65 billion, the non-OECD countries play a minor, but increasingly significant role. These figures show that direct investment inflows and outflows in the Community, the USA and the other OECD countries are roughly in balance, while Japan is a major country of origin and the non-OECD countries still act largely as target countries.

By far the most important recipient of foreign direct investment is the United Kingdom, which alone accounted for 43% of foreign investment in the EU from 1985 to 1992. It is followed by France, with a share of 15%, Spain and the Netherlands, each with 9%. The main sources of foreign direct investment in the EU are the EFTA countries and the USA. The leading country of origin of EU foreign investment is again the United Kingdom, followed by the Federal Republic, which plays a rather subordinate role as a target country. However, Britain's share, which was about 47% from 1985 to 1988, fell back to 20% from 1989 to 1992, whereas France's share rose from 13% to 25%. The Federal Republic accounted for 20%, the Netherlands for 13%. Nearly three quarters of EU foreign investment goes to the USA.

While foreign investment in the EU has been roughly equivalent to investment by the EU abroad over the years, there are noticeable differences in distribution among the various sectors of the

economy. European enterprises have primarily sought to secure energy supplies to the domestic economy with their investments. The food-processing and chemical industries have also been focal areas of EU foreign investment. The service sector as a whole has accounted for only about one third. The EU's service sector is, on the other hand, the main recipient of foreign investment, which accounts for about two thirds of the total investment volume. Within the service sector the emphasis is on financial services. This sectoral distribution is due both to the peculiarities of the provision of services, which usually requires direct contact with customers, and to the EU internal market programme, which has resulted in extensive deregulation and harmonization of the Member States' widely varying market access legislation in this sector in particular.

### **Needs and Strategies for Investment**

The world economic order conceived after the Second World War, which found visible expression in the two Bretton Woods institutions, the IMF and the World Bank, attempted to regulate only the trade in goods, the most important form of international activity in the real economy; the GATT provided for a process of market liberalization for such trade. This framework was also based on the assumption that national economic policies enjoy largely guaranteed autonomy, which is, however, coming under increasing pressure from the worldwide activities of large enterprises. By transferring their facilities to countries where regulation is less stringent, they can take advantage of differences between systems of economic regulation, which exerts pressure on states to lower their standards and on national economic policy-makers to move towards greater harmonization. The political aim behind the establishment of freedom of movement for goods, capital and, to some extent, people was to help increase prosperity and ensure peace in the world. Against this background, however, economic globalization is gathering momentum, which, seen from the angle of economic policy and democracy, raises the question of how controllable the whole process is.

At the international level there have been attempts for some time to establish international rules to counterbalance the loss of national autonomy in economic policy associated with the phenomenon of the globalization of economic activity. They include UN codes of conduct for multinational enterprises and OECD codes on the free movement of capital. During the GATT Uruguay Round a separate agreement on

trade-related investment measures was signed, the signatory states undertaking not to adopt any investment measures that contravene the rule on national treatment (Article III of GATT) or the prohibition of quantitative restrictions (Article XI of GATT). Measures incompatible with GATT are set out in an illustrative list, which includes, for example, requirements relating to local content and export performance, compliance with which is a prerequisite for the approval of investment projects. The agreement also includes a vaguely worded declaration of intent to negotiate a more detailed agreement on investment policy and competition policy (Article 9 of the TRIMs agreement) at a later stage (not later than five years after the entry into force of the WTO agreement). In addition, the General Agreement on Trade in Services (GATS) includes important provisions of considerable relevance to foreign direct investors in this sector, e.g. freedom of establishment and the principle of national treatment, although the latter is still subject to restrictions. Finally, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) helps to reduce the risk of product imitation in the case of foreign investment.

There is growing recognition of the need for a sound worldwide regulatory framework for foreign direct investment. Thus the western industrialized countries that make up the OECD decided at the ministerial meeting of 23rd-24th May 1995 to begin negotiating without delay within the OECD framework on a multilateral convention on investment, with the aim of concluding before the Ministerial Conference in 1997 an agreement setting high international standards for the liberalization of legislation on access for and the protection of foreign direct investment and establishing an effective dispute settlement procedure. Accession to such an agreement will be open to non-OECD countries, which are to be consulted during the negotiations.

