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**Research Report**

## Do we really need a multilateral investment agreement?

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Briefing Paper 9/2013

## Do We Really Need a Multilateral Investment Agreement?

### Summary

We currently observe a renaissance of the debate about a multilateral investment agreement (MIA). The last attempts to establish such an agreement failed in 1998 at the Organisation for Economic Co-operation and Development (OECD) and in 2003, as part of the Doha Development Agenda of the World Trade Organization (WTO). The reasons for these failures are both the resistance of emerging countries and developing countries to one-sided policies mainly aimed at protecting international investors, and divergences among industrialised countries, particularly regarding the liberalisation of market access regulations.

The proponents name several arguments in favour of a resumption of negotiations about an MIA:

First, we can now observe a fundamental shift in global investment flows. Companies from emerging countries are increasingly investing abroad and aim at a better protection of their foreign direct investment (FDI) in developing and industrialised countries. The traditional criticism put forward by influential, emerging countries against an MIA appears to be weakening as the result of a growing convergence of interests.

Secondly, among industrialised countries themselves there is a growing consensus regarding international investment rules. One sign of this are the *Shared Principles for International Investment*, adopted in 2012 by the EU and the U.S.A., whose purpose is to smooth the way for a *Transatlantic Trade and Investment Partnership*. With this gradual convergence, in particular regarding the inclusion of market access provisions, a further stumbling block along the way to an MIA appears to have been done away with.

Thirdly, the increasing regionalisation of investment rule-making is advanced as an argument which can facilitate the leap to the next-higher, multilateral level. As a result of so-called "Mega-Regionals" – like the *Transpacific Partnership* between the U.S.A. and 10 other countries in the Pacific Region, the *Regional Comprehensive Economic Partnership* between the Association of Southeast Asian Nations (ASEAN) and six other countries, including China or the planned *Transatlantic Trade and Investment Partnership* – it is possible that a consolidation of investment rules will arise which would simplify the negotiations about an MIA.

These current trends can in fact help to smooth the path to a global accord. However, the main question driving the international debate should not be whether it is possible to establish an MIA. What is more important is the question whether the institutional form of an MIA is suitable for effectively solving the most pressing challenges in the current investment regime. This is not very likely, since an MIA is unlikely to lead to significantly more FDI flows or to give stronger consideration to the interests of the developing countries. An MIA will most likely also not lead to greater coherency between the investment rules and other policy areas.

It is more promising to tackle these challenges in the context of regional co-operation, since this permits better accommodation of the treaty contents to the specific needs of the countries involved. Negotiations at the regional level should be supplemented by co-ordination efforts on the global level. The G-20 is the appropriate orchestrator for talks about these systemic questions, talks which in turn should be carried on with the inclusion of the OECD, WTO, and the United Nations Conference for Trade and Development (UNCTAD) and other stakeholders.

### Deficits of the current investment regime

In contrast to world trade, no comprehensive multilateral accord exists for investments. Global investment flows are protected by a fragmented system of more than 2,800 bilateral investment agreements and 300 free trade agreements with investment chapters. Most of these agreements establish far-reaching and binding standards of protection for international investors, such as national treatment, fair and equitable treatment, and liberal financial transfer clauses. Among the essential features of international investment agreements (IIAs) is that investors can assert their rights against host countries directly before transnational arbitration tribunals.

In recent years, a lively debate has developed about the economic and social effects of IIAs and about the limits imposed on host countries' policy space by IIAs, a debate in which the following critical arguments are advanced:

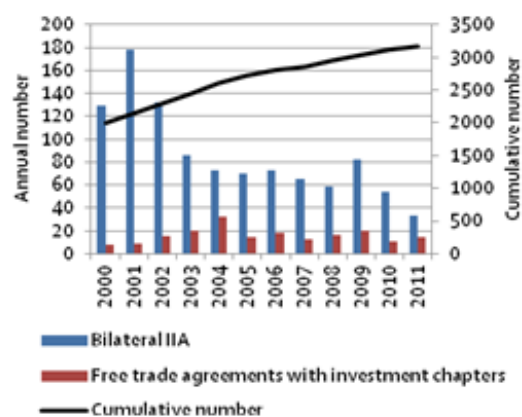
Firstly, the effectiveness of IIAs as an instrument for promoting investment flows is called into question, even though some econometric studies show a generally positive influence of IIAs on FDI flows. However, IIAs which provide greater legal protection to international investors have no significantly greater impact on the volume of FDI flows than "weaker" agreements. In addition, company surveys have shown that IIAs play only a minor role in the investment decisions of many investors. Only free trade agreements with investment chapters which simultaneously liberalise market access for investors can significantly increase FDI inflows. Finally, IIAs are only one determinant among many which affect the volume of FDI inflows.