Unlike straightforward exporting or the issue of manufacturing licences, direct investment represents a long-term commercial commitment abroad. The object of direct investment is to acquire ownership or gain control of enterprises and production facilities in other countries. Investors thus seek to bring effective influence to bear on how the business is run. They may do so either by acquiring existing enterprises through mergers or equity holdings or by opting for "green-field" investment, which creates new production capacity. In the case of equity participation, a stake of 10% or more of the voting

share capital is generally regarded as direct investment. Smaller shares are simply financial or portfolio investments, the investor being interested only in the return on his capital.

Companies opt for direct investment for many reasons, and the view taken by economic policy circles and the public of direct investment varies. Companies usually invest abroad because they are unable to make the most of competitive advantages in the form of established brands or technical know-how by exporting them or issuing licences owing, for example, to restrictions on market access in the shape of trade protection measures or practices of foreign suppliers that restrict competition. In many cases tax incentives and cost benefits are also important considerations, although the significance of differences in labour costs is generally overrated.

### The EU Initiative

In its communication of 1 March 1995 on "A level playing field for direct investment world-wide" the Commission rightly says that the negotiations on multilateral rules for direct investment should not be limited to the industrialized countries but held in the WTO so that such important actors as China, Korea, Brazil, South Africa, the ASEAN countries and the countries of Central and Eastern Europe may be involved. Although it is true that the OECD countries, if left to themselves, could reach a comprehensive agreement more quickly, despite the not inconsiderable differences of opinion among them on such issues as national treatment when enterprises are first privatized, the level of subsidization permitted as an investment incentive and an exemption for regional integrating areas, this approach would ignore the existence of the WTO, the most suitable framework for such negotiations in terms of both competence and procedures.

Foreign direct investment is the subject of a debate similar to that on the liberalization of trade in goods and services. On the one hand, social and environmental dumping are denounced as forms of unfair competition; on the other hand, the developing countries in particular fear that foreign direct investment may be misused to increase their economic and political dependence. It is often claimed in the countries of origin that investment abroad leads to the relocation of firms and jobs to other countries, "essentially to take advantage of their labour cost advantages and then to sell the goods produced abroad in domestic markets at very low prices" (social dumping). Foreign direct investment is

also criticized when it is used to evade stricter environmental requirements at home (environmental dumping).

These criticisms are largely unfounded. For one thing, labour costs associated with unskilled labour account for only 5 to 10% of production costs. For another, EU foreign investment is concentrated on sectors where labour intensity tends to be lower. Although a significant decline in employment in the EU has followed the internationalization of the textile, clothing and electronic consumer goods sectors, it merely reflects the direct effect of the relocation of production. EU foreign investment has made it possible to maintain a core of highly skilled jobs in these sectors. Jobs in the EU that depend on exports have a long-term future only if producers have their own production capacities in foreign markets. The overall effect of foreign investment on employment must also be considered. Empirical studies on the USA, the United Kingdom and France show that the loss of unskilled jobs due to direct investment in developing countries is more or less offset by the increase in highly skilled and thus better paid jobs. Direct investment abroad does not, in other words, pose a problem for employment levels, but it does set a task for labour market policy, which must help to ensure that the necessary change in the structure of employment is accomplished without frictional losses.

Where environmental dumping is concerned, it should be remembered that less strict environmental protection requirements often reflect a lower level of economic development and/or pollution locally. The development process that foreign direct investment helps to stimulate will result in an increase in prosperity and in pollution in the recipient country. More stringent local environmental protection legislation is therefore likely in the medium term. However, critical references to environmental dumping often conceal protectionist endeavours in the western industrialized countries, their real concern being less the conservation of natural resources than protection against cheap imports.