Secondly, the critics advance the argument that IIAs greatly limit host countries' policy space for regulating FDI. On the one hand, this effect is intended as a means of attracting FDI. Host countries hope to signal international investors via IIAs that their respective national investment regimes are open and reliable. On the other hand, the very rapidly rising number of investor-state dispute settlement procedures is a sign of the restrictive influence of IIAs, which in turn was never intended by the parties to such agreements. In particular, IIA-specific clauses like the sweeping requirement of fair and equitable treatment make it possible for investors to go to court against a broad range of host country measures. It is not least due to the legal actions taken by international investors against the health- and environment-related measures of governments that the restrictive influence of IIAs is criticised.

A further point of criticism against the current investment regime and in particular the system of arbitration is the inconsistency of arbitration awards and the inconsistent interpretation of the protection standards contained in IIAs. As a reaction to these shortcomings, the countries of the North American Free Trade Agreement (NAFTA) have begun to formulate protection standards in their IIAs in greater detail and to increase their regulatory latitude by

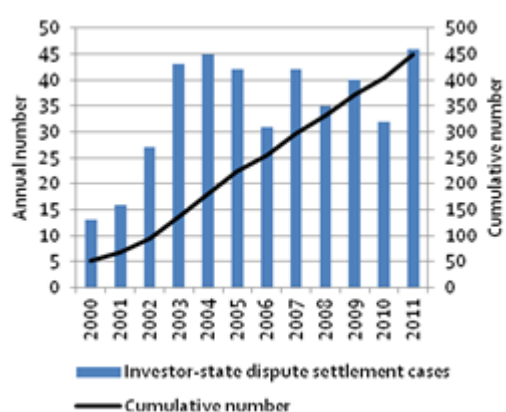
specifying exceptions. These reforms are being taken up by more and more countries.

**Fig. 1: Number of bilateral IIAs and free trade agreements with investment chapters, 2000-2011**



Source: Authors' presentation based on data from UNCTAD

**Fig. 2: Number of investor state dispute settlement cases, 2000-2011**



Source: Authors' presentation based on data from UNCTAD

Finally, IIAs are also the target of criticism due to their impact on other policy areas. Traditionally, IIAs were entered into above all as instruments for promoting FDI, and were oriented correspondingly in one-sided fashion to the protection of investors. This one-sided orientation is no longer suitable in view of a growing interconnectedness of different policy areas. The protection standards contained in IIAs intervene deeply in the national regulatory system of any host state, affecting not only investment-specific policies but also, as already mentioned above, a multitude of other areas subject to public regulations. IIAs which are all-too one-sided in their orientation towards the protection of investors can have an unduly restrictive effect on the ability of the host countries to act in other political arenas.

Against this background, the effectiveness and legitimacy of the current investment regime is being called into question. One sign of this is not only the criticism of many non-governmental organisations and such international organisations as UNCTAD but also the reactions of many countries. Australia intends to negotiate IIAs in future only without investor state arbitration clauses. Latin American countries like Bolivia, Ecuador and Venezuela have already cancelled their membership in the International Centre for the Settlement of Investment Disputes (ICSID), which is affiliated with the World Bank, and South Africa intends to cancel its IIAs with European countries. These developments are signs of an erosion of the current investment regime.

### What can a multilateral investment agreement achieve?

In analogy to the world trading system, argue the proponents of an MIA, universal rules would be preferable in the area of investments too, due to the fragmentation of the system of more than 3,000 bilateral accords (Aslund 2013).

However, it appears doubtful whether the integration of trade and investment policies will have comparable economic effects. Irrespective of its normative permeating force, the multilateral logic does not apply automatically to the dismantling of non-tariff barriers. The *World Trade Report 2011* shows that "deep integration" within the framework of bilateral or regional accords – for example regarding the dismantling of technical trade barriers or the liberalisation of services – often has no discriminating effect on third parties (WTO 2011). Non-members cannot easily be excluded from the benefits of this integration.

The same holds true for investment policies as well. For the benefits of bilateral IIAs are not necessarily concomitant with negative effects on non-members. Among the special features of IIAs are, for example, most-favoured nation clauses, which explicitly extend the benefits of bilateral integration steps to non-members as well. In view of the wide-ranging overlaps and structural connections we indeed already have a multilateral investment system, but one which is constituted above all by a fragmented and complex network of bilateral accords (Schill 2009). This co-operative fragmentation must not necessarily involve negative consequences for the system as a whole.

In view of the non-discriminatory nature of the current investment regime, it is to be doubted that an MIA can help meet the three challenges described at the beginning.

*Would an MIA lead to an increase in FDI inflows?* The proponents of an MIA argue correctly that the bilateralisation of rules of investment only promotes lack of transparency and higher complexity, thus leading to elevated transaction costs for international investors. Irregardless of the already-described systemic overlaps of bilateral IIAs, they differ from one another in detail and make it difficult for international investors to evaluate the existing legal framework for investment. An MIA could therefore result in more investment flows, especially since the signal effect

of a multilateral accord would be greater than the multitude of individual accords.

However, the positive effect of an MIA due to the lowering of transaction costs depends on whether a multilateral accord would supplant the bilateral IIAs among the members. Developments in the world trading system, which is characterised by the simultaneity of multilateral, regional and bilateral integration, makes such a sea change appear doubtful. An MIA would thus merely add another level of regulation, and opacity and complexity would only be increased even further.

*Would an MIA bolster the bargaining power of developing countries and take regulatory aspects more into account?* As described at the beginning, IIAs are for the most part one-sided in their orientation to the protection of international investors. One argument advanced for an MIA is that of the dismantling of power asymmetries between industrialised and developing countries. A comparison with negotiations in the WTO or the United Nations Framework Convention on Climate Change shows that by forming coalitions developing countries are quite capable of having a decisive impact on the course of multilateral negotiations. However, should the developing countries prevail and succeed in anchoring exceptions to the regulation of FDI and the accountability of investors in an MIA, it would be equivalent to a Pyrrhic victory: capital-exporting industrialised countries (and emerging countries) would pull back from the multilateral negotiations and would again concentrate on negotiating bilateral or regional accords.

*Could the coherency of rules of investment be improved in the context of MIA-negotiations?* On the one hand, the issue here is to take into account previously neglected issues such as the negative effects of host countries' investment incentives or investments of state-owned companies. On the other, the aim would be to reduce the potentially negative impact of investment rules on other policy areas such as international financial and trade policies, or health and environmental policies. It appears doubtful that a stand-alone MIA which only addresses investment rules would improve the coherency of the current investment regime.

Finally, one fundamental question also remains open: in what forum could an MIA be negotiated? The WTO is advanced by proponents of an MIA as an appropriate platform for negotiating rules of investment. However, the WTO currently finds itself in a deep crisis which makes it impossible for it in the short or medium term to assume responsibility for new policy areas such as investment. In addition, other forums for negotiation such as the OECD or UNCTAD are automatically excluded because they are allied too closely with the interests of already industrialised or emerging and developing countries.

### Act regionally, co-ordinate globally

The shortcomings of the current investment regime can be better dealt with in the context of regional negotiations;



these should, however, be accompanied by a political dialogue on the global level.

The regionalisation of investment rule-making is already in full swing and has reached a new level with the negotiations of "Mega-Regionals" such as the *Transpacific Partnership*, the *Regional Comprehensive Economic Partnership*, or the *Transatlantic Trade and Investment Partnership*. These regionalisation processes are significant not only because of the high volume of trade and investment flows which are affected. Also important is the impact of these integration processes on the framework of future international investment policies. The U.S.A. and the EU, for example, have expressed the aim that a transatlantic accord shall establish the standards for future investment rules.

One benefit of these regionalisation processes is the integration of rules of investment into the context of a free trade agreement. These so-called WTO-plus accords encompass not only trade in goods but also such areas as services, the rights to intellectual property, competition, investments, and sustainability. These accords either go beyond the level of regulations agreed on in the WTO or open up fully new fields of regulation. This integration of different contents of regulations within a process of negotiation corresponds not only to real economic developments like the spread of global value chains. These accords also include for the most part environmental or labour rules.

In addition, current research findings show that free trade agreements with investment chapters, in comparison to stand-alone bilateral IIAs, stimulate more FDI flows. In addition, one may expect it to be easier within the framework of regional negotiations to arrive at a consensus regarding the above-described contents of regulations than in multilateral negotiations.

It is naturally the case that regional negotiations are no panacea for processing the shortcomings of the current investment regime. In particular, it must be ensured that these highly complex WTO-plus accords do not result in a creeping discrimination against developing countries. In addition to measures for increasing the negotiation capacities of developing countries there is therefore need of an accompanying process of coordination on the global level. This should lead to a better understanding between the traditional, capital-exporting, industrialised countries, the emerging countries, whose companies are increasingly investing abroad, and the developing countries, which often continue to be cut off from global investment flows.

The G-20 is the natural candidate to be the initiator of a concomitant process of coordination. The G-20 comprises not only the industrialised countries but also the most important of the emerging countries and takes into account – even though inadequately up to now – the interests of the developing countries via the participation of regional organisations such as the African Union. Orchestrated by the G-20, these discussions should be conducted with the inclusion of international organisations like the OECD, the WTO, and UNCTAD, along with that of business and civil society stakeholders.

The discussions should include new topics that have not been dealt with in IIAs. In particular, the discussions should include the balance between liberalisation and regulation of investment policies, the financial incentives of host countries, the investments of state-owned companies, the integration of voluntary sustainability standards, and the consolidation of the existing system of bilateral IIAs. In view of the current dynamic changes in the investment, these processes should be set in motion as quickly as possible.

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Axel Berger works on global investment policy issues, with a focus on emerging and developing countries. His current major areas of research are the diffusion patterns and development impacts of international investment agreements.