The recipient countries criticize foreign investment for merely creating extended workbenches for the assembly of components that have to be imported, with a minimum of domestic inputs required. This form of foreign direct investment neither widens the domestic technology base nor contributes to internal value added. It also imposes a burden on the balance of payments. A further criticism often to be heard is that the sole purpose of such investment is the

avoidance of trade protection measures, such as anti-dumping tariffs. One objection to this argument is that only a small proportion of foreign direct investment, most of which still comes from the industrialized countries, serves to create extended workbenches. Where such investment is economically successful, it is, moreover, usually followed by further investment in major production facilities, which have a favourable effect on employment and demand in the host country. As output is often intended for export, the effect on the trade balance is similarly positive. The Japanese automobile industry's involvement in the United Kingdom is an example of this trend.

### **Need for System of Rules**

Like trade flows, investment flows will be of greatest benefit to the whole economy if they can be based on a transparent and predictable system of generally recognized rules. A system of multilateral rules on direct investment can also be used to allay the fear of abusive exploitation of foreign involvement. By analogy with the multilateral rules on trade in goods and services, the basic components of a system of this kind should be:

- ☐ generally free access for investors and investment,
- ☐ national treatment of investors and investment,
- ☐ accompanying measures to uphold and enforce commitments to foreign investors.

Only a few, well-founded exemptions from the general requirement of free market access for foreign investment should be permitted to ensure the maintenance of national security and public order. Nor should any distinction be made between investors from different countries of origin (most-favoured-nation treatment). Once investments have been made, no distinction should be made between a foreign and a domestic investor (national treatment). The accompanying measures should include an effective mechanism for settling disputes between the country of origin and the recipient country and legislation on the free movement of capital, and especially on the transfer of profits and capital and on expropriation, which should be possible only in internationally recognized exceptional cases and on payment of immediate and appropriate compensation. The negotiators should also enter into a standstill commitment not to introduce any new restrictions contrary to these principles and a roll-back commitment to repeal gradually any legislation that impedes liberalization.

More regulation worldwide is needed. The erratic fluctuations of the dollar exchange rate have only recently revealed once again the urgent need for the world trade order and international monetary policy to be linked more closely. The cooperation with the two Bretton Woods institutions, the IMF and the World Bank, for which Article V of the WTO agreement and the Ministerial Declaration on the WTO's contribution to greater coherence in global economic policy pave the way, must be described in more concrete terms. Monetary policy aspects must also be covered by multilateral rules on foreign direct investment, given the potential significance of changes in exchange rates for the investment decisions taken by enterprises.

These rules should also include provisions on the labour and environmental protection legislation to be observed by any enterprise wanting to invest abroad. Where such legislation is less strict in the recipient country than in the country of origin, provision should be made for enterprises operating in the recipient country not only to comply with local legislation but also to endeavour to help improve living and working conditions in the host country by conforming to more ambitious work and environmental protection standards, which should tend to be guided by circumstances in the country of origin. This might take the sting out of the critical references to social and environmental dumping. In observing stricter legislation than applicable in the host country, multinational enterprises should be guided by the pertinent conventions of the International Labour Organization (ILO) and by the commitments which the country of origin and/or the host country have entered

into under international environmental protection agreements.

### Multilateral Harmonization

The far-reaching liberalization of investment flows makes the multilateral harmonization of further framework conditions, particularly in the field of social and environmental legislation, take on an increasing degree of urgency. The inclusion of environmental protection in the multilateral trade regulations is needed. Discussions, in which trade unions are involved, should open on minimum social requirements, without the inclusion of social and environmental aspects resulting in covert protectionism. It has to be pointed out that improved opportunities for foreign investment will not necessarily lead to increased competition, but could be used by large multinational undertakings to build dominant market positions, make international cartel arrangements to secure their foreign investment or conclude mergers which would restrict competition.

The efforts to establish multilateral investment rules must not, moreover, remain in isolation: they must form part of the efforts to create an international competition order, like that already promised by the TRIMs agreement. Improving the opportunities for multinational enterprises to operate in foreign markets will not necessarily improve competition in those markets. Concentrations of enterprises may lead to the creation and subsequent abuse of market-dominating positions which a national competition policy is incapable of controlling. In addition, cartel agreements on the regional sharing of markets and

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concerted pricing practices are gaining in significance at the international level as a means of restricting competition. The EU's experience with competition policy may serve as an example and model: a competition policy guided by Articles 85 to 95 of the EC Treaty and the EC merger directive. For the most part, competition policy could certainly remain a national responsibility provided that cooperation among national authorities was ensured and a multilateral body was set up to deal with cross-frontier cases.

### EU Strategy

The Commission document also fails to make any reference to the regionalization of the agreement that is the goal. This has less to do with the question of how to treat such integrating economic areas as the EU, NAFTA and ASEAN. The concept of Article XXIV of GATT, which concerns trade in goods, should apply to investment flows. It should be considered whether the commitments to be entered into should not be varied to suit specific types of country, such as the developing countries or the transforming countries of Central and Eastern Europe and especially the former Soviet Union. As with the Uruguay Round agreements, this might be achieved with longer transitional periods in the case of roll-back or with temporary exemptions from the principle of national treatment. An approach that takes account of the peculiarities of certain groups of countries will improve the prospects of a successful conclusion in the foreseeable future to the negotiations among the WTO member countries, which will soon number 130.

In the context of direct investment the vital importance of effective protection of intellectual property, ensuring that technical know-how or manufacturing processes transferred abroad by direct investment cannot be exposed to unfair competition, must be recognized, and it has to be pointed out in consequence that all contracting parties to the WTO should comply fully and within the prescribed deadlines with their contractual obligations under the agreement on trade-related intellectual property rights.

There is also a need to take the economic interests of developing countries into account to a greater extent than has hitherto been the case. Also, Western investment capital is needed to assist the economic transformation process in the countries of Central and Eastern Europe and the CIS and the conclusion of a Multilateral Investment Agreement, to which those countries must be parties, will improve the investment climate there.

If this EU strategy is to be implemented, there must be a Community approach at the international level. This is, however, made difficult by the unclear distinction between the Union's and its Member States' competence in the investment policy sphere. Given the close link between trade (for which the Union alone is responsible) and foreign direct investment, and in view of the increase in responsibilities in the area of capital transactions with third countries since the second stage of economic and monetary union began, there is much to be said for the closer coordination of the Member States' positions and for their representation by the Union and Commission during negotiations, particularly at WTO level. The fact that the EU as such is a member of the WTO, but not of the OECD, is a further, though internal, argument for conducting negotiations at WTO level. The adoption of a code of conduct for the representation of the EU and its Member States in the WTO, on which the Council and Commission have been negotiating for more than a year, also becomes more relevant in this context. It should be remembered that in its resolution of 14th December 1994 concerning the ratification of the results of the Uruguay Round of negotiations the European Parliament called for this code of conduct to be adopted, with the European Parliament involved, in the form of an interinstitutional agreement.

The EU should take advantage of the WTO Ministerial Conference scheduled to take place in Singapore in December 1996 to bring about a decision on the launching of negotiations on a multilateral investment agreement. These negotiations should be open to all WTO member countries. It is politically significant in this context that the negotiations will begin before the 1997 deadline set by the OECD for the conclusion of the industrialized countries' negotiations. The Council should not delay in giving the Commission a clear mandate to begin preliminary negotiations within the WTO framework to pave the way for the Ministerial Conference to take such a decision. The above-mentioned confusion as regards competence must not be allowed to impede this process. The European Parliament also attaches the utmost importance to the Union's future ability to act as a single entity in matters relating to investment policy. The patchwork of innumerable bilateral investment agreements, which is largely due to the Member States' insistence on their increasingly anachronistic competence in this sphere, must at last be replaced with a coherent EU economic policy in which exports and investment are but the two sides of the same coin: economic globalization